Nippon Paint Group Medium-Term Plan (FY2021-2023)
Progress Report Presentation Q&A Summary
(March 16, 2022)

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

Q1	You stated that you will maintain the operating profit target of 140 billion yen for FY2023. However, the current business environment is significantly different from the one prevailing when the Medium-Term Plan was announced on March 5, 2021 due to raw material price inflation, deterioration of the Chinese real estate market and other factors. What are the reasons that allow you to maintain the operating profit target of 140 billion yen in this situation. Do you have strong pricing power? Or did you achieve greater-than-expected market share gains?
A1	Our revenue targets in the Medium-Term Plan announced last year were 890 billion yen in Year 1 (FY2021) and 1,100 billion yen in Year 3 (FY2023). Our Year 1 revenue was 998.3 billion yen and our Year 2 (FY2022) revenue forecast is 1,200 billion yen. We expect to achieve our Year 3 revenue target one year early. These are better results than we expected and are attributable to the strengths of our platform (business foundation), operating leverage, and pricing power due to market share gains. However, we were seriously impacted by the higher cost of raw materials in FY2021 and are already dealing with unexpected events in FY2022, such as the Ukraine crisis and lockdowns in China due to the resurgence of the pandemic. However, I believe we can turn challenges into opportunities and beat our competitors in the medium and long term by steadily raising selling prices and improving margins due to operating leverage on higher revenue and by leveraging the strengths of our platform all the more because of this challenging environment. In fact, our strengths stood out in FY2021. As shown on page 8 of the presentation, assuming the FY2022 operating profit guidance of 115 billion yen, we will need to improve our operating profit by 25 billion yen to achieve our FY2023 guidance of 140 billion yen. Raising our operating profit margin to 13% is not the only way to achieve the operating profit growth needed. For instance, we can achieve an operating profit increase of around 25 billion yen and achieve the guidance through the combination of 10% revenue growth, which we achieved in prior years, and a 1.0pt improvement in the operating profit margin. With solid underlying paint demand, we expect to achieve an operating profit of 140 billion yen, which is in line with our initial plan, by achieving steady growth despite the current challenging environment. Our plan is to offset the impact of higher prices of raw materials, the unstable global situation, and disruptions of international logistics by leveraging the strengths of our platform.

Q2	The paint market is in a challenging environment in all regions due to raw material price inflation. Can we assume that your competitiveness has increased despite the current tough environment?
A2	Based on the concept of "Asset Assembler", the headquarters does not overly interfere with the management of Group partner companies. For instance, DuluxGroup's excellent management team knows better than anyone else how to achieve steady growth in the Australian market. By respecting the autonomy of our partner companies to a certain degree, we can let them manage their operations in an unrestricted and autonomous manner. For example, Betek Boya in Turkey will miss many opportunities under the current hyperinflation if they are required to ask headquarters for approval every time they have an opportunity. Our extremely talented management teams of partner companies have high levels of risk sensitivity, which underlies the concept of "Asset Assembler" and makes our management structure unique in the world. In addition, all management team members of the partner companies have a strong commitment not only to achieving revenue growth and market share increases but also to achieving earnings growth. This also highlights our strengths.

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

Q1	Our estimate for the Chinese decorative paints market is around RMB 85 billion. Is this consistent with your assumption shown on page 13 of the presentation? We expect that decorative paint demand for new construction, which accounts for the 2/3 of the total decorative paints market, is likely to decline in FY2022. However, you forecast GDP+α growth for this market. Please give us a breakdown of growth between the DIY and Project segments.
A1	There are many views on the size of the decorative paints market, and our assumptions are different from yours on some points. Our assumptions are that around 2/3 of overall paint demand is in the new construction segment and the remaining demand of around 1/3 is in the renovation segment. As we stated at the Investor Briefing on the NIPSEA Business in September 2021, we estimate that the market composition of these two segments is roughly 50:50 in Tier 0 and 1 cities. Our sales composition of the DIY and Project businesses is roughly 6:4 and their market shares are 27% and 9%, respectively. You can estimate based on this information that the new construction market in the Project segment is larger than the new construction and renovation markets in the DIY segment and the renovation market in the Project segment. Our FY2022 market forecast is relatively strong for DIY and soft for Project. From FY2021 to FY2023, however, urbanization and the provision of high quality housing are unlikely to suddenly stop. We forecast positive growth with an increase in per-capita paint consumption. We have revenue from decorative paints for new construction as well as from renovation. In addition, there is still DIY paint demand for newly built move-in-ready units, although this

	demand is declining. By targeting this demand, we achieved 35% DIY revenue growth and 29% Project revenue growth in FY2021. We have good prospects for achieving double-digit revenue growth in FY2022.

