FY2022 4Q Financial Results Conference Call Q&A Summary

(February 14, 2023)

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

Q1	Your operating profit forecast for FY2023 is 140 bn yen, which is the same as your operating profit target in the Medium-Term Plan (FY2021-2023). This creates the impression that you set the guidance to align with this plan. What is the logic behind the FY2023 guidance? I see that your exchange rate assumptions are slightly conservative. Did you factor in the impact of the earthquake in Türkiye? I would also like to know if your revenue growth forecast of 10%-15% for China TUC is in line with current market conditions.
A1	We regard the Medium-Term Plan targets as must-reach targets, but that is not how we determined our operating profit guidance for FY2023. I will give you more information in the Medium-Term Plan Update Meeting scheduled for April 7, 2023. Anyway, our assumptions underlying the Medium-Term Plan were different from our current assumptions, such as for raw material prices and exchange rates. Also, we did not include the acquisition of Cromology and JUB in the plan. Taking these items into account, you could say that our FY2023 operating profit guidance should be higher than the Medium-Term Plan target. We assume a stronger Japanese yen in FY2023 than in FY2022. However, we believe the operating profit guidance for FY2023 of 140 bn yen is well within reach driven by revenue growth through market share gains and the flow through of price increases in every region. We also anticipate an improvement in the raw material price contribution (RMCC) ratio and the absence of one-off items. In China, economic activities gradually resumed following the end of most Zero-COVID measures. Our outlook for demand in the seasonally strongest demand period of March is unclear with the Chinese New Year holidays having ended recently. I can assure you that the operating profit of 140 bn yen is a must-reach target and we have an even higher internal budget. However, numerous unexpected events have occurred in the past couple of years, such as Russia's invasion of Ukraine in 2022. Even though we cannot anticipate all unexpected events, we have determined that this is a fully attainable target. The earthquake in Türkiye has had no direct impact on our business at this stage. We will give updates if we identify any impact as we obtain further information on damage. At this time we expect that no significant revision to our guidance will be needed.

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

Q1	What is your decorative paints market outlook for your TUC and TUB segments in China in the 1Q of FY2023? Please also give us your take on market trends in the 2Q and afterward, as well as moves of competitors.
A1	As you can see on page 9 of the presentation, we expect the market conditions for both the TUC and TUB segments to be slightly softer in the 1Q of FY2023 compared to the 1Q of FY2022. However, we are aiming for market share increases in these segments. For FY2023, we expect that demand will be solid in the TUC market and yellow in the heatmap, which means the market will be slightly stronger than in FY2022. On the other hand, we expect that the TUB market will be roughly the same as in FY2022. We project revenue growth of up to 5% in TUB with some market share growth. Our focus is more on increasing market share in TUC. In terms of competition, Nippon Paint is a very powerful brand in the TUC segment with a very high market share. We want an even higher market share. We have a very high market share in Tier 0 and 1 cities. In addition, we are conducting aggressive sales promotion activities in Tier 3-6 cities, where our competitors have an edge, and we believe our efforts are bearing fruit. We will continue to drive our market share to beat out our competition in terms of the speed of market share gains.

	In the TUB market, we need to set priorities in our actions for increasing market share based on the assessment of market conditions and customer situations. Specifically, we will focus on increasing distributor penetration and firmly capturing repainting demand, including in large-scale renovation projects, rather than on increasing our market share with large real estate developers. Based on these plans, we forecast 10%-15% revenue growth in TUC and 0%-5% revenue growth in TUB, and are aiming for even higher revenue growth.

Q2	Does your management team in China believe that the TUC market has started to stabilize considerably and logistics disruptions will not be a big issue? Your market share in the former DIY segment was 27% in FY2021. Please give us the market share update for FY2022.
A2	Our management team in China believes that the outlook for TUC market conditions is not bad at all. This view includes a rebound in demand from the low point in September and October 2022 when we had a large opportunity loss due to the impact of lockdowns. There were logistics bottlenecks in Tier 0 and 1 cities in 2022, but we believe these disruptions are ending in those cities as well as in other cities. I will give you more information about our market shares in FY2022 at the Medium-Term Plan Update Meeting, but you can assume that there was no market share loss.

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

Q1	The operating profit margin in Nipsea China appears to be declining compared to the level in FY2019, although a simple comparison may not be appropriate due to seasonal factors. According to page 6 of the presentation, you forecast an increase of at least two percentage points in the operating profit margin in 2023. What is your logic behind this outlook, including the RMCC ratio and advertising expenses?
A1	Page 6 of the presentation shows the operating profit margin in overall Nipsea China, including the automotive business, in FY2022. A simple comparison of the levels in FY2019, when raw material prices were much lower, and FY2022 is not appropriate. However, the operating profit margin, excluding one-off items, has been recovering in FY2021 and FY2022. In the TUC market, we will focus on increasing sales of economy products in Tier 3-6 cities and raising our market share in FY2023. Price carryover effects will make a full year contribution. Also, with operating leverage kicking in as revenue grows and raw material prices moderate, we expect an improvement in the operating profit margin even with some deterioration in product/mix.

