FY2024 2Q Financial Results Conference Call Q&A Summary
(August 8, 2024)

◆ Questions from Yasuhiro Shintani, SMBC Nikko Securities, Inc.

Q1	For NIPSEA China's TUC segment, is it accurate to conclude that the 5% revenue growth was mainly due to an increase in sales volume, with no corresponding price increases? Furthermore, could you give an overview of the demand trends and any market share gains observed across Tier 0, Tier 1-2, and Tier 3-6 cities?
A1	Given the current market conditions in China, we chose not to implement price increases. The 5% revenue growth in the TUC segment was largely driven by higher sales volume. However, the price/mix was adversely affected due to price reductions on certain economy products in response to competitive pressures. When examining revenue distribution within the TUC segment, Tier 0 and Tier 1-2 cities contribute a larger share of the revenue, while revenue growth has been higher in Tier 3-6 cities. The sales composition across the TUC, TUB, and Other segments—which include wood coatings, businesses in Hong Kong and Taiwan, and raw material sales—remains largely unchanged. Nonetheless, the Other segment has seen substantial sales growth, which has slightly negatively impacted the price/mix. Despite these challenges, NIPSEA China’s overall decorative paints business has maintained a solid operating profit margin. This has been achieved by upholding prices for premium products and implementing strategic measures, enabling us to achieve both revenue growth and profitability.

Q2	Was the increase in sales volume largely driven by the expansion of CCM (Computerized Color Matching) system installations and the growth of the store network? Additionally, do you anticipate that the Other segment will continue to experience strong sales growth in the third quarter and beyond?
A2	The Other segment is highly sensitive to fluctuations in market supply and demand. As a result, our primary focus will be on driving growth within the TUC and TUB segments, which form the core of our decorative paints business in China. Our performance in the TUC segment has been particularly strong. Last year, we achieved a 19% revenue increase in the first quarter, followed by an additional 15% increase this year. In the second quarter, despite a nearly flat market, TUC managed to secure a 5% revenue growth on top of the 15% growth from the same period last year. For the full year, our goal is to achieve a revenue growth of 10-15%.

◆ A question from Takashi Enomoto, BofA Securities Co., Ltd.

Q1	Given that the full-year financial guidance for 2024, released in February, has remained unchanged, the operating profit for the second half is expected to be approximately 5 billion yen lower than in the first half. I understand that your operating profit is typically slightly higher in the second half compared to the first. Could you please clarify the reasons behind the anticipated lower operating profit in the second half, including any seasonal factors or other contributing elements?
A1	The second half typically benefits from more favorable seasonal conditions compared to the first half. However, the expected decrease in operating profit this year is mainly attributed to exchange rate fluctuations and the delayed consolidation of two Indian businesses, rather than any unexpected challenges. As highlighted on pages 5-6 of the presentation, we are projecting positive growth (in local currency) across almost all regions for the full year. Additionally, we anticipate that most regions will continue to experience positive growth in the second half, reflecting favorable business conditions. Regarding exchange rate fluctuations, our February guidance was based on an assumed yen/dollar exchange rate of 141.2 yen per dollar. However, the actual exchange rate in the first half averaged 154.1 yen per dollar, and the yen has recently appreciated to 142 yen per dollar. Considering our exchange rate sensitivity and the situations of other companies, we have decided not to revise our full-year guidance at this time.

◆ A question from Yuta Nishiyama, CitiGroup Global Markets Japan Inc.

