

FY2021 1Q Financial Results Conference Call Q&A Summary
(May 14, 2021)

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

Q1	<p>Please tell us your stance on price hikes to respond to raw material price increases. Your competitors have announced that they can expect to absorb the impact of raw material price increases through price hikes for products and cost reductions. How are you coping with the raw material price increases? Please also tell us which business segments or regions could be affected by the raw material price increases or where you would not be able to easily pass on the higher cost of raw materials.</p>
A1	<p>All paint manufacturers use the same raw materials, so we are basically under the same conditions. We are not planning on price hikes to pass on raw material price increases in order to absorb the impact of these increases. Rather, we will use different strategies from region to region by taking into consideration our positioning based on the competitive landscape. The ease of raising prices of our products to pass on the higher cost of raw materials differs depending on market share. Therefore, it would be misleading to give you strategies for individual regions and segments.</p> <p>However, as I have stated on many occasions, we can achieve our KPI only by increasing our net profit through price hikes and cost reductions, in addition to increasing revenue. So, we are working on absorbing the impact of raw material price increases.</p> <p>One more point is that the severe cold wave in North America has made it difficult to procure some raw materials. We are coping with shortages of raw materials by taking actions such as using substitutes and allocating raw materials among our operating regions in the best possible manner. We expect that our competitors are taking similar actions. We are committed to achieve the FY2021 guidance and the goals of the new Medium-Term Plan. We are determined to deal with raw material price increases while retaining our commitment to achieving our goals.</p>
Q2	<p>I believe the Chinese decorative paints business is your focus for market share improvements. Please tell us your price increase strategies for the DIY and Project segments.</p>
A2	<p>I would like to refrain from providing this information. As I have been stating on various occasions, the competitive environment is different in the DIY and Project</p>

	<p>segments. Our strength is our capability to adapt to various situations very quickly and deliver results. Our approach is not to use cut-and-dried strategies for the DIY and Project segments. There is more than one way to deliver results based on our perception of market conditions that is about the same as the views of others. Consequently, we will use various actions to achieve Maximization of Shareholder Value.</p>
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◆ Questions by Tomotaro Sano, JP Morgan Securities Co., Ltd.

Q1	<p>A simple comparison of operating performance between the 1Q of FY2020 and FY2021 may not be appropriate considering the severe impact of COVID last year. While the DIY segment and the Project segment in your Chinese decorative paints business achieved solid revenue growth of 57% and 110%, respectively, year on year, the operating profit margin of the overall Chinese decorative paints business improved by 1.2 percentage points. Could you tell me how much the operating profit margin improved in the DIY and Project segments? Also, you explained earlier in the conference call presentation that the Chinese business was affected slightly by the raw material price increases and that you raised prices of some products in the DIY segment to mitigate the impact. Can we assume that higher raw material prices had a negative impact on the operating profit margin in both the DIY and Project segments?</p>
A1	<p>As you have pointed out, revenue and the operating profit margin in the 1Q of FY2021 were higher than in the 1Q of FY2020, when sales were weak due to the impact of COVID. In China, raw material prices change relatively quickly in response to market price fluctuations. Consequently, we are under profit margin pressure. However, we are managing to absorb the impact of raw material price increases by raising prices with a small time lag and holding down costs.</p> <p>I cannot disclose information about price sensitivity of the DIY and Project segments, but I can tell you that margin pressure is higher in the Project segment. It is not easy to raise selling prices when we deal directly with our customers. In addition, we have competitors. Therefore, the situation is close to your assumptions to some extent.</p>

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

Q1	You said that the DIY and Project segments in the Chinese decorative paints
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	<p>business achieved significant revenue growth, which resulted in market share gains. Weren't there any special factors, such as front-loaded demand? I think you were able to maintain a very high capacity utilization in the industrial coatings business in the 1Q of this year without any particular impact of the Chinese New Year holiday. How about the situation in the decorative paints business? In China, where COVID infections are under control, do you have some confidence that the strong market trends in both the DIY and Project segments in this year's 1Q will continue in April and afterward? Please explain the market environment and actions you are taking to increase market share in China.</p>
A1	<p>Our Chinese business was severely impacted by COVID in the 1Q of FY2020. However, our revenue in the Chinese business increased significantly compared with the prior-year period because the market has recovered. As you can see in the heat map on page 18 of the presentation, the Chinese decorative paints market is red, showing that the market grew by 10% or more year on year. We expect that some competitors achieved a higher growth, but we believe we surpassed many of our competitors in terms of revenue growth. Market conditions were very strong because March is a peak demand period, not because of any special factors.</p> <p>Looking ahead to the market conditions in the April-June quarter, we expect that demand momentum will basically remain relatively strong. In addition, we do not expect any incidents that would hold down demand at this time. In the heat map for the 2Q of FY2021 on page 28 of the presentation, the Chinese decorative market is yellow. Based on these assumptions, we are aiming for growth that outpace the market, and we don't see any factors at this time that would prevent us from achieving this goal.</p>

