FY2020 2Q Financial Results Conference Call Q&A Summary

August 14, 2020

◆ Questions by Takashi Enomoto, Merrill Lynch Japan Securities Co., Ltd.

Q1	I would like to ask about the performance of NIPSEA China in 2Q. Profit margins are improving, but please explain the background behind this, as well as the raw material cost ratio. Also, revenue in the Project segment grew significantly while that in the DIY segment did not increase much. Is this because of the difference in product mix between the two segments? I also believe the profitability of the Project segment is lower compared to the DIY segment. Is there a deterioration in the product mix in the decorative paints business in NIPSEA China? Please explain the details of the changes in the 2Q earnings of NIPSEA China.
A1	As shown on P16, as you pointed out, there were factors that contributed to profits, such as employment subsidies. In addition, the reduction in raw material cost made a steady contribution although I can't provide any specific figures. Furthermore, in April-June, as I explained earlier, we focused on recovering loss of the busy season in March, so we did not spend much in sales promotion such as advertising expenses. We are trying to determine the right time to focus more on sales promotion and, from a strategic viewpoint, we are considering to launch sales promotion activities in 2H of the fiscal year. Regarding the DIY segment, although the restrictions on the entry of professional painters into houses have been lifted to a certain extent, I feel that the overall situation, including economic conditions, is still somewhat weak. Under these circumstances, we achieved recovery at least to the same level as the previous fiscal year, which is good news, but were unable to recover the loss of sales in March. Revenue in the Project segment grew significantly, which would normally lead to a decrease in profitability. However, we have gathered that the decrease in advertising expenses, raw material prices, and procurement costs contributed to profits as we focused on supplying products to customers. The ‘Tanshin’ base profitability (figures based on legal disclosure) was higher in 2Q due to employment subsidies. Operating profit margin on a ‘non-GAAP’ basis was 15.2% in FY2019 and 17.6% in FY2020, which shows a profitability improvement YOY also in a ‘non-GAAP’ basis.

Q2	Your explanation about the recovery of the sales loss in March you achieved in April through June sounds like a special demand. Do you see any trends, for instance, such

	special demand falling from July onwards?
A2	We don’t see it as special demand; we managed to keep a prior-year level revenue for 1H. Let me reiterate that March is the busiest month of the year, and we recovered the product lost during the period in April-June. As for 2H, we do not anticipate any special demand. The market conditions for the Project segment are expected to remain relatively strong. We had some discussions when preparing the heat map for 3Q and 4Q, but considering that the market conditions were fairly strong in 2H of the previous fiscal year, we cannot safely assume a V-shaped recovery in 2H of the current fiscal year. In addition, the heavy rainfall and flooding in July is likely to impact the Project segment; therefore, the overall image will most likely be what I had explained earlier.

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

Q1	Regarding P25, you projected weak market conditions in 2H in the DIY segment of NIPSEA China. As you explained earlier, there are negative factors such as the impact of heavy rainfall and flooding, as well as the situations where professional painters cannot enter work sites due to COVID-19 related restrictions. How much 3Q revenue do you expect to decrease YOY, and what measures will you take if such situations become normal? Regarding the Project segment, I would like to know your outlook on the painting process of developers applying paint work on skeletons and continuing demand for renovation, separately for the DIY segment and the Project segment in 3Q and 4Q respectively.
A1	Regarding the DIY segment, as I mentioned earlier, it is not necessarily that professional painters are not allowed to enter work sites, according to local management. However, the momentum of consumption among contractors and users has not recovered, and the overall economic environment is somewhat weak. Under such circumstances, we plan to implement various promotional activities as described on P25 as measures to prevent our share from falling. On the other hand, as I mentioned earlier, the Project segment has recovered considerably in April-June, but the sentiment of developers as a whole is not necessarily strong despite government’s stimulus measures such as monetary easing. Under these circumstances, we are focusing on supplying products, and I cannot tell you about the figures for July; however, I think the Project segment is currently in line with our assumptions. However, as I mentioned earlier, the heavy rainfall and flooding in July were an unexpected factor and may have a negative impact on 2H. Nonetheless, in the long run, we can contribute to the reconstruction phase caused by the incident. For this reason, we cannot make a

	judgement based on the short-term negative impact alone.

