FY2023 3Q Financial Results Conference Call Q&A Summary

(November 14, 2023)

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

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| Q1 | The profitability of NIPSEA China improved remarkably both year-on-year (YoY) and quarter-on-quarter (QoQ), with the operating profit margin recovering to around 15%, excluding credit loss provision in 3Q, amounting to approximately two billion yen. I believe that the margin improvement can be attributed to the high profitability in the TUC business and the efficient control of SG&A expenses. What specific factors drove the margin recovery? Was there a deterioration in price/mix caused by TUC sales growth in Tier 3-6 cities?<br>Is there a possibility that the control of SG&A expenses in 3Q will affect sales growth in FY2024 and beyond? |
| A1 | I can't disclose the specific amount of credit loss provision recognized, but I can tell you that it is smaller than two billion yen.<br>The TUC business saw a significant increase in sales volume, while its price/mix slightly deteriorated. However, the improvement in operating margin can be partly attributed to the increased percentage of TUC sales in the total decorative paints sales in NIPSEA China, resulting from the sales growth in the TUC business.<br>We implemented more rigorous cost controls to improve the operating profit margin, starting from the 2Q, which stood at 9.4% on a Non-GAAP basis and slightly over 11% when excluding the credit loss provision. However, our primary focus is not solely on seeking market share gains without regard to profitability, but rather on prioritizing market share gains alongside improvements in operating profit margin. I believe this strategy has successfully contributed to the enhancement of the operating profit margin. Furthermore, the higher sales volumes resulting from market share gains in Tier 3-6 cities, in addition to Tier 0 and Tier 1-2 cities, have allowed us to benefit from operating leverage. Additionally, the improvement in profitability can be attributed to our ability to achieve both sales and profit growth in Tier 3-6 cities, where demand tends to favor economy products over premium products.<br>We are not optimistic about the economic conditions in China, and we anticipate that the market conditions will resemble those of the same period a year ago when the landscape was challenging. Despite this, we are committed to working our way through to achieve market share gains and profitability improvement, overcoming the gloomy outlook.<br>We do not anticipate that the control of SG&A expenses will have a significant impact in the next fiscal year and beyond, given the strength of our brands. We will make necessary investments and cut down on unnecessary spending while maintaining our pursuit of both revenue growth and profitability improvement. |

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| Q2 | I presume that your raw material costs in the 2Q and 3Q decreased compared to a year ago. Did you implement sales promotion activities accompanied by price reductions in the 3Q? |
| A2 | We have maintained the prices of some economy products whose prices were lowered in the 2Q. Our premium products whose prices have not reduced have continued to sell well. Consequently, the overall TUC business benefited somewhat from the moderation of raw material prices. The operating margin improvement in the 3Q was attributed to higher demand driven by price reductions in economy products and benefits from the moderation of raw material prices.<br>However, demand varies from quarter to quarter due to seasonality. Therefore, a year-on-year comparison, rather than a quarter-on-quarter comparison, will more accurately reflect a change in our business conditions. |