Q2	Your operating profit margin in Nipsea China was high in the 3Q of FY2022. Do you expect the margin to recover to that level? On another note, will you continue to take pricing actions despite the current moderation of raw material prices?
A2	I cannot say anything about operating profit margin targets. What I can tell you is that we are aiming to drive our margins to even higher levels. We will not be satisfied even assuming that our operating profit margin will improve by more than two percentage points in FY2023. We know that this guidance is not easy to attain with competitors also taking actions to increase their market shares. However, we are taking appropriate measures with the proper balance between market share gains and earnings growth. Regarding price reduction pressure, we think customers in the TUB and industrial businesses will possibly demand price cuts. On the other hand, we don't expect a very strong downward price pressure in TUC, including the DIY business. Paints and coatings are not price sensitive products because expenditures on paint and coatings as a percentage of disposable personal income is not high. As a result, pricing power is determined by brand power. If competitors cut prices, we will be required to consider reducing prices. However, we expect the downward price pressure to be relatively low in the short term.

◆ Questions by Ryokichi Kondo, CoatingMedia Co., Ltd.

Q1	Please tell us about the impact of the Next Career Plan early retirement program on your operating profit in FY2023.
A1	The operating profit margin in the Japan Group in the 4Q of FY2022 was effectively 6.1% before the special retirement payments of 2.2 bn yen. The margin was 6.9% after removing expenses related to Nippon Paint Corporate Solutions (NPCS) that were not incurred in FY2021. Given the profit structure of paint and coatings industry, we believe an operating profit margin of 10% is fully attainable and assume that our competitors have similar operating profit margins. The Next Career Plan impacted our operating profit because of special retirement payments of 2.2 bn yen in other expenses in FY2022. On the other hand, our personnel expenses will decrease by around 2 bn yen every year. In other words, the special charge associated with the Next Career Plan will be recovered almost completely in one year. However, the aim of the Next Career Plan was not to reduce personnel expenses but to encourage employees to alter their thinking in order to change inefficient tasks so that they can focus on work with more added value. In addition to lowering personnel expenses, we plan to improve production efficiency and increase added value, raise selling prices wherever and whenever necessary, and increase our market share. We hope these actions will translate into a significant improvement in our operating profit margin in all business segments in FY2023.

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

Q1	Page 9 of the presentation shows that your outlook is rather weak for the business environment in Oceania, the Americas and Europe in FY2023. What are your strategies in these three regions?
A1	The paint market in Oceania is centered on DIY paints. Now that pandemic-linked demand has subsided, we expect that sales volumes will be somewhat weak in FY2023. Assuming this business environment, we will aim for market share growth while accompanied by revenue growth through pricing actions. DuluxGroup has successfully increased its market share even while raising prices due to inflation and implementing many other price increases. They are making steady progress with increasing their current market share of over 50% to an even higher level, say 60%. In the Americas, we expect DIY demand will be pressured as the number of people who relocate decreases due to the impact of interest rate hikes on the housing market. In fact, one of our major competitors that announced its earnings results recently has a relatively conservative earnings guidance. Dunn-Edwards will aim to maintain its market share by capitalizing on its high-end brands, in particular in California. In Europe, repainting demand is larger than new construction demand as in the Oceania market. In FY2022, DIY demand was especially soft in FY2022 after the strong pandemic-linked demand in FY2021. We expect sales volumes to decrease in FY2023 from FY2022. We also expect sales volumes to decrease in the trade market, where Cromology has a leading market position, but we will aim to increase our market share in this segment as well. Overall, our plan is to further increase revenue in all three regions as we maintain profitability and our market share. We will not reduce selling prices just to increase our market share.

Q2	Can we assume that a big increase in sales volume cannot be expected in FY2023 in Oceania, the Americas and Europe?
A2	We assume that sales volume growth will be sluggish in these regions. Although we expect market volume growth will be negative, we project revenue growth because price increases in FY2022 will make a full year contribution in FY2023. Please see pages 6 and 7 for our assumptions for the FY2023 forecast, such as assumptions for a positive contribution from price increases and market share improvements.

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

Q1	According to the FY2023 forecast on page 5 of the presentation, you expect a 21 bn yen increase in operating profit because of revenue growth and an improvement in the RMCC ratio. Could you explain how much of this operating profit growth is attributable to the RMCC ratio improvement? Could you also tell us whether the RMCC ratio improvement will contribute to operating profit only in the 1H of FY2023 or will this improvement continue to contribute to earnings in the 2H and FY2024?
A1	Let me explain the outline of operating profit growth due to higher revenue and an improvement in the RMCC ratio on page 5 of the presentation: ①Revenue growth of around 10% will increase revenue by about 130 bn yen, which will raise our operating profit by approximately 13 bn yen based on an operating profit margin of 10%; ②An operating profit margin improvement of one percentage point through an improvement in the RMCC ratio and other actions will increase our operating profit by around 13 bn yen. With operating profit growth in ① and ② combined, we can expect operating profit growth of around 26 bn yen. However, we made a conservative estimate by taking into account the possibility that the operating profit margin improvement will not make a full year contribution. As a result, we arrived at operating profit growth of around 21 bn yen. The operating profit margin forecast of 10% on a group basis is not satisfactory after considering that our operating profit margins in some regions are in the mid-teens. Our earnings guidance is must-reach targes, and we will aim for earnings that exceed the guidance.

