FY2023 2Q Financial Results Conference Call Q&A Summary
(August 10, 2023)

*A supplementary explanation (highlighted in yellow) is provided on the credit loss provision at NIPSEA China.

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

Q1	What factors contributed to the decline in NIPSEA China's operating profit margin for the 2Q when compared to the 1Q, even though raw material prices were lower than in 1Q and there was a stronger demand in 2Q compared to the 1Q, which was affected by the Chinese New Year holiday? While one potential factor could be the shift in product/mix with increased sales of economy products. Please explain in details. Furthermore, kindly elucidate the factors behind the decision to upwardly revise the financial guidance for the TUC business, even in light of the downturn in the Chinese real estate market. Is this revision driven by a strategic pursuit of increased volume through price reductions?
A1	In the 1Q of FY2023, NIPSEA China demonstrated a robust performance, buoyed by the rebound in economic activities subsequent to the relaxation of pandemic-related restrictions that continued throughout the latter half of FY2022. This resurgence led to substantial earnings driven by pent-up demand from the previous year and the moderation of raw material prices. Consequently, our 1Q operating profit margin surpassed projections, although the 2Q operating profit margin decreased from the 1Q. Notably, on the non-GAAP basis 2Q operating profit margin improved to 9.4% from the 7.6% recorded in the second quarter of FY2022. In the 2Q, we observed robust performance in April. However, in our pursuit of expanding market share, we made the strategic decision to reduce prices on certain products, including economy items, in May and June, as a response to the prevailing economic slowdown. Particularly, the rebound in demand within Tier 0 cities had a favorable effect on margins, offsetting the downturn experienced in the 2Q of FY2022 due to lockdowns. Nonetheless, the deterioration in product/mix, stemming from elevated sales expansion in Tier 3-6 cities, exerted an adverse influence on the operating profit margin in the 2Q of FY2023. Furthermore, in the TUB business segment, there were cases where we had to resort to legal measures to recover trade receivables. Based on our internal policy, an almost 100% credit loss provision is recognized against trade receivables for which legal action is pursued for debt retrieval. Consequently, these delinquent debts have had an unfavorable effect on our operating profit margin. We are committed to pursuing volume growth and expanding market share, perceiving the present business landscape as a chance, even if it means sacrificing some degree of our margins. Nonetheless, it's important to note that our operating profit margin has improved consistently compared to the same period of the previous year.
A2	I will give you the following supplementary explanation about the credit loss provision in China. ・Let me tell you first that the TUB business, which includes transactions with real estate developers, currently accounts for approximately 6%* of our consolidated revenue. Accordingly, the performance fluctuations in this business do not significantly impact our consolidated performance. *Compared to FY2022, the relative weight of the TUB business decreased with the growth of the TUC business. To illustrate, the revenue composition of the TUB business: NIPSEA China revenue (c. 35% of the consolidated revenue) x Decorative paints revenue in NIPSEA China (c. 80% of the overall revenue in NIPSEA China) x TUB revenue in the decorative business in

	NIPSEA China (c. 20%-25% of the overall decorative revenue) ・The breakdown of sales in the TUB business between the real estate developers and others is approximately 40% to 60% and trade receivables from others generally have lesser collection issue. ・We recorded a credit loss provision of approximately 15 bn yen for trade receivables from leading private developers last year. But that was related to a limited group of customers (10-plus developers). We have not recorded any additional provision for this specific group of customers this year. Furthermore, we have switched to cash-on-delivery transactions with customers who have a potential debt collection risk starting in the second half of FY2022 through FY2023. ・We have focused on more than 100 developers, and the amount of trade receivables which were issued before we switched to cash-on-delivery and are in arrears have started to increase due to the economic conditions these days. ・There have also been increasing cases in which we take legal actions to collect the trade receivables issued in the past (before we switch to cash-on-delivery) and are in arrears. Based on internal policy, 75%-100% of the amount of trade receivables which are undergoing legal actions will be recorded as a credit loss provision. The credit loss provision recorded in the 2Q as a result of us taking legal actions has impacted our operating profit margin. With historical recovery at 50-plus %, we believe our credit loss recognition is adequate. ・To be specific, the impact of credit loss provision will be 1-plus % of the full-year revenue at NIPSEA China. The amount of credit loss provision is larger in the first half than in the second half, and the 2Q recorded the largest amount of credit loss provision (slightly below 2% of the 2Q revenue) on a quarterly basis. Since the trade receivables covered are basically those issued before we switched to cash-on-delivery, we expect that trade receivables that will be subject to credit loss provision will start decreasing gradually from the second half through FY2024. ・The 2Q operating profit margin at NIPSEA China was 9.4% on a Non-GAAP basis but will be 11-plus % after excluding the credit loss provision accompanying legal actions even after taking into account the impact of higher sales composition of economy products (including higher sales growth in Tier 3-6 cities) in the product/mix and price reduction on some economy products. ・We expect the percentage of trade receivables for which credit loss provision will be recorded following legal actions will start decreasing gradually in the 3Q. I have stated that we will prioritize market share gains, but we will not reduce selling prices in total disregard of profitability. I hope this supplementary explanation will clear up the misunderstanding that our operating profit margin in NIPSEA China will continue to decrease.