Q1	According to pages 5-6 of the presentation, although you have slightly lowered your sales growth rate forecast for nearly all regions and businesses for the full year 2024, you have managed to either maintain or improve your operating profit margin projections. Could you please explain the factors that have contributed to the improvement in operating profit margins across each region, as far as possible?
A1	The primary factor is the fluctuation in raw material prices. We've observed that raw material prices have generally stabilized, and in some regions, the raw material cost contribution (RMCC) ratio has even declined. However, the impact varies by region. For example, NIPSEA China is unable to fully convert the stabilization of raw material prices into profits due to the current business environment. As a result, they are making adjustments through product mix changes or by reducing selling prices. Despite these challenges, sales volume has been increasing, and with a certain level of operating leverage, we anticipate the overall operating profit margin to surpass our initial expectations. However, in Türkiye, the business environment remains uncertain due to factors such as the application of hyperinflationary accounting, rising interest rates, and inflation-driven fixed costs. Consequently, we have adjusted our projections for Türkiye's operating profit margin to be more conservative than initially expected. Despite these challenges in the second quarter, we still expect to achieve a double-digit operating profit margin.

	In Indonesia, our operating profit margin surpassed 30%, despite slower-than-expected sales growth, thanks to an intrinsically low fixed cost ratio. However, with sales growth slightly below expectations, a modest increase in the fixed cost ratio, and concerns about a weakening economic climate, we project that the operating profit margin will be slightly lower than the 32.9% achieved in 2023. Nonetheless, we still expect the margin to remain above 30%. Overall, through careful cost control and efforts to recover sales volume, we remain confident in meeting our initial guidance.

◆ Questions from Atsushi Ikeda, Goldman Sachs Securities Co., Ltd.

Q1	Could you provide an overview of the competitive landscape in China? A local competitor reported that the market contracted by around 20% during the second quarter. With numerous competitors experiencing financial deficits, what is your outlook on the potential for industry restructuring and consolidation in the future? Furthermore, we have learned that your company has increased prices for certain products in China. Considering your statement that your strategy is to prioritize "revenue growth and profitability over market share expansion at the expense of profitability," can we infer that your future focus will be on enhancing profitability, using the 12% operating profit margin achieved in the second quarter as a baseline?
A1	In response to your inquiry regarding potential industry restructuring, we want to clarify that, independent of our competitors' actions, our strategy has been to collaborate with select small-scale companies as our OEM manufacturers. As a result, we currently have no plans to pursue acquisitions through equity investments. While we have noted that an overseas competitor recently acquired the Chinese operations of another company, our approach differs. The likelihood of us acquiring a competitor in a similar fashion is low at this time. Regarding the information about price increases, we are unsure of its origin. In fact, we have limited the extent of price reductions on certain premium products. While the Tanshin-based operating profit margin for NIPSEA China in the second quarter was 12%, the margin for the TUC segment was significantly higher. Rather than setting specific targets for operating profit margins, we strive for optimal margins tailored to each region and business, taking into account their unique characteristics. We believe that both revenue growth and profitability are essential, and our local management in China is focused on balancing these two aspects as the key to achieving Maximization of Shareholder Value (MSV). In a soft market, instead of over-investing in advertising or aggressively cutting prices, we prioritize profitability while still pursuing revenue growth. This balanced approach is a key strength of our strategy.

Q2	Would it be correct to say that the market is nearing a turning point and that your company is raising prices to take advantage of the existing price gap?
A2	Although we may restrict price reductions, this is not the appropriate time to implement price increases. Price hikes can only be considered when raw

	material costs are rising or when market conditions are particularly strong. Our current assessment suggests that consumer confidence is significantly weak. Nevertheless, the demand for paint remains solid, given its essential nature. We have maintained the prices of certain premium products without reducing them, which may have led to some confusion, with the limitation of price cuts being mistaken for price increases.

