Integrated Report 2024 Briefing Q&A Summary

September 5, 2024

◆ A question from Participant A

Q1	You mentioned that the Group operates under a Co-President structure, with Co-President Wee focusing on maximizing earnings per share (EPS), while Co-President Wakatsuki concentrates on maximizing PER. While EPS has shown consistent growth in recent years, PER has experienced a downward trend. In light of these dynamics, could you provide insights into the advantages and potential challenges associated with this Co-President structure?
A1	To begin with the conclusion, we currently do not foresee any challenges with the Co-President structure. At the press conference announcing their appointments, Chairperson Hara of the Nominating Committee provided a simple and straightforward explanation to clearly communicate the distinct roles for each Co-President. Co-President Wee, drawing on his experience in corporate management, is focused on maximizing EPS. On the other hand, Co-President Wakatsuki, with his expertise in finance, is dedicated to maximizing PER by shaping market expectations regarding our sustainable EPS compounding through strategic initiatives such as mergers and acquisitions, capital market communications, and financing activities. As you may be aware, PER is not something we can directly influence. Instead, we see it as a reflection of the capital markets' expectations regarding our ability to deliver sustainable EPS compounding, our proven track record, and the trust investors place in our company. While we have consistently demonstrated sustainable growth within our existing businesses, we have yet to fully showcase sustainable EPS compounding through M&A. Although no large-scale M&A transactions took place in 2023, as Co-President Wakatsuki has noted during financial results calls and investor meetings, several negotiations are currently progressing behind the scenes. As outlined in the "Management Focused on Stock Price" section on page 27 of the Integrated Report, the decline in PER is partly due to external factors. To address this, we plan to reverse the trend by driving EPS growth through proactive M&A, enabling inorganic growth. This approach is intended to strengthen market expectations and increase confidence from the capital markets.

◆ Questions from Participant B

Q1	With respect to the decline in PER, valuations across the paint sector—including Nippon Paint—have been on a downward trend, with the exception of one U.S. competitor. Could you provide a comparison of your company's valuations with those of the broader paint sector? Additionally, some attribute this decline to slower growth outside the U.S. or the impact of rising global interest rates. What are your thoughts on the key factors driving the declining valuations across the paint industry and among competitors?
A1	As outlined in the "Management Focused on Stock Price" section on page 27 of the Integrated Report, macroeconomic factors have had a substantial impact. Since 2022, rising long-term interest rates in the U.S. have triggered a broader market adjustment, particularly affecting companies with high valuations. Furthermore, our analysis indicates that defaults among property developers in China have also contributed to the decline in valuations. Sector trend analysis shows that the PER of high-valuation companies has significantly declined as shown in the historical trends of our competitors, largely driven by macroeconomic factors. While our PER remains relatively high when viewed over the past five years, it has been affected by both broader

	macroeconomic conditions and the general decline in the PER of high-valuation companies within the paint industry. A closer look at our company reveals that, until 2020, our PER increased due to strong investor interest in businesses heavily tied to China, the full integration of our Asia joint ventures, and the low liquidity of our stock. However, since 2021, this trend has reversed, driven primarily by macroeconomic conditions. Additionally, our PER has declined significantly, partly as a natural correction following the sharp rise around 2020. The current PER is influenced by a mix of factors. For instance, a decrease in U.S. long-term interest rates could lead to an improvement in the PER of high-valuation companies, though this is beyond our direct control. Looking ahead, our priority is to showcase our track record in driving inorganic growth and to strengthen our communication with investors on critical topics, as outlined in "Our Strategy for Maximizing PER" on page 29 of the Report.

Q2	Could you highlight the explanation provided in the Integrated Report regarding the factors contributing to the recent decline in ROIC?
A2	Investor interest in ROIC has been increasing, and our approach to it is detailed in "Our Finance Strategy Presented by Co-President Wakatsuki" on page 44 of the Integrated Report. If we were to use our robust cash generation capabilities for share buybacks, we could enhance ROIC, much like one of our U.S. competitors. We believe this strategy would align with the expectations of investors who prioritize ROIC. Accelerating EPS growth through both the expansion of existing businesses and M&A is central to our strategy for achieving MSV. As a result of our M&A activities, goodwill from acquired companies has been added to our balance sheet, which has caused a slight decrease in ROIC over the past five to ten years. However, we do not disregard ROIC; in fact, we monitor it closely. As explained in "ROIC of major acquired assets" on page 45 of the Integrated Report, we use ROIC as a key management metric both at the time of acquisition and in the post-acquisition period. Our goal is to manage acquired companies so that their ROIC exceeds the consolidated WACC (weighted average cost of capital) of approximately 6% within around four years after acquisition. As we engage in M&A activities, a temporary decline in consolidated ROIC is inevitable. However, we believe that solely remaining a pure paint company and relying on organic growth, with an annual EPS increase of around 5% and allocating cash to share buybacks, does not align with our mission of maximizing shareholder value. Instead, we see it as essential to invest in businesses and transactions that support our long-term growth. While value creation through M&A remains a priority, and we closely monitor ROIC, including the cash conversion cycle (CCC), ROIC is not our highest priority.