Q2	Do I accurately comprehend that the upward revision of the financial guidance for TUC includes the pursuit of increased market share? Also, do the one-off factors totaling 5.6 bn yen within NIPSEA China's 2Q results include both a positive impact from subsidy income and a negative income from credit loss provisions linked to the commencement of legal actions?
A2	The upward revision of the guidance for TUC includes market share gains. The one-off factors totaling 5.6 billion yen solely comprise subsidy income and gain on sale of real estate assets, excluding any credit loss provisions associated with legal actions.

Q3	What is the magnitude of the credit loss provision that has been recognized as a result of commencing legal action?
A3	I will abstain from disclosing the specific amount of credit loss provisions that have been recognized. *Please refer to the additional explanation provided above (highlighted in yellow).

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

Q1	What were the main factors driving the Japan segment's operating profit margin to surpass 10% in the 2Q? Is there a possibility for the operating profit margin to decline in the 3Q or subsequent periods, considering the potential absence of advantages stemming from decreases in raw material prices?
A1	Several factors have contributed to the substantial enhancement of the operating profit margin in the 2Q. For instance, both volume growth and pricing initiatives have bolstered the operating profit margin in the automotive and marine businesses. In the decorative and industrial businesses, pricing measures have partially counterbalanced the decline in sales volumes. We have undertaken a diverse range of measures with the objective of enhancing profitability. These include initiatives like the introduction of a voluntary early retirement program, named the Next Career Plan, in FY2022. The cumulative outcomes of these efforts have begun to positively influence margin enhancements. Operating profit margin of 10% is indeed a significant benchmark, yet surpassing this milestone for the entire fiscal year of FY2023 remains a formidable challenge. Our commitment to enhancing profitability remains steadfast, and we will persist in implementing measures to that effect. Ongoing pricing actions in the decorative business offer potential for further margin gains contingent upon the trajectory of raw material prices. Our overarching aspiration is to bring the operating profit margin back to the levels achieved in FY2017 and FY2018. The sustainability of the operating profit margin surpassing 10% in the Japan segment in the 3Q and beyond hinges on factors like raw material price trends and other factors. Nonetheless, our projection indicates that the operating profit margin for the entire FY2023 will surpass the guidance issued in February, which anticipated an improvement of 2 percentage points or more from the preceding year.

Q2	Could there be potential scenarios where the difference between selling prices and raw material costs decreases over the latter half of this year?
A2	Unless there is a substantial change in the prevailing patterns of raw material prices, we find it unlikely that the price differential will diminish, particularly given the ongoing implementation of pricing strategies in certain businesses. Nonetheless, the extent of margin improvements will hinge on the extent of recovery in sales volumes in the decorative and industrial businesses.

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

Q1	You mentioned that the TUC business of NIPSEA China faced subdued demand in May and June. Were there any distinctions or particular traits observed between metropolitan areas and provincial regions? Based on my understanding, the TUB business predominantly centers on cash-on-delivery transactions with government-linked real estate developers. This mitigates the potential risks associated with collection of trade receivables. Kindly provide an overview of the prevailing business environment in the TUB business segment as well.
A1	Primarily in our TUB business, we encountered a minor decrease in demand in May and June. Conversely, the demand in our TUC business remained fairly stable, showing minimal variation from month to month. However, we perceived a general weakening of economic conditions in May and June compared to April. In relative terms, the operational landscape surrounding TUB presented slightly greater challenges, although there was no significant distinction in demand