Q2	<p>In addition to the DIY segment, in which you have maintained a very strong market position, what actions have been extremely successful in the Project segment? Please also tell us about market share trends and your outlook for the Project segment.</p>
A2	<p>As I have explained before, the Project market includes new housing as well as a relatively large repainting sector. There are also major renovation and upgrading projects. As a result, our sales channels are expanding. In the Project market, we can take advantage of our comprehensive strengths. As the leader in this market, we have drawn attention to our scale and reliability of operations, which we are sure have helped us to capture new project orders.</p> <p>As stated on page 21 of the presentation, overall paint demand is robust,</p>

	including for public facilities and security housing, so we see no signs of a slowdown in the growth of the Chinese decorative paint market. Under these market conditions, I believe we have an excellent reputation among our customers for our ability to deliver one-stop solutions and to supply paint and coatings as well as paint-related services.
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Q3	Regarding the cost structure of your Chinese business, I think the workforce increase and expansion of sales channels are the reasons for the profit margin decrease in the 1Q of FY2021. Please tell us your outlook for the operating profit margin as the cost of raw materials rises. Can we use the operating profit margin in the 1Q as a benchmark for comparisons with your profitability in the future?
A3	Regarding the 1Q operating profit margin, I have mentioned that the procurement cost of raw materials has increased a little. We expect that we can achieve a slightly higher operating profit margin in the 2Q.

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

Q1	You did not revise your earnings forecast for FY2021. Based on the 1Q results, I expect that you will be able to achieve your initial guidance easily. Please tell me if you see any downside risks such as a slowdown of growth in China and increases in the cost of raw materials, credit risk, and fixed costs.
A1	<p>Nothing can be achieved easily because earnings are the outcome of our best efforts. Solid sales are a positive factor as overall paint demand is definitely recovering. Although automobile production is failing to keep up with the growth of final demand, we expect that final demand will be relatively high. However, just as with the current semiconductor shortage, we believe that we are constantly vulnerable to supply chain risk factors involving raw materials and that this risk is greater for high-end market sectors like automobiles.</p> <p>Regarding our costs and operating profit margin in our Chinese business, the existence of competitors in the Project segment does not allow us to easily pass on raw material price increases. Consequently, we are taking various actions to achieve sales and profit growth without depending solely on passing on raw material price increases. Therefore, the risk of a sudden drop in our earnings is not high.</p> <p>The paint industry is less vulnerable to geopolitical risk involving imports and exports and U.S. relations with China. However, we need to pay close attention to</p>

	these risk factors. We are not seeing any major downside risk that needs to be factored into the current assumptions. Our focus is on how we are going to boost sales under these circumstances.
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Q2	According to your explanation in A1, are you saying that you are expecting to achieve your guidance by controlling expenses such as sales promotion expenses because demand is growing? Does that mean you are not worried about the possibility of the need to cut prices and take other actions if demand decreases?
A2	Prices are always a concern. To answer your question in terms of a matter of degree, we do not see a significant risk involving prices.

◆ Questions by Yoshihiro Azuma, Jeffries (Japan) Limited

Q1	Revenue in your Chinese business looks too high, and I wonder if the final demand really increased that much. How much of a difference is there between final demand and intermediate demand? For instance, the auto industry has a very long supply chain, and each manufacturer in the supply chain accumulates safety inventory. As a result, intermediate demand is higher than final demand in the auto industry. How about the situation in the paint industry?
A1	<p>While I cannot give you a quantitative figure, paint is product that cannot be stored for a long time because it stays good only for a relatively short time. Therefore, I think intermediate demand for paint is largely the same as the final demand.</p> <p>Nevertheless, as I have mentioned earlier, revenue in the Chinese business in the 1Q of FY2020 fell by about 30% compared with the 1Q of FY2019. So, please remember that the revenue growth in the 1Q of FY2021 is the recovery from the downturn in the 1Q of FY2020.</p> <p>China's housing floor-area sales and real estate development investments were strong, which I believe is due to the strength of the Chinese market. Thanks to the hard work of our people in China, our Chinese business performed very well, achieving growth that outpaced the strong market growth.</p>