Q2	With Project market growth slowing, are you considering changing your sales model from the perspective of risk management to distribution via distributors as your competitors do, rather than selling products directly to real estate developers? Your consolidated price/mix in FY2021 was around 5% according to page 6 of the presentation. Is this figure for NIPSEA China also close to 5%? Is your FY2022 price/mix forecast better than the FY2021 price/mix?
A2	Considering that blue-chip developers will continue to grow their businesses, we don't think we need to lower the sales ratio of developers in the Project business. We achieved strong revenue growth by increasing our market share with the top 100 developers. However, some developers have become financially constrained, which has caused our Project revenue growth to moderate temporarily. In light of the recent developments in the Project segment, we cannot avoid a slowdown of growth. On the other hand, we expect that some developers will continue to grow. We have strengthened cooperation and established strong relationships with those developers. We will prioritize improving margins in FY2022, and take a selection and concentration approach based on profitability for transactions with real estate developers and paint stores. Looking at the volumes and price/mix, most of the 29% revenue growth in FY2021 was attributable to higher volumes and the contribution of price increases was minor. We expect that more than half the revenue growth in FY2022 will be from volume growth. We will continue to raise selling prices wherever and whenever possible in order to steadily increase earnings. Our strategy is to pursue volume increases due to market share gains and continuous selling price increases.

Q3	Is it possible to raise selling prices in DIY and Project in FY2022 by roughly the same percentages? Or is it easier to raise selling prices in DIY due to its market characteristics but rather difficult to raise selling prices in Project due to the tough competitive environment?
A3	Generally speaking, it is relatively easier to raise selling prices in DIY due to the competitive environment and market characteristics. Our Chinese team raises selling prices based on agreements with customers, although with much difficulty. The overall growth of NIPSEA China's decorative paints business is the total of growth in the DIY and Project businesses. We are not satisfied with the current operating profit margin levels, but we did achieve operating profit growth. While some competitors are recording losses in the Project segment, we will further step up actions to improve margins. However, if competitors seize the opportunity to take an offensive pricing strategy, our market share may decline. We assume that the current environment in the overall Project

	market in FY2022 makes an offensive pricing strategy more difficult compared to the environment in FY2019 and FY2020. Therefore, we will raise selling prices wherever and whenever we can based on agreements with customers.

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

Q1	Regarding the Net Debt/EBITDA ratio on page 34 of the presentation, your forecast for FY2023-end was 1.6x based on the Medium-Term Plan announced on March 5, 2021 and your forecast for the end of FY2022 is 4x based on the presentation. Are you going to maintain your aggressive M&A strategy? Please tell us your medium-term M&A strategy including in terms of Net Debt/EBITDA.
A1	The paint industry is relatively capex-light and has a very stable capacity to generate cash flows. Due to these characteristics, I think the probability of bankruptcy among paint manufacturers is very low and Net Debt/EBITDA is not necessarily a consideration for M&A decisions. We have secured a certain understanding on these points from financial institutions and rating agencies. Therefore, having Net Debt/EBITDA of 4x is not a reason to preclude M&A. Net Debt/EBITDA numbers are forecasts at this time and will decline in the future if operating profit increases. There was a case with a competitor. Its Net Debt/EBITDA ratio rose when it acquired another company but its stock price increased after the Net Debt/EBITDA ratio declined due to a recovery of cash flows. By taking these factors into account and maintaining close communications with financial institutions and rating agencies, we will consider obtaining financing while paying attention to financial soundness. We are confident that we can maintain strong growth. At the same time, we need to obtain the understanding of financial institutions and rating agencies. Net Debt/EBITDA ratios that allow for M&A vary depending on the situation. As a result, we have no upper limit for the Net Debt/EBITDA ratio.

Q2	Is my understanding correct that you are at the growth stage in which you utilize leverage rather than at the stage of deleveraging?
A2	We are not pursuing M&A as an objective. Rather, we will constantly pursue M&A opportunities that have growth potential and save cash and repay debt when we have no M&A deals in the pipeline. We believe the paint market that gives us added value to us will expand to the adjacency arena. Based on this assumption, we will use capital for investments to pursue growth. Needless to say, our growth is predicated on achieving Maximization of Shareholder Value (MSV).