	patterns between metropolitan and provincial areas. As previously mentioned, in the TUC business, demand exhibited notable strength, partially attributed to a recovery from the corresponding period in the preceding year. Moreover, we have chosen not to lower the prices of our premium products. Instead, we have implemented price reductions for certain economy products. This strategic shift has resulted in considerable growth in sales volume and the acquisition of greater market share in Tier 3-6 cities. In the TUB business sector, we've employed a strategy aimed at boosting sales by engaging the top 30-100 major developers. This approach has yielded an augmented market share, coupled with increased market presence in new constructions initiated by these developers. Presently, our approach towards major developers involves a discerning selection process for business interactions. We have also transitioned to cash-on-delivery payment terms. Concurrently, we're actively pursuing the expansion of our customer base to distributors, among others. Trade receivables relating to non-residential projects, such as hospitals and schools, as well as those originating from distributors, are essentially trouble-free. But we have encountered instances of delayed payments of trade receivables from certain developers that were outstanding prior to our switch to cash-on-delivery terms. Trade receivables in arrears that necessitated legal intervention for debt recovery are recognized as a part of our standard credit loss provision. The specific value of one-off provisions is not disclosed to prevent any potential misinterpretation among investors. We have disclosed it to clarify its impact on the reduction in margins, as the provision's magnitude has surpassed our initial projections within the scope of routine business operations. *Please refer to the additional explanation provided above (highlighted in yellow).

Q2	Have you experienced any impact from the decrease in demand in provincial cities, especially considering that a notable percentage of economy product sales come from TUC?
A2	In a bid to invigorate demand and gain a competitive edge, we are implementing price reductions on certain products. While this price adjustment doesn't cover our entire product range, we are vigorously pursuing sales promotion initiatives for specific items within Tier 3-6 cities. By offering these products at slightly reduced prices compared to previous rates, we are effectively surpassing our competitors. As a result, we have witnessed growth in sales volume. Backed by robust underlying demand, now is the time to capitalize on the extensive markets in Tier 3-6 cities and strive for increased market presence. Presently, our focus is on attaining greater market share rather than concentrating on margin improvements. It's worth noting that our efforts are yielding profits.

Q3	Considering that the historical operating profit margin for NIPSEA China stood at approximately 15%, is the goal of restoring the margin to that level still a priority for you?
A3	Although our fundamental approach remains unchanged, we also acknowledge that an excessive adherence to the fixed operating profit margin of 15% might result in missed business opportunities. Our core strategy involves prioritizing market share expansion and establishing a competitive advantage before emphasizing solid margins. We are dedicated to refraining from chasing market share gains without consideration for the potential costs, solely relying on the historical precedent of a 15% operating margin. Instead, our approach involves assigning varying levels of importance to market share gains and margin enhancements, contingent upon prevailing market dynamics. In the case of Tier 3-6 cities, which present growth prospects, we are actively pursuing market share expansion while not overly fixating on overarching margin enhancements. This exemplifies NIPSEA's adaptability and proactive

	stance.

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

Q1	Please provide us with your overall perspective on the operating profit margin for the second half, along with your insights into the trends of raw material prices?
A1	Presently, raw material prices are stable, and our financial projections hinge on the premise of maintaining these current levels. In certain businesses of our Japanese operations, we will continue with price revisions. Nonetheless, a substantial impetus for pronounced price hikes across global markets is not apparent. In the second half, NIPSEA China's primary emphasis will remain on increasing market share. Hence, we anticipate a marginal decline in its operating profit margin, due to a shift in product/mix that has led to a deterioration, despite the growth in volume. In regions beyond NIPSEA China, our endeavors include both market share gains and margin enhancement.