Q2	Are there rough estimates of YOY figures for the DIY segment and the Project segment particularly in 3Q and 4Q?
A2	We do not disclose estimates beyond what are available on P25. Please use the figures on P25 for your estimation.

Q3	I would like to ask about raw materials. You provided Naphtha price assumptions. How much will the lower raw material prices contribute to profits compared to the initial forecast? Or, how much effect would lower raw material prices have globally compared to the same period of the previous fiscal year? Some competitors expect that the effect of lower prices of raw materials will level off in 1H and decrease in 2H. In your case, as lower prices of raw materials have already made profit contribution in the business in China, will there be no significant improvement in 2H? Please provide explanation on the overall effects of lower prices of raw materials again.
A3	Compared with the same period of the previous fiscal year, the lower raw material prices will basically have a positive impact. On the other hand, as I have mentioned a few times, customers and competitors are in the same situation, so not all price decreases for raw materials translate into a profit increase. For instance, we accept price cuts for customers, but we request customers to accept price increases when the prices of raw materials have risen. In addition, the effects of lower raw material prices in 2Q may show with a time lag in 3Q. However, compared to the assumptions prepared in May, we have conservatively estimated the effects of lower raw material prices. As for the amount, I'm very sorry but I cannot disclose any figures. On the other hand, raw material prices in our business in China, such as titanium oxide, are basically trending downward, and we do not basically assume an increase in prices for resin-related monomers and other raw materials. A slight increase in prices will have various impacts, but as a whole, please understand that our full-year earnings forecast incorporates all these assumptions.

Q4	Looking only at NIPSEA China, are you saying that you do not expect a greater impact from lower raw material prices in 2H compared to 1H, and that there is no significant difference between 1H and 2H in terms of the effects of lower or higher raw material prices ? Is my understanding correct?
A4	Looking at 1H, we saw abnormal figures in January-March and raw material prices were higher than what they are now. The situation is certainly the same for the competition, but

	we are not expecting raw material prices to have any significant effect after April-June.

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

Q1	I would like to ask about profits by region in 1H and 2H. You posted a profit decline both in 1H and 2H. Looking at the direction of outlook by region, it's clear that demand driven by stay-at-home restrictions will fall in Australia. In Japan, although the automobile sales bottomed out in 2Q, the market is expected to remain relatively weak in 2H. As for China, compared to YOY figures for 2Q, I am assuming that performance will improve in 2H. However, as you had explained earlier, with advertising expenses in 2Q being deferred to 2H and a relatively strong market that was experienced in 2H of FY2019, are you saying that we cannot expect a significant recovery in 2H? Please tell us the direction of outlook and the degree of recovery by region.
A1	Regarding the Oceania, our performance was certainly very strong in 1H. Our profit growth in 2H is expected to be slightly lower compared to 1H. August and September are busy months in this region; therefore, we need to look at the market conditions during this period carefully, but we do not have a clear outlook yet. We do not expect a sharp decline in demand, but our 2H performance may go up or down depending on our performance trends in August through September. At this point, we expect 2H to be weaker than 1H. Regarding Japan, as you pointed out, our outlook for 1H and 2H are mostly the same. While we expect some recovery in demand, part of the market will likely remain weak. For example, in the industrial coatings business, we are projecting weaker customer trends in the coil coatings and construction machinery markets. As for the automotive coatings business, although the market is expected to pick up, the market is projected to roughly level off in 2H compared to 1H. . As for NIPSEA China, we actually had a considerable discussion within the Company, but September could be a turning point because it is the next busiest season after March. As I mentioned earlier, we assume various changes in market conditions, and we cannot be optimistic about 2H of the fiscal year, although we have not seen the second wave of COVID-19 coming on strong, due to customers being on high guard about the COVID-19 impact, notably in the DIY segment. Having said that, compared to the extremely difficult market conditions in 1Q, we naturally expect an improvement in 2H but the profit margin will not change significantly.