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

Q1	Is there a change in your outlook for your margins to start improving in the 2Q of FY2022? What are your assumption for crude oil or naphtha prices when you negotiate with customers for selling price increases? Don't additional price hikes reduce demand?
A1	Our current 2Q FY2022 forecast is as of its announcement in February 2022, and uncertainties have not declined since the announcement. As a result, the timing of the margin improvement may be slightly delayed. However, we have no plan to revise our FY2022 guidance because we expect to restore the operating profit margin on a full-year basis. Yet the business environment remains challenging. Taking the Chinese business, for example, January and February are off-season and March, when demand is usually highest, was impacted by lockdowns and other restrictions. Even after considering this, we are not changing our full-year forecast. Our assumptions for naphtha prices were in the high-60,000 yen range when we announced our FY2022 guidance in February 2022. We have increased our naphtha price assumptions to the mid-70,000 yen range. This significant change in price assumptions makes it difficult to form an outlook. While the prices of raw materials for water-based paint are less correlated with naphtha prices, the cost of raw materials for solvent paint is significantly correlated with naphtha prices. Therefore, our partner companies will determine the impact of naphtha price fluctuations on our earnings based on the understanding that the naphtha price assumption in the high-70,000 yen range may not be high enough. Regarding the possibility of lower demand due to selling price increases, we anticipate that demand will be impacted by increases in wages for professional painters and prices of materials other than paint if inflation increases across the economy. The cost of paint accounts for a small percentage of the cost of DIFM and DIY. We don't expect paint demand to decline much due to selling price increases, in particular for paint purchased by consumers, such as in the DIY market in Australia. The impact of selling price increases differs from region to region because of differences in business models. We believe overall paint demand is less sensitive to prices increases.

Q2	You have recently announced selling price increases for industrial coatings and decorative paints in Japan. Don't you expect any decrease in demand due to these price increases?
A2	It's not easy to raise selling prices because we must take into account our relationships with customers. Maintaining demand is our basic premise when raising selling prices. Just as with overseas customers, raising selling prices in Japan is not easy. However, we believe the current environment is not the same as in many industries in Japan many years ago when companies could not raise prices because they were afraid that competitors would adopt an offensive pricing strategy. Now, competitors raise selling prices when costs increase more than can be

	offset by each company's own actions. So, we believe we can raise selling prices to a certain degree. That includes our Japan segment. Our partner companies in Japan will take actions including raising selling prices, while taking into consideration progress with achieving targets, in order to reach the targets.

◆ Questions by Konatsu Ochi, Nikkei Inc.

Q1	Please tell us how much you expect Russia's invasion of Ukraine will impact demand.
A1	We have some exports to Russia and Ukraine. However, we expect the direct impact on our businesses will be very small. There are some possibilities that the increases in crude oil and other raw material prices will impact consumption behavior and reduce renovation and other demand. From the perspective of the impact on our performance, the elimination of production delays caused by the shortage of semiconductor chips in the industrial and automotive coatings businesses will have larger benefits. From the perspective of the overall economy, we are concerned about the risk that stagflation (when wages do not increase but prices rise during an economic downturn) beginning all over the world. Our operating regions have different market characteristics, and our business models closely reflect the situation in each region. For instance, we expect paint demand will remain robust in Australia and Asia overall.

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

Q1	You explained that your stock price is EPS x PER. During this presentation, you explained your medium-term EPS growth potential. I assume you can deliver EPS growth by taking actions to respond to the current raw material price inflation and by leveraging Nippon Paint's strengths of brand power and a high market share in every region. Your PER is 22x based on Bloomberg's EPS forecast for FY2023, which is lower than the PER of around 30x-50x in FY2021. Please give us your views on this, including the possibility that the valuation investors are giving you is too low.
A1	Our share price started declining early this year when we announced our secondary share offering on January 7, 2022. Our share price slightly rebounded after we announced our full-year financial results for FY2021 on February 14, 2022. All in all, the stocks of some competitors were down more than ours. The market environment is definitely very challenging. We conducted the secondary share offering with the objective of increasing the daily trading volume, which was 0.1% of net sales, assuming that the low liquidity inhibited sound share price formation. We asked financial institutions about the need to sell their holdings in our shares and designed the secondary