Q2	Your gross profit margin exceeded 40% when raw material prices were lower. Considering this, can we expect a gross profit margin improvement of around one percentage point in FY2023 even based on conservative assumptions for exchange rates and other factors?
A2	When we announce our earnings guidance, we use a forecast that we believe is firm at that point. Please understand that we will need to revise our guidance if there is a significant change in our assumptions.

Q3	I understand it is difficult to factor in potential credit losses into your earnings forecast. Nevertheless, am I right to assume no potential credit loss in FY2023 given the current business environment?
A3	We started rigorously managing receivables from real estate developers in around 2021. Specifically, we ask some developers to conduct transactions in cash if they want to maintain business relationships with us or to buy our products from distributors. As a result, we believe only a very small part of our outstanding receivables may become uncollectable. Therefore, we do not think that we will need to record credit loss provisions of more than 10 billion yen, although there is uncertainty due to economic circumstances. We did not factor in subsidies and other items that have a positive effect on the earnings guidance, either.

◆ Questions by Kazuki Sakaguchi, Daiwa Securities Co., Ltd.

Q1	What are the reasons that your operating profit in the Japan Group improved in the 3Q and 4Q of FY2022? I presume the major contributor is selling price increases. Please also tell us if the pace of operating profit improvement varies from business to business. In addition, could you explain why you forecast only a 0%-5% growth in automotive revenue in FY2023? Based on page 9 of the presentation, I think we could expect a higher growth.
A1	Operating profit in the Japan Group in the 4Q of FY2022 improved from the same period a year earlier driven by price increases, volume growth and a recovery of automobile production. Volume growth tends to increase operating profit in our group businesses because operating leverage will cause marginal profit to increase. In addition, a recovery in the marine business is another contributor, although it is not shown in the presentation. The marine revenue in Japan Group includes overseas revenue, and the marine business

	improved its earnings on a global basis. I think different people have different takes on the FY2023 forecast. Based on the automotive market conditions in the 1Q and FY2023, we can expect a higher revenue growth assuming that we will not lose our market share. Different automobile models have a different impact on our earnings. In particular, the impact will differ depending on whether our products are used in top-selling vehicle lines. Therefore, our sales will be affected by the actions of consumers. By taking these points into consideration, we have made a slightly conservative forecast. Operating profit in the decorative business and industrial business is driven both by selling price increases and volume growth. For instance, the decorative business is impacted by unpredictable factors, such as vulnerability to weather changes. We set the earnings forecast as a must-reach target and will aim to exceed the forecast.

Q2	Does your forecast for operating profit improvement in the Japan Group factor in selling price increases as well as volume growth in each business?
A2	We assume volume growth in each business.

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

Q1	I have a question about your assumptions for the FY2023 forecast in Japan, Nipsea China and Nipsea Except China that are on pages 6 and 7 of the presentation. Is your revenue forecast for FY2023 mainly based on the assumption of volume growth? If so, your revenue growth forecast for the decorative business in Japan, the automotive business in Nipsea China, and the Indonesia business appears to be high. What is the reason for this?
A1	I will refrain from going into details. However, the forecast assumes increases in both sales volume and selling prices. For instance, we expect price increases to contribute to revenue growth in Nipsea China but the forecast also factors in price/mix changes due to a higher proportion of economy product sales. In addition, the forecast incorporates sales growth in semi-finished goods and adjacencies products. Therefore, you cannot estimate our business growth only by looking at volume growth. For the Indonesia business, we expect revenue growth of around 15% driven by market share increases through volume growth and contributions from price increases. For Türkiye, we assume that inflation will remain high, and that revenue growth will be driven mainly by price increases rather than volume growth. We do not anticipate significant volume growth in these regions as well as other regions. For the Japan Group, as I stated earlier, we will aim for growth through the full year contribution of selling price increases accompanied by market share gains.

Q2	In Indonesia, you explained in November 2022 that the business environment would be challenging in the 4Q of FY2022. Can we assume that performance is currently recovering?
A2	Our Indonesia business achieved very strong revenue growth in the 3Q of FY2022 because of the last-minute demand before price increases. At our 3Q earnings call in November 2022, I stated that our 4Q performance would be weaker than expected by taking into consideration business sentiment in October and demand following price increases. However, it turned out that our 4Q performance was strong because our sales increased steadily in November and December.

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