Q2	Comparing 1H with 2H, you expect that the Japan segment will be roughly the same, the Oceania segment will become weaker, and China will be much stronger than in 1Q. This

	makes your outlook for 2H look rather conservative. Is this because of provisional factors such as impairment loss in 2H?
A2	No, we did not consider any provisional factors.

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

Q1	In the Japan segment, 2Q performance was quite week with operating loss posted. Please tell us how much profit would actually have been generated if there had been no decrease in royalty income from overseas subsidiaries in the automotive coatings business and headquarters' costs, as you explained earlier. In addition, you mentioned that the market conditions in the Japan segment will remain unchanged from 1H to 2H. Could you tell us whether the profitability in 2H will remain low? I think there are some profit improvement measures you cannot implement immediately, such as measures related to production sites, but please tell us about your efforts on improving profitability including cost reduction in the Japan segment.
A1	The reason for the decline in royalty income was the decrease in overseas sales. We allocate considerable human resources in the automotive coatings business in the Japan segment for support of overseas, and we receive royalty income in return. Royalty income is a high-margin revenue, so we were unable to absorb fixed costs due to the decline in royalty income associated with the sharp drop in overseas sales. In other words, the profits of the Japan segment will recover to a certain extent if overseas sales increase. Furthermore, fixed cost allocation in the Japan segment may slightly differ from the reality. In terms of the headquarters' costs of the Japan segment, it would not be consistent with the actual situation to allocate such costs e.g. pro rata to each region on a sales basis. Therefore, we do not calculate the results that do not include overseas royalty income and the headquarters' costs, but please understand that the Japan segment would not be in loss if overseas royalty income level had been as in normal year and headquarters' costs had not been included. As explained by CEO Tanaka at the February 21 briefing for institutional investors, we have clearly identified creating a sustainable business base in Japan as a management issue. As we have some aging production facilities in Japan, there is no change in our policy in continuing necessary investment, including those for the medium to long term. On top of that, we have reexamined and reviewed our non-urgent investments. Our view is that rather than pushing forward with Western-style cost reductions, such as large-scale restructuring programs, we should invest aggressively in areas where we have been pursuing too much cost reductions, such as the Japan segment, and create a sustainable

	business base even if it leads to a slight profit decrease temporarily.

Q2	In the Japan segment, operating profit excluding dividends from overseas group companies was over 3 billion yen in 1Q. If revenue returns to around 40 billion yen in normal times, can we assume that operating profit will be at the same level as in 1Q?
A2	Yes. Despite the high variable cost ratio, the biggest factor behind the profit decline is certainly the decrease in sales. In other words, I think that if overseas automobile sales pick up, profit will rise significantly and accordingly. Your analysis is correct.

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

Q1	Please consider disclosing the full-year operating profit forecast by region as additional data. We would also like you to disclose the forecast figures for 2H of the fiscal year in addition to the full-year forecast on P25. The market environment is unclear due to the COVID-19 impact, but can we expect you to disclose such data from the next fiscal year after the situation returns to normal?
A1	I fully understand your request. Let us take it for future consideration.

Q2	We would like to ask you to give an analysis of the YOY changes in the performance trends of NIPSEA China DIY segment in April, May and June. Although there are uncertainties, the Chinese economy is improving, so even after taking into account the strong performance you achieved in 2H of FY2019, the full-year forecast on P25 suggests that there will be little growth in 2H. Please explain the performance trends in April, May, and June and the outlook for 2H.
A2	We do not disclose monthly trends from April to June, but our performance was certainly slightly better in June than in April. There is no doubt that the YOY analysis of 2Q reflects some seasonality and is on a slight recovery trend. In particular, our performance in April was considerably affected by the huge COVID-19 impact in March, so our performance is improving overall compared to the peak of COVID-19 impact. According to some media reports, the COVID-19 infection is subsiding in China but, according to the local management, it is still difficult to make any assessment. The paint industry is not subject to significant geopolitical risks, and this business is a local production for local consumption, so the COVID-19 impact is relatively small. On the other hand, consumers and companies that depend on exports are not necessarily free of concerns about the outlook of the Chinese economy in various ways. So, we cannot know for sure until the actual results come about. Our assumption is that the DIY segment, in particular, is weak

	and will not improve consistently YOY in July, August and September.