Q2	While I see that you outperformed the market growth in both the DIY and Project segments in China by leveraging your capabilities, please tell me what actions you are taking to win market share in the Project market. According to your earlier explanation, you need brand power to some extent to boost sales in the Project
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	<p>market. Meanwhile, I don't think brand power clearly affects sales in the Project market as much as it does in the DIY market. What actions are you taking to acquire market share in the Project market? The Project market may not be so simple that you can acquire market share by just cutting prices. I assume you are taking about a combination of actions, such as hiring people, changing the evaluation system, extending the accounts receivable collection period, and accelerating deliveries. How effective is differentiation other than in price in the Project market?</p>
A2	<p>The meaning of brand value is different in the Project segment and the DIY segment because customers in the Project segment are real estate developers. For B-to-B customers, centered on real estate developers, low prices are not the highest priority when choosing a supplier. I think they also place importance on reliability, such as completing projects on schedule and maintaining a sound logistics network. Those are the needs of local customers. We not only sell paint and coatings but also provide solutions with the understanding of what customers need most. I believe our comprehensive capabilities including the reliability of our products, large number of production locations, quality of services, and capability to deal with problems if they arise are giving us an advantage over competitors in providing solutions.</p> <p>We are placing a great emphasis on convincing customers to do business with the Nippon Paint Group by providing paint and coatings as well as solutions. We launched a Project business team ahead of competitors, and we have built our brand by providing reliability, which is leading to an increase in market share.</p> <p>This approach is not limited to our Chinese team. All our partner companies are providing solutions to customers with the same mindset, and I believe this is translating into market share gains in our operating regions.</p>

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

Q1	<p>Is the revenue growth of 78% at Betek Boya, shown on page 26 of the presentation, on a local currency basis? Please provide more information about the business environment, exchange rate impact, and business performance in Turkey. Betek Boya delivered fairly strong results in the 1Q of FY2021, and I would also like to know the qualitative outlook for its 2Q performance and thereafter.</p>
A1	<p>The revenue growth figure is on a local currency basis. In Turkey, most of the raw materials we use are imported, so local prices are highly sensitive to exchange</p>

	<p>rate fluctuations. However, this is true for all our competitors in Turkey. Therefore, raw material price increases are passed on to selling prices. A depreciation of the Turkish lira boosts import prices, causing people to make purchases before prices rise. Consequently, demand tends to be eaten up before actual demand materializes. What I mean is that the strong 1Q results at Betek Boya were not only due to the strength of actual demand but also to various moves by customers that anticipate price increases going forward. Betek Boya is the No.1 paint manufacturer in Turkey and it is appropriately dealing with customers, including for product deliveries. I believe that is why this company was able to achieve strong revenue growth on a local currency basis.</p> <p>On the other hand, the depreciation of the Turkish lira has increased the cost of imports. So, we must consider how much to sell and the timing of these sales. Betek Boya has inventories carried over from prior periods, so their focus is the bottom line. I don't think they can be expected to continue delivering 70-80% revenue growth.</p> <p>Betek Boya was already an excellent company before the acquisition by Nippon Paint Holdings. The acquisition reinforced their capital base, which allowed them to become even more competitive. Before the acquisition, they were using bank borrowings for their expenditures for business expansion and working capital requirements. In those days, they were in a tough situation. Their bank borrowings had Turkish-lira denominated interest rates of 20% and euro-denominated borrowings were rising rapidly due to the depreciation of the Turkish lira. Joining our group removed these constraints and allowed Betek Boya to make reinvestments. The management is highly motivated and focusing on growth. We have been able to retain basically all of the management team members. This is also why they are very happy about joining the Nippon Paint Group. Betek Boya has strong commitment to further revenue growth, which I believe will continue to be apparent in their performance.</p>
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Q2	If factors for Betek Boya's 78% revenue growth on a local currency basis in the 1Q of FY2021 are broken down into the three elements of frontloading of demand, market expansion, and market share gains, how do you rank them in order of significance?
A2	There is no answer. All three elements are reasons for their strong revenue growth.