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

Q1	DuluxGroup's profit growth has been slowing, which we attribute in part to current market conditions. Additionally, you mentioned that the core brand is set to undergo its first major revamp in a decade during the second half of this year. Could you share more details on the planned initiatives moving forward? If there are distinct strategies for the Pacific and European markets, please outline the specific actions planned for each region.
A1	The situation varies significantly between the Pacific and European regions. In the Pacific market, where underlying market growth has remained relatively stagnant, DuluxGroup managed to achieve an average annual revenue growth of 5% before being acquired by NPHD, primarily driven by inflation and market share expansion. Following the acquisition, leveraging our financial strength, they have boosted their annual growth rate to approximately 8%, largely through additional acquisitions. However, this growth trajectory is not immune to market conditions. For example, they experienced a temporary surge in retail sales during the pandemic, which was followed by a downturn as conditions normalized. The full-year 2024 forecast for DGL (Pacific) projects a 5-10% revenue growth. Despite a 4% revenue increase in the second quarter, we remain confident in achieving the full-year target. In the Pacific region, the focus is not on recovery but on driving further growth by revamping the core brand for the first time in a decade and launching new promotional activities. While cost reduction and leveraging operating efficiencies are viable strategies, DuluxGroup has successfully positioned its brands as premium by consistently allocating a specific percentage of sales to marketing efforts. Although their SG&A expenses are higher, partly due to a lower RMCC ratio compared to other regions, maintaining a healthy growth rate should allow them to sustain their operating profit margin. This approach should enable them to meet their full-year targets without significant concerns. In Europe, our focus is on expanding market share in the trade-use sector while establishing a stronger presence in the retail sector. It is unusual for a mature market like Europe to experience prolonged softness for two consecutive years, but this can be attributed to the overall economic downturn, influenced by factors such as the conflict in Ukraine. We do not anticipate these challenging conditions to persist indefinitely. As the market stabilizes and begins to recover, we are committed to enhancing operational efficiency and driving sales growth, with the goal of elevating our market share in France from second place to first. While it may take some time for their European operations to fully recover, they are currently generating sufficient cash flow and do not require additional capital injections. Moreover, they are focused on optimizing certain supply

	chains to enhance their operating profit margin and return to a growth trajectory.

Q2	Is the campaign in the Pacific region associated with significant costs?
A2	The costs are within the normal range. DuluxGroup positions itself as a marketing-driven company and effectively manages expenses accordingly. As a result, we do not anticipate the campaign activities to incur unusually high costs. When comparing year-on-year figures on a Tanshin basis, it's important to note that the 2023 numbers were positively impacted by one-off insurance proceeds (net of cost) associated with flooding in 2022. While it's true that the company did not see significant growth on a non-GAAP basis, it's crucial to emphasize that they are not in an unfavorable situation.

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

Q1	Our analysis suggests that your performance in Japan during the April-June quarter was affected by production cuts from automobile manufacturers and a slowdown in new housing starts. Could you provide insight into the factors that contributed to the strong operating profit and operating profit margin in the second quarter despite these challenges?
A1	As you correctly pointed out, the market conditions were challenging. Prices of certain raw materials in Japan have been rising, and we are facing broader inflationary pressures, including increasing personnel costs. This trend is consistent globally, and we have been working closely with our customers to implement necessary price increases. In terms of cost management, we are committed to continuing structural reforms to address any bloated cost structures and functional redundancies that arose from the company split. While we appreciate your positive assessment of our second-quarter performance, we have set our targets even higher. All our local management teams are stepping up their efforts to reach the next level. The marine business has benefited from relatively favorable market conditions. Additionally, since our marine business includes overseas operations, it is influenced by foreign exchange rates. A key factor in this sector's performance has been the improvement in profitability, particularly within our overseas operations. Although the marine business's contribution is small relative to the overall performance of Japan Group, profitability has significantly improved compared to several years ago.

Q2	Is there a possibility that the impact of automobile manufacturers' output cuts during the April-June quarter, which influenced the second-quarter financial results, might also affect the third-quarter outcomes?
A2	As indicated by the heat map on page 8 of the presentation, the automotive market in Japan is expected to remain nearly flat for the year compared to last year. While this is unlikely to significantly impact our performance, due to the considerable uncertainties, I will refrain from making any further comments at this time.

◆ Questions from Takako Fujiu, Nikkei Inc.