Q3	You mentioned in May that your market share was rising. Hasn't there been intense competition in China?
A3	The DIY segment is facing certain competition. In the DIY segment in 2Q, sales of economy products increased. These products are in the high-volume zone and subject to more price competition. Competition is not so intense in the high-end products. However, we are also making sales drives in the high-volume zone to increase our market share. In a sense, we are voluntarily jumping into areas where competition is intense.

Q4	Do you see that competition with competitors became more intense than three months ago?
A4	Three months ago, there were relatively many competitors who were unable to deliver products. One of our advantages was that we reopened our factories earlier, got ready to resume production, and restored the delivery system faster than our competitors. We feel that our quick recovery provided customers with a sense of security and certainty. Competitors are catching up, and we expect that our advantage on that front that we enjoyed during the peak of the COVID-19 impact will diminish gradually going forward.

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

Q1	I understand that you will focus on M&A in the future, but I think the future outlook of the demand environment and the industry is not clear. There are competitors whose earnings are deteriorating, which makes them a suitable M&A target in terms of valuation. Please explain your M&A policies and the timeline and policy, in particular about making your joint venture in Asia a wholly-owned subsidiary.
A1	Regarding M&A, you are right. If a company's business performance is somewhat sluggish, that naturally provides an M&A opportunity. All valuations are relative, and it is not for us to catch a falling knife. DuluxGroup and Betek Boya contributed significantly to our profits in the current severe market environment because we were able to acquire companies with excellent management and businesses with a very high market share. My point is that we will not blindly look for an M&A target just because the market environment is right. Rather, we are constantly looking out for opportunities but will implement M&A only if we can find a deal that contributes to the maximization of shareholder value (MSV) eventually and such company that can fit into our spider web management in the medium to long term. Regarding your second question about the timeline for the conversion of our Asian joint

	venture into a wholly-owned subsidiary, the answer is the same as what I mentioned previously. I will refrain from commenting on whether or not or when it will be implemented. In March, we established a proper governance system and are ready to discuss the subject. However, we will not comment on anything beyond that.

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

Q1	As for dividends from overseas subsidiaries in the P10, it appears that the dividends have declined significantly this year compared to the relatively large amount of dividends recorded in 2Q of prior years. Has there been any change, and have the changes been caused by deferring of timing for recording dividends or the COVID-19 impact?
A1	The reason is deferring of recording dividends because of slight delays in the closing of accounts regarding NIPSEA China due to the COVID-19 impact, and the resulting delay in the final resolution on dividends. Dividends from overseas subsidiaries are entirely eliminated from our consolidated results.

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

Q1	Regarding Asia excepting for NIPSEA China shown on P17, the rate of decline in operating profit also appears to be larger than that in revenue on a non-GAAP basis. Please provide us with the background for this. Given that raw material prices have fallen YOY, are there any special factors behind this decline? What are the qualitative changes regarding changes in profits in Asia excepting for NIPSEA China?
A1	Despite the differences in the rate of decrease between revenue and operating profit, revenue's decline was close to 40% on a ‘Tanshin’ basis and around 35% on a ‘non-GAAP’ basis. This simply reflects that we were unable to cover fixed costs, and there were no other special factors.

Q2	Simply calculated, the marginal profit is about 30%. I did not expect operating profit in Asia excepting for NIPSEA China on P17 to fall this much taking into consideration the effects of lower raw material prices. Is the decline in operating profit due to a decline in sales?
A2	Yes. Profits fell sharply, notably in the automotive coatings business in Thailand but this does not mean that the Thailand Group's profitability is high. In addition, the Malaysia, Singapore and Thailand Group, which comprise Asia excepting for NIPSEA China, are not

	very different in profitability and profit structure. Our impression is that we managed to achieve a positive profit in this region despite the severe market environment.

End