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

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| Q1 | You explained that eight billion yen of the 10 billion yen increase in the operating profit guidance was attributed to better business performance. Please give us a breakdown of the eight billion yen increase by region and key factors driving operating profit increase. |
| A1 | Although I cannot give you details, the 10 billion yen operating profit guidance revision was based on comprehensive assessment of various scenarios. Of this amount, two billion yen is FX impact. The FX impact also had some positive impact on revenue. However, we did not revise the revenue guidance because there were regions where sales were somewhat lower than our original plan. Notwithstanding, the ups and downs in sales from region to region can be absorbed in our large-scale consolidated revenue of 1,450 billion yen.<br>That being said, some regions deviated from our original performance expectations. We considered various scenarios when assessing the outlook for the second half of this year during the 2Q. Therefore, it wasn't necessary to make significant changes to our plan. Instead, we aimed for the best possible performance in each of our regions given the current circumstances, particularly in the 3Q.<br>Turning to the Japan segment, we not only achieved revenue growth but also operating profit improvement as a notable positive development. This was attributed to production recovery, notably in marine and automotive coatings, and price adjustments to a certain degree based on agreements of our customers. In the decorative and industrial businesses, on the other hand, we maintained a stable level of total revenue despite slightly lower sales volumes, driven by pricing actions. Although raw material costs have moderated to a certain degree, the outlook for the yen-based costs does not allow optimism. But all in all, we believe we have several earnings drivers in this segment.<br>For Türkiye, we factored in some buffer given that it is a very volatile market. Although our performance in the 3Q was affected by adjustments for hyperinflationary accounting, I think the impact on operating profit is lessening somewhat. That said, our Turkish operations will continue to be subject to very unstable factors such as FX impact and interest rate hikes, which prevent us from having a clear visibility going forward.<br>The outlook for the Chinese economy is not favorable, as I have mentioned on various occasions. Nevertheless, NIPSEA China managed to achieve revenue growth with a solid operating profit margin in the 3Q. Since the 4Q is typically the softest demand period, we have a better prospect of delivering earnings growth compared to the same period a year ago, rather than compared to the previous quarter.<br>We anticipate that the performance in other regions will be within the scope of our original plan. In Europe, we achieved price increases and a slight market share gain at the same time. Although sales volumes remain sluggish in the overall European market, we have started to see some market recovery momentum, notably in France which is the primary market for Cromology. Our European operations are projected to slightly outperform our original plan in various aspects albeit not to a great degree.<br>The revision of guidance reflects our update based on the results through the 3Q, aiming to avoid being too conservative. |

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| Q2 | Kindly share information regarding the operating profit trends in Southeast Asia. |
| A2 | Our performance is strong especially in Malaysia, robust in Indonesia, and not bad in Singapore. Although our performance was somewhat sluggish in Vietnam, the impact was not large because this business accounts for only a small percentage of our total earnings in this region. |

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

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| Q1 | Concerning the impact of raw material price increases, on page 5 of the presentation, your 4Q projections for naphtha prices show an increase to around 70,000 yen, which is 5,000-10,000 yen higher than in the 3Q. Do you anticipate a smooth passing on of these raw material price increases to customers? Additionally, could you please provide your outlook for raw material prices from next year onwards? If raw material prices continue to rise, do you plan to implement further price adjustments to maintain the operating profit margin level? Or do you believe it will be challenging to avoid a decrease in the operating profit margin? |
| A1 | The naphtha price in the presentation is a yen-based price affected by yen's depreciation. Raw material prices are moderating globally, and we project the raw material cost contribution ratio in the 4Q to be generally stable, albeit some difference from region to region. The $TiO_2$ market is relatively stable reflecting the soft demand in China. Consequently, we can purchase raw materials at an optimal price globally by leveraging our sourcing ability. Our policy is to pursue margin enhancement by taking pricing actions in some countries and regions, while keeping a balance with market share gains. |

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| Q2 | I figure that raw material prices declined in the 2Q and 3Q. Were there requests from customers to lower selling prices? |
| A2 | There is always a dilemma with respect to selling prices in terms of our global operations. The frequency of price adjustments is not high in our decorative business; the issue is more about our responses in relation to competitors' moves. On the other hand, in the industrial business, especially, we cannot deny having received customers' requests for price cuts admitting that our relationship with customers is different between customers in Japan and outside Japan. With raw material prices not declining across the board, we raise prices to an appropriate level where necessary after consulting with customers to gain their understanding about our businesses. Frankly speaking, it is not easy to raise prices. Rather, price adjustments can only be achieved with much effort and indicate the strengths of our Group's distribution network. |