	offering to restructure our shareholder base by attracting investors who properly understand our growth story. We implemented the secondary offering based on these considerations as the background but ended up exposing our weaknesses involving liquidity and shareholder composition. As a result, the share offering triggered short-term short selling, which some pointed out as one reason for the decline in our stock price. However, our stock price recovered to a certain extent in February and March. Our FY2022 PER forecast is around 27x, but I will refrain from commenting on the valuation of our stock because different people have different views on PER multiples. Our "Asset Assembler" model is a platform that allows us to deliver very solid growth with MSV as our sole mission. For instance, it is obvious that our M&A strategy has been successful if you look at the excellent assets we added in Asia and Australia. But we may not have given investors a sufficient understanding of our earnings growth potential and management policies. I have two supplementary comments. The first is about selling price increases to respond to raw material price inflation. We are in a challenging environment in the short term, but I believe the paint industry has a certain mechanism that allows paint companies to secure margins in the medium-term. We do not assume raw material prices will decline at this time. However, there are good prospects that margins that declined due to raw material price increases will recover after raw material prices start to decrease. The second comment is about the Chinese business, a subject where there is strong interest among investors. Some people expect that weakness in the Chinese new construction market will cause the performance of the overall Chinese business to weaken. However, our business operations have moved a step higher. We have a business platform that covers the entire Chinese market in various platforms and strong brand power in China. In the decorative paints business in China, for instance, the Project business achieved strong growth from FY2019 to FY2020 while the DIY business growth was moderate. However, the DIY business achieved sufficient growth in FY2021. It is true that the Chinese business constitutes a large percentage of our Group's operations. Going beyond that, our revenue forecast for FY2022 and afterward of more than 1,000 billion yen demonstrates the strengths of our platform. Pursuing long-term earnings growth is as important as pursuing the maximization of PER. Our Japan domicile gives us an excellent platform with the capability to obtain financing with a very low interest rate, which creates the potential for net income and EPS growth.

Q2	Your focus is on EPS growth. If you add ROE and ROIC to your financial metrics, I believe the valuation of your stock will change. For instance, if the stock of a company with an ROE of 20% is priced at a PER of 20x, that stock can be regarded as undervalued. Your M&A strategy on page 29 of the presentation lists a higher ROIC than WACC as your financial discipline. However, there is no clear quantitative criteria, such as by how much you

	would expect ROIC to be higher than WACC. There is a possibility that your lack of clear-cut financial metrics for reexamining corporate value has contributed to your unsatisfactory stock price performance. Please tell us if you plan to add any financial metrics and also your views about these metrics.
A2	Pursuing a high ROE could increase financial leverage. While we place importance on ROIC, we use funds to assemble assets as shown on page 10 of the presentation. This "Asset Assembler" model is only possible with our Japan domicile as well as our financing capability. Considering this, our basic strategy is to pursue earnings and EPS growth. When we review an M&A target, we check the ROIC and determine corporate value by using the DCF method. We are paying attention to various financial metrics, but our prioritized metrics may be different from those of investors. ROIC-based management has become popular, but sticking too much to this approach may cause opportunity losses and undermine growth potential. We see this as one of our long-term issues. For instance, when we acquired DuluxGroup in 2019, investors thought we overvalued this company based in the mature Oceania market because its EV/EBITDA ratio was 16.2x. We were debt-free at that time, and the acquisition through leveraged loans with low interest rates had the potential for double-digit EPS growth and further expansion of our businesses. The addition of DuluxGroup brought the Selleys brand into our Group and has enabled us to expand into the adjacency arena. If DuluxGroup had remained an independent listed company in Australia with a market capitalization of around 250 billion yen, as it was when the company was acquired by NPHD in 2019, I believe it wouldn't have been able to afford the acquisition of Cromology. We make M&A decisions from a high perspective including post-acquisition synergies and corporate value other than the acquisition price, based on the Board's approval after sufficient discussions. More closely examining various financial metrics will deepen your understanding of our business model. Looking back at past M&A, we established MSV as our mission along with the change of the Board's composition in FY2018. We acquired decorative paints manufacturers in Turkey and Australia in FY2019 and started working on the full integration of the Asia JVs and the acquisition of the Indonesia business in FY2020. In this way, the acquisitions based on our M&A strategy, which is designed to accelerate our growth with extremely low risk, have started to contribute to our earnings. We will maintain our existing M&A strategy. However, considering, for instance, that we will not use financial leverage as high as 10x, we may reach the limit of financing through borrowings at some point. Then, we may use equity financing, but this is low priority. We will obtain funding as much as possible through borrowings and leverage those financial resources to create various forms of value.