Q1	In light of the recent significant fluctuations in exchange rates and the volatility in global stock markets, have you adjusted your M&A strategy or approach to financing?
A1	Our fundamental approach remains unchanged. While the Deputy Governor of the Bank of Japan has expressed support for quantitative easing, it's unlikely that policy rates will rise to 3%, 4%, or 5% in the near future. Therefore, we believe our strong financing capability remains a significant advantage. Additionally, while changes in the perception of bank liquidity could potentially influence banks' lending stances, this is not currently the case. As long as banks maintain their financial soundness, we are confident that our advantage will remain intact. In the meantime, the valuations of potential acquisition targets can fluctuate with changes in their stock prices. As a result, we maintain a policy of avoiding acquisitions of companies with high valuations. When it comes to the yen's fluctuations, a stronger yen can be advantageous for acquisitions. However, we believe that significant movement in exchange rates in either direction is not ideal. We will carefully manage our financing for acquisitions, taking into account our exchange rate sensitivity on the balance sheet.

Q2	I believe that corporate value can vary significantly depending on whether a transaction is denominated in US dollars or yen. Considering the recent exchange rate fluctuations, is there a possibility that you might choose to wait for exchange rates to stabilize before moving forward with future M&A transactions?
A2	Typically, when we acquire companies in US dollars, yen appreciation can reduce their US-dollar-denominated cash flow, leading to fluctuations in the overall cash flow generated. However, this impact is relative to the cash flow in the local currency. We do not plan to implement a strict policy regarding this matter. Additionally, we do not convert US-dollar-denominated cash flow into yen for debt repayment. Instead, we focus on managing our net debt while actively building cash reserves in the local currency. However, if interest rates were to rise, repaying in yen might become more advantageous, potentially leading to a reduction in gross debt. While we are mindful of this possibility, we believe that the decision to proceed with acquisitions should not be heavily influenced by exchange rate fluctuations.

◆ A question from Shigeki Okazaki, Nomura Securities Co., Ltd.

Q1	Could you provide an update on the market conditions for NIPSEA China's TUC segment and the Indonesia business? I understand that the Chinese market experiences quarterly fluctuations, and you mentioned that the second quarter was more challenging than expected three months ago. The full-year TUC revenue forecast was slightly revised downward. Should we attribute this adjustment to market conditions rather than a decline in market share? In Indonesia, your first-quarter performance was sluggish due to the effects of Ramadan and the election. It seems that the second quarter also showed

	minimal or no growth. Could you provide some insights into the current situation, including the competitive landscape?
A1	For NIPSEA China's TUC segment, the market environment has been challenging, and we did not expect any significant improvement. As paint is a consumer good, predicting market trends can be difficult. Our analysis shows that while market assumptions have remained relatively stable, we successfully achieved a 5% revenue increase, expanded our market share, and maintained our operating profit margin despite these tough conditions. However, we remain cautious, as the overall market environment is still challenging and does not warrant undue optimism. Given these circumstances, we are actively pursuing both profitability and growth in the second half of the year. With a revenue growth rate of approximately 10% in the first half, we are targeting a 10-15% growth rate for the full year 2024. This means we are aiming for stronger growth in the second half compared to the second quarter. In Indonesia, the first quarter's performance was sluggish due to holidays and the presidential election. Although there was a slight improvement in the second quarter, growth remains subdued. This can be attributed to a weaker-than-expected Indonesian economy, which is experiencing a strong sense of stagnation, compounded by societal issues such as online gambling. However, we have planned various initiatives to expand our market share in the third and fourth quarters. With a strong start in July, we are not overly concerned about the overall business environment. Lastly, when compared to local competitors, we do not believe we are significantly lagging behind, especially considering that our competitors experienced a decline in revenue in the second quarter.

*We apologize for the temporary disconnection of the phone line during the Q&A session, which was caused by the earthquake in the Kyushu region.

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