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

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| Q1 | Could you provide more details on the demand trends in NIPSEA China's TUB and TUC businesses? Did demand in the 3Q show a slight decline compared to the 2Q? Are you anticipating a demand recovery to begin in the 4Q?<br>The new housing starts in China have been on a decline for the past two years. How do you foresee this sluggish growth affecting the TUB and TUC businesses in 2024? |
| A1 | The revenue guidance for the entire NIPSEA China segment, as outlined on page 26 of the presentation, remains consistent with the August guidance, showing a growth range of +5-10%. However, there have been adjustments to the revenue guidance for TUC, now set at around 20% compared to the previous +20-25% in the August guidance, and for TUB, revised to around -15% from the previous estimate of around 0% in the August guidance. These modifications are indicative of the impact of the economic slowdown in China on the demand for paint as consumer products.<br>The TUC revenue has consistently grown compared to the previous year, with a 19% increase in the 1Q, 15% growth in the 2Q, and 10% growth in the 3Q, although its quarter-on-quarter growth is slowing down. Nevertheless, the TUC revenue saw a significant 10% year-on-year increase in the 3Q, defying the market slowdown. This resilience in our business demonstrates that we don't believe our business model is weakening. However, we will closely monitor market developments as the TUC business is susceptible to overall Chinese |

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| | economic conditions.<br>The percentage of the TUC business, generally more profitable than the TUB business, has increased due to the economic climate. Combined with the benefits of operating leverage, TUC revenue growth has contributed to operating profit growth and product/mix improvement. We anticipate that operating leverage will enhance our competitive advantage and operating efficiency.<br>The reasons why the growth trends in the TUC and TUB businesses are not necessarily correlated with new housing starts in China are explained in the Integrated Report 2023. The focus of paint demand in Tier 0 and Tier 1-2 cities in China is shifting to repainting. Consequently, we see growth prospects in repainting demand in the TUC business, which accounts for around 70% of our total decorative revenue. Additionally, we anticipate growth in repainting demand in the TUB business with the existing markets offering growth potential as well.<br>I will give you the FY2024 guidance at the 4Q results announcement in February next year. |

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| Q2 | The annual dividend guidance was revised upward from 13 yen to 14 yen per share. Please explain the dividend policy for the fiscal year 2024 and beyond. |
| A2 | Our dividend policy is to maintain a payout ratio of 30%. The reason for the dividend increase to 14 yen per share this time was an increase in EPS. Our basic capital allocation policy is to continue strategic M&A activities, as represented by the already announced acquisitions in India and Kazakhstan. This is done to enhance total returns to shareholders and maintain a steady dividend payment with a target payout ratio of 30%.<br>Based on our sole mission of Maximization of Shareholder Value (MSV), we pursue the maximization of both EPS and PER. To align with the policy of maintaining a payout ratio of 30%, we will increase dividends in step with EPS accretion. |

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| Q3 | What is your outlook for factors that will drive earnings, including in India and Central Asia, based on your growth strategy for the fiscal year 2024 and beyond? |
| A3 | We have not released our FY2024 guidance yet. The FY2023 revenue guidance of 10% growth does not basically include the contributions from acquisitions. In other words, we can expect operating profit growth that exceeds revenue growth from existing businesses alone, combined with the benefits of operating leverage. In addition to growth from existing businesses, we anticipate contributions from newly acquired companies. Consequently, we will naturally pursue EPS growth that exceeds the upwardly revised FY2023 guidance of 48.97 yen in FY2024 and beyond.<br>We do not see any factors at this time that are likely to cause a significant decrease in sales. There is no change in our basic strategy of accelerating growth based on the top-line growth of existing businesses, including the Chinese business. This growth will further drive bottom-line growth, combined with ongoing M&A endeavors. |

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

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| Q1 | After your explanation, I got the sense that your tone regarding the performance of NIPSEA China has softened compared to three months ago. Have there been any changes in the business conditions within the Chinese business, particularly in the TUC business, over the past three months? |
| A1 | The market conditions in China have remained challenging. It is true that I harbored some vigilance about our performance and market conditions when we announced our 2Q results in August. Despite being aware of the high motivation of NIPSEA China's local management and our plans for accelerating growth in the TUC business, we delivered strong results in the 3Q. We achieved revenue |