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

Q1	Page 21 of the presentation describes your progress with the paint related business strategy. There have been a few cases in which a large paint manufacturer expanded into paint related areas such as waterproofing materials. Conversely, I believe only a few manufacturers of paint related materials such as waterproofing materials and building materials have expanded into the paint industry. What are the reasons for your expansion into the adjacencies area and what makes you think you will be successful? In addition, I expect that margins are considerably lower in the adjacencies area. Do you think this segment will grow into a promising business?
A1	Actually, paint manufacturers do expand into the paint adjacencies area, and vice versa. Delivering a wide range of products to customers to meet end demand in a one-stop manner leads to greater competitiveness. The same goes for adjacencies manufacturers. Expanding product offerings benefited our relationships with real estate developers in particular. The paint related business is a solidly profitable business, basically with double-digit margins. If acquired companies require large capital expenditures, they will need a substantial equity investment from NPHD. Then, it will be difficult for these companies to contribute consistently to our earnings. However, every company we acquired has a relatively high margin on its own and does not require large capital expenditures. This is the business model we are building. In addition, our M&A targets are companies with powerful brands and very stable cash flows. Each acquired company may not be able to generate significant synergies like DuluxGroup has done, but assembling these assets means assembling businesses for the Group. At the same time, these are very low-risk investments and we can expect every asset to generate secondary synergies. However, we are not open to any type of acquisition opportunities. Rather, we must be selective. We are very confident about the growth potential of the paint industry. Regarding the adjacencies area, we are considering whether we should assemble assets based on the paint related business that started with the acquisition of DuluxGroup or acquire a company with valuable strengths to establish a foothold for expanding into a new business area.

Q2	Does the adjacencies area basically refer to waterproofing materials? Please also tell us the impact of raw material market conditions on your paint related business.
A2	The adjacencies area we refer to as the paint related business includes SAF (Sealants, Adhesives, and Fillers) and CC (Construction Chemicals). Besides these, Betek Boya sells ETICS (External Thermal Insulation Composite Systems). Betek Boya has an ETICS market share of around 40% with a powerful brand and an excellent cash flow generating capability. We will supply a very wide range of products rather than limiting our products to specific categories such as waterproofing materials. For instance, adhesives come in a wide range of types from B-to-C products sold in hardware

	stores to B-to-B products for construction. We will roll out a broad range of products by taking into consideration the characteristics of individual products. Regarding the impact of raw material market conditions on the paint related business, logistics and other expenses have generally increased. This has impacted margins, as in the paint and coatings business. Therefore, we will operate businesses while assuming that the cost of raw materials will increase.

◆ Questions by Yoshihiro Azuma, Jefferies (Japan) Limited

Q1	I assume prices are determined by some price calculation formula in the automotive coatings business to respond to inflation. On the other hand, I believe there are items such as logistics costs that are not included in the price calculation formula. Please tell us whether you are taking actions such as incorporating those items in the price calculation formula to respond to inflation.
A1	The frequency of price revisions is very low, only once or twice a year currently, although the frequency varies depending on contracts with customers. We negotiate with customers when revising prices. In an unexpected situation such as the current rising cost of raw materials, we talk with customers about price revisions at times other than the usual frequency. Local teams are negotiating with customers for price revisions including charging logistics and other costs separately as additional charges. Since customers are impacted by high raw material prices as well, not everything goes the way we want. However, price revisions are progressing overseas.

Q2	I believe your use of an M&A strategy and other measures to maintain the proper balance between business growth and leveraging is great. However, there are currently concerns about inflation and interest rates are extremely low in Japan. Considering these points, do you think about adopting an aggressive M&A stance by using high financial leverage?
Q2	As you pointed out, the Group has the competitive advantage of being able to obtain financing in yen. In addition, increases in interest rates overseas may strengthen our relative competitive strengths. Since our interest expenses on loans are very small, the important point when procuring funds is to obtain a sufficient understanding of financial institutions and creditors required for receiving loans. The Net Debt/EBITDA ratio of 10x is an extreme example, but we have not stated that the current level of 4x is the upper limit for this ratio. It depends on the circumstances.

End