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

Q1	Please give us the revenue figures in the DIY and Project segments in China compared with the 1Q of FY2019. According to reports, some competitors achieved revenue growth of about 15% in the DIY segment over the same period. How does this compare with your performance?
A1	Obviously our revenue growth was significantly higher in the Project segment than in the DIY segment. Our DIY revenue increased compared with the 1Q of FY2019, but our Project revenue growth was much higher. I cannot give you any more information.

Q2	Do you see any possibility that raw material prices in China will increase further from the 1Q to 2Q? With your demand outlook remaining firm into 2Q, do you expect to maintain the current level of operating profit in the 2Q?
A2	<p>Looking at seasonal factors in the Chinese business, March is a peak demand period as I mentioned earlier. On the other hand, demand is not that strong in January and February. In fact, overall demand tends to be stronger in the 2Q and 3Q. September also is a peak demand period. When we look at revenue trends in prior years, revenue is generally higher in the 2Q than in the 1Q. Our profit margin basically increases with revenue growth due to operating leverage. Our operating profit margin (Tanshin base) in the overall Chinese business was 15.7% in the 1Q of FY2019, 16.2% in the 2Q, 16.6% in the 3Q, and 13.6% in the 4Q. While various factors come into play, we can expect that higher revenue generally results in a certain level of operating profit margin improvement.</p> <p>The ongoing increases in raw material prices offset the positive impact of higher revenue on our operating profit margin. Our operating profit margin was 12.6% (Non-GAAP base) in the 1Q of FY2021 in the overall Chinese business. We do not regard this as the base level. We will use numerous initiatives to generate as high an operating profit margin as possible, or exceed our guidance. We will not know the results until they come out, so we will take actions with flexibility to respond to the market environment.</p>

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

Q1	I would like to confirm your plans regarding management. Isn't it going to be too much of a burden on your part, serving as the Co-President and taking on the
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	duties of the CEO while continuing to perform the duties of the CFO? Can you maintain your aggressive M&A stance? Or, are you going to slow down a little and place priority on strengthening the organization?
A1	Under our new management structure, Wee Siew Kim and I will be Co-Presidents but not Co-CEO, and we have no CEO and CFO. The reason is that Wee Siew Kim and I are jointly responsible for the overall management. I am also performing the duties of the CFO and Wee Siew Kim is performing the duties of the COO. The scope of my duties did not expand greatly following the change in the management structure. If we focus on our priorities and refine our own strengths, we can keep things well under control. More importantly, we took up this new structure with confidence that our partnership can deliver sufficient returns and results. So, I do not have the slightest intention of slowing down our M&A strategy. We will stay focused on examining appropriate target companies at appropriate prices.

◆ Questions by Yoshihiro Azuma, Jeffries (Japan) Limited

Q1	What kind of benefits has Spider Web Management, which you have promoted over the past two years, produced? Please give an explanation with an example.
A1	<p>The key point of Spider Web Management is that all decisions are not necessarily left to the headquarters in Japan. We respect the autonomy of each partner company, so we can choose not to collaborate with a partner company if things are unlikely to work. For instance, the headquarters in Japan must be aware that we have no special expertise to increase our market share in Oceania. We acquired DuluxGroup in Oceania along with the management team who are the most qualified to achieve market share gains in Oceania. Therefore, our focus is on creating an environment in which the local management can stay motivated to aim for growth and other progress. DuluxGroup had been deploying the Selleys brand in Asia, but not always with a great success. However, once the Selleys brand business was transferred to NIPSEA, the business, although small in scale, quickly became profitable. We expect that this business will be more successful by collaborating with Vital Technical, which we acquired in March. The headquarters in Japan has very little involvement in this project.</p> <p>On the other hand, the headquarters in Japan closely oversees the governance of overseas partner companies. However, that does not mean that we give directions to our partner companies on everything and require them to ask for our</p>

<p>approval. For example, it would be a problem if they decided on an acquisition worth hundreds of billions of yen on their own, and we have a structure in place to prevent such incidents. Our approach is to firmly respect the autonomy of every partner company based on the idea that skilled management can maximize the efficiency of operations of their company. DuluxGroup and Betek Boya are excellent examples. The Indonesia business is also performing well. We will continue to use this approach for the advancement of the Nippon Paint Group.</p>

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