Q2	Based on information available to me, there seems to have been a buildup in distributor inventory within NIPSEA China's TUC business starting from April or May. Could you confirm this? Are you intensifying marketing activities in Tier 3-6 cities due to subdued sales in metropolitan areas? Alternatively, is your strategic focus on Tier 3-6 cities, despite lower profitability? Kindly provide insights into demand trends across different tiers and clarify the strategies devised to align with these trends.
A2	We haven't observed any rise in distributor inventory, and it's not a major area of concern for us. However, in response to some apprehensions regarding softened demand due to an economic slowdown, we're implementing price reductions and offering sales incentives to stimulate demand and prevent loss of sales to competitors. We have the highest market share in both Tier 0 and Tier 1-2. Moreover, our competitors aren't currently undertaking aggressive sales campaigns to narrow the gap. On the contrary, we must adopt an assertive approach to propel sales in Tier 3-6 cities and outpace the competition. Demand in both Tier 0 and Tier 1-2 cities has shown substantial recovery and growth compared to FY2022, which was marked by the Corona pandemic. The demand in these cities depends primarily on repainting needs. While the likelihood exists for a delay in repainting demand due to an economic slowdown and reduced relocations, we have implemented measures to offset the repercussions of demand fluctuations. In Tier 3-6 cities, demand in the new build market has remained robust. We are actively driving sales in these cities with an emphasis on future market expansion. We deploy distinct strategies tailored to the demand dynamics in Tier 0 and Tier 1-2 cities, as well as in Tier 3-6 cities. However, there are no significant shifts observed in demand trends across these categories.

Q3	Do you intend to continue vigorous sales efforts in Tier 3-6 cities over the next three to five years?
A3	Over the past three to five years, we have consistently enhanced our market share in Tier 0 and Tier 1-2 cities. Our committed stance involves maintaining an all-encompassing and proactive approach.

◆ Questions by Takehiro Yamada, Toyo Keizai Inc.

Q1	Please provide us with your forecasts for profitability across regions and business segments for FY2024 and beyond.

A1	Discussions are currently underway regarding the upcoming Medium-Term Plan, which covers the period from FY2024 and beyond. While I won't delve into specifics, it's important to note that our partner companies across all regions are consistently striving for heightened growth. As an example, consider DuluxGroup in Australia, where it currently holds a 50% market share. Despite this substantial presence, they are actively exploring avenues for more growth and the acquisition of additional market share. Furthermore, in light of the recent challenging business environment affecting its European operations, the management team at DuluxGroup is engaged in discussions to enhance the operating platform of Cromology. Notably, the Co-Presidents have taken on a role as Directors in these deliberations. NIPSEA currently commands a 75% market share in Singapore and holds a 45% market share in Malaysia. While their robust market position might present some restraints in terms of additional market share gains, they continue to be dedicated to both sustaining and enhancing their market share. Drawing insights from the lessons of the past few years, marked by challenging performance, the Japan Group is currently exploring the feasibility of extending strategic measures, previously executed for individual optimization in each business, across the entire Japan Group. These initiatives are helping all Japan Group companies in achieving margin enhancements, increasing market share, and fostering revenue growth. I firmly believe that there is significant growth potential in this area. We are of the opinion that our current operating profit margin is not yet at its optimal level. While the raw material cost contribution (RMCC) ratio is affected by market price trends, we are consistently engaged in price adjustments and cost reductions as key performance indicators (KPI). Our approach involves seeking growth through market share gains and margin enhancements. In addition to our steady organic growth, we aim to enhance the operating profit margin further by leveraging operational efficiencies for marginal profit improvements. By employing the Asset Assembler model for M&A activities, we can sustain the advantage of low financing costs, given that Japanese yen interest rates are lower than those of foreign currencies. Our emphasis remains on progressively accumulating M&A initiatives, as an increasing number of companies align with our concept of fostering autonomous growth of acquired entities through our business model, which complements autonomy and accountability. Our growth potential beyond FY2024 holds no bounds, as we aspire to grow both organically and inorganically.

Q2	What, in your opinion, poses the most significant risk to your growth projection?
A2	We have no specific concerns regarding risks. For instance, in the case of an M&A deal, we consistently exercise thorough scrutiny, ensuring a vigilant evaluation before proceeding. Investors and analysts often show heightened apprehension about the so-called "China risk." However, our business model is primarily based on local production for local consumption. Unlike the conventional business frame work you might expect to see at manufacturers, our approach doesn't entail halting the global distribution of all products in the event of China's potential decoupling from the global economy. This does not mean that we have no reliance on China. Nonetheless, NIPSEA China generates ample cash flows through its localized production and consumption approach. These cash flows are utilized for dividends and investments. A notable strength of our partner companies lies in their capacity to achieve autonomous growth without the infusion of external capital. In my view, a remarkable pool of talent stands out as a source of our strength. We consistently monitor the risk of valuable talents leaving our Group, along with potential conflicts of interest between the headquarters and local management teams. Nevertheless, by embracing a culture that values the autonomy of partner companies, we extend assistance to exceptional local management teams,

	nurturing autonomous growth while ensuring their motivation and effectively connecting partner companies to our global platform. Therefore, we do not perceive a significant human resource risk. Instead, our forte lies in amassing low-risk assets, and we take pride in building a business model that doesn't demand excessive concern regarding risks. Our strategy revolves around enhancing profitability while mitigating risks to the maximum extent possible.