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| | growth despite the challenging market climate, with an enhanced operating profit margin. Personally, this pleasantly surprised me.<br>In the meantime, our strategy for NIPSEA China has remained consistent—driving bottom-line growth through market share gains. I have explained on numerous occasions that this is our key performance indicator (KPI). In the rapidly changing Chinese market, we were pursuing growth in the Project business three years ago and are currently focusing on the TUC business. We believe the TUC business still has ample growth opportunities in Tier 3-6 cities. The paint and coatings market has small and medium-sized companies facing a more challenging business climate than we are. Under these circumstances, we will pursue solid market share growth to increase both revenue and profit with attention to the operating profit margin.<br>We did not disclose the credit loss provision related to NIPSEA China in the 2Q, and the 2Q operating profit margin, excluding the provision, was a little over 11%. However, the operating profit margin for NIPSEA China on a Non-GAAP basis in the overall context was 9.4%, which I think may have raised some concerns in the capital markets. I believe the change in the tone of my explanation for the 3Q results is attributable to the strength of the results combined with enhanced information disclosure. |

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| Q2 | When comparing revenue growth between a specific Chinese competitor and NIPSEA China's TUC business, the TUC business exhibited slower growth than the competitor in the past but outperformed in the 3Q. Have you identified any factors that contributed to the TUC business achieving faster revenue growth than the competitor? |
| A2 | We find it challenging to compare revenue growth between the TUC business and the local competitor under the same conditions because our business segmentation in the disclosure documents is different. The local management continues to perceive this company as a formidable competitor. Our priority is to increase our market share rather than focusing on “beating the competition or being beaten by the competition.” The scale of our TUC (formerly DIY) business is much larger than the competitor’s DIY revenue, which, we believe, results in the same absolute revenue growth translating into a different revenue growth rate.<br>Please note that our primary competitor in the premium market will continue to be another competitor. The competitive climate in the premium market differs from that in the economy market or in Tier 3-6 cities. Based on a comprehensive assessment of these competitive situations, we achieved market share gains. These gains are strictly based on our estimates and were realized in stable growth market conditions, as shown in the heat map on page 6 of the presentation. |

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| Q3 | Earlier, you mentioned accomplishing market share gains in Tier 3-6 cities. Have there been any alterations in the sales composition from one city to another? |
| A3 | Our primary battlefield was Tier 0 and Tier 1-2 cities until a few years ago. However, based on the review of the overall TUC market, we identified growth opportunities in Tier 3-6 cities where we had not focused much effort. We assessed that we can achieve a significant market share gain in Tier 3-6 cities with the effective deployment of sales forces. These efforts have resulted in a solid market share gain.<br>I will refrain from disclosing the details, but our main focus will continue to be Tier 0 and Tier 1-2 cities because Tier 3-6 cities are expected to remain around 20% of the total TUC revenue. |

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| Q4 | Your FY2023 revenue guidance for the TUC business is 20-25% growth YoY. Based on the growth rate in the TUC business through the 3Q, I estimate that TUC revenue will grow by around 30% in the 4Q when sales volumes are normally |

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| | smaller than in other quarters. How confident are you about the revenue guidance? |
| A4 | We had the same debate internally. Decorative revenue decreased in the FY2022 4Q compared to the previous year, marking a rare instance in our history where we registered negative revenue growth in local currency terms. Considering this, we anticipate a rebound in revenue from the FY2022 4Q due to last-minute demand from distributors.<br>I acknowledge that this is a somewhat challenging target, but the upward revision of the operating profit guidance to 10 billion yen takes into account these factors. |

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

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| Q1 | Is the increase in financial costs to 6.1 billion yen in the 3Q due to interest rate hikes? Your financial costs were stable at around three billion yen until the 2Q. Do you expect these costs to remain above six billion yen in the future? |
| A1 | The increase in financial costs is attributed to adjustments for hyperinflationary accounting in Türkiye, which may not be a permanent factor. (*Financial costs of 6.1 billion yen include a loss on the net monetary position of 3.6 billion yen.) |

End