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

Q1	Regarding the rationale behind the upward revision of your financial guidance, page 24 of the presentation gives a rough idea about an expected revenue boost of around 9 billion yen from volume growth and a lower RMCC ratio. Furthermore, pages 25 and 26 of the presentation highlight that revenue is expected to surpass forecasts in Japan and Türkiye, show strength in NIPSEA except China, and only slight weakness in NIPSEA China. Kindly explain the regional business conditions in detail. Can we assume that the contribution from the lower RMCC ratio at NIPSEA China started decreasing in the 2Q and peaked in NIPSEA Except China in the same quarter? Additionally, can we expect the positive impact of the lower RMCC ratio to start benefiting Japan, Australia, and Europe in the 3Q or beyond?
A1	The market's strength and direction of each region are presented on the right-hand side of pages 25 and 26 of the presentation, for comparison with our February guidance. Regarding the NIPSEA China's full-year revenue guidance, we expect TUC to outperform, TUB to underperform. We maintain a moderately cautious forecast for the automotive business. Overall, the performance in NIPSEA China is expected to be in line with our February guidance. Revenue in the Japan Group is expected to be largely on par with our February guidance, while its operating profit margin is likely to surpass our February guidance. This is partly attributed to the recovery in the automotive business. The overall performance of NIPSEA Except China is expected to slightly exceed our February guidance. In the Malaysia, Singapore, and Thailand Groups, the operating profit margin is likely to top our February guidance due to increased revenue and a reduced RMCC ratio. The Indonesia business is currently on a recovery trajectory, in contrast with its relatively weak performance from the latter part of FY2022 through early FY2023. Although Türkiye demonstrated robust performance in the 2Q, this factor was not taken into account for the upward revision of the guidance due to uncertainties surrounding the full-year effects of hyperinflationary accounting. In the DuluxGroup segment, we expect performance to be largely on par with our February guidance. Similarly, we project our overall performance in the Americas to stay consistent with our February guidance, as the underperformance in the decorative business is offset by the outperformance in the automotive business.

Q2	The presentation outlines an upward revision of the operating profit guidance by 18 billion yen. This revision is divided into approximately 9 billion yen attributed to volume growth and a lower RMCC ratio, and another 9 billion yen attributed to the depreciation of the yen. Is it correct to assume that the one-off factors involving NIPSEA China and Australia, which amount to 6.9 billion yen, will not have an effect on the full-year operating profit after considering the anticipated one-off expenses to be recognized in Australia in the second half? Furthermore, is it accurate to deduce that there won't be any net gain resulting from the recent consolidation of NPT, considering that the advantages gained will be counterbalanced by the initial expenditures incurred this year?
A2	Cumulative one-off factors, amounting to 5.6 billion yen, including the subsidy

	income in NIPSEA China I mentioned earlier, will contribute positively to our annual operating profit. On the contrary, the favorable impact of one-off factors in Australia will be largely offset by the estimated one-off expenses, totaling approximately 1.5 billion yen, projected to be recognized in the second half. Despite the recognition of one-off factors, the operating profit margin for the second half is expected to decline marginally compared to the first half. Nonetheless, we have presented it as the target that must be attained. NPT has been newly included into consolidation starting from the second half and is expected to make a positive contribution. However, this positive impact will be countered by initial expenses, including M&A costs. Consequently, the newly consolidated NPT will likely make only a modest contribution to the consolidated operating profit for the full fiscal year.

Q3	Has the revision of the financial guidance factored in buffers against certain risk factors? Furthermore, could you specify how the one-off factors, including the subsidy income at NIPSEA China totaling 5.6 billion yen, contribute to the upward revision?
A3	The upward revision of the operating profit, totaling 18 billion yen, includes the one-off factors amounting to 5.6 billion yen at NIPSEA China. These factors are specifically recognized in both the factors referred to as "c. +9 billion yen from volume growth and lower RMCC ratio" and "c. +9 billion yen from weaker yen vs. Feb. 2023 FX rate."

End