◆ Questions from Participant C

Q1	I personally found your analysis insightful, especially your observation that your stock price does not always correlate directly with Chinese macroeconomic indicators. Given that your stock price often fluctuates in response to these indicators, I appreciate your effort in clarifying that the relationship is not always straightforward. Regarding my question, could you provide the basis for stating in the Integrated Report that your cost of capital is 6%? Additionally, could you outline the specific measures you are implementing to reduce your cost of capital?
A1	There are several ways to calculate WACC, but the figure presented in the Integrated Report was determined using various data points to maintain a level of objectivity. Our WACC calculation considers both debt and equity. However, we currently

	do not have specific initiatives in place aimed at reducing WACC. At this stage, our primary focus is on accurately understanding our WACC and ensuring that our assets are generating value efficiently, including capital efficiency. We are closely monitoring the performance of each asset post-acquisition to assess their contribution.

Q2	Regarding climate change-related data, there is increasing emphasis on disclosing GHG emissions, particularly Scope 3 emissions. I understand that the Scope 3 data for Dunn-Edwards have not yet been released. Could you provide a timeline for when the data for all group companies will be made available?
A2	In this year's Integrated Report, we have successfully disclosed Scope 3 emissions data for most regions of NIPSEA Group, including China. Dunn-Edwards is slightly behind in compiling climate change-related data, in part due to its smaller scale of operations. While we have not yet established a specific timeline for disclosure, we are actively working with Dunn-Edwards to ensure compliance with legal disclosure requirements, such as those set by the Sustainability Standards Board of Japan (SSBJ).

◆ Questions from Participant D

Q1	As outlined in "Management with Focus on Stock Price" on page 27 of the Integrated Report, the premium valuations you experienced from 2020 to 2021 have nearly disappeared. Our analysis indicates that the decline in PER is driven by factors such as the risks associated with Chinese macroeconomic conditions and an inability to fully meet capital market expectations, as seen in the underperformance of the recently acquired Cromology. While your Chinese business has consistently outperformed the market, this success has not been fully reflected in capital market valuations. We believe investors are primarily concerned with the long-term risks associated with operating in China. A question that has come up from some of the investors I regularly engage with as a sell-side analyst is: is it correct to assume that there is no realistic possibility of your company divesting or splitting off its Chinese business?
A1	Our analysis of Chinese macroeconomic factors is detailed on page 27 of the Integrated Report. Regarding business risks in China, we acknowledge that investor opinions vary. For instance, during a recent meeting, a Chinese investor commented, "No other company operates in the Chinese market as effectively as Nippon Paint. It's remarkable that Nippon Paint continues to grow while maintaining margins, whereas many companies expanding into China are struggling." Similarly, a long-only investor praised our operations, saying, "Having observed the Chinese market for years, I see that your company has performed remarkably well." While we recognize that quarterly sales growth rates can fluctuate, we do not see significant risks when assessing our annual sales growth. Additionally, as demand for repainting increases, the correlation between our performance and the new-build market is expected to weaken further. Should our market share continue to grow and solidify our dominant position, we anticipate even greater stability in our Chinese business. In our pursuit of sustainable EPS compounding through both organic and inorganic initiatives, as Co-President Wakatsuki has previously outlined, we take a prudent management approach focused on building stable cash flow and profits with limited business risk, rather than engaging in high-stakes, high-profile M&A deals. In our M&A strategy, we target companies that are resilient to market fluctuations, demonstrate consistent cash flow generation, experience minimal performance volatility, and are attractively valued. Regarding Cromology, while we cannot yet claim that it is performing optimally,

	the company is not operating at a loss on an annual basis, nor does it require any capital reinjection. Additionally, local management reports that its market share is increasing. We look forward to engaging with investors on the thresholds that will determine Cromology's success or failure. While we anticipate continued growth in our China business, its share of our consolidated revenue may decrease as we advance our M&A efforts. Although we have no plans to deliberately reduce the proportion of our China business, our pursuit of Asset Assembler model will naturally result in a shift in the regional and business composition of our portfolio. We remain committed to a management approach that drives sustainable EPS compounding through both organic and inorganic initiatives, focusing on low-risk, stable, cash-generating assets.

Q2	It seems that some of the recently acquired companies are not performing as well as initially expected. Including an explanation of these cases in the Integrated Report could offer a more balanced and comprehensive view for stakeholders.
A2	Since the current management framework was introduced in 2019, none of the companies we've acquired have required impairment. However, there are cases, such as the acquisition of Cromology in Europe, where progress has fallen short of our initial expectations. We believe offering a more in-depth analysis of these instances in the Integrated Report would provide valuable insights for stakeholders.

Q3	I assume that some of the companies within your China business may not be performing as well as others. It would be valuable to see a comparison between these underperforming companies and those that have been more successful. Additionally, it would be interesting to compare your company's performance with that of housing material companies, for example.
A3	We will continue to develop content aimed at closing the recognition gap with investors.

◆ A question from Participant E

Q1	My question relates to the "Illustrative operating leverage model" on page 43 of the Integrated Report. I understand that your strategy is to maintain margins while capitalizing on the leverage effect. Could you provide specific timelines and regions where you expect to achieve additional profit growth after securing market dominance?
A1	In the Integrated Report, we explain that businesses with relatively low fixed costs, including capital expenditures, are well-positioned to generate leverage effects. This means that as we grow our top line through effective business operations, we can simultaneously improve margins. We strategically reinvest these excess margins into growth initiatives, such as marketing efforts. Our primary focus is on expanding the top line, with the expectation that achieving market dominance will ultimately lead to margin improvements. A prime example of this scenario is our largest competitor in the U.S., which, as the price leader with over 50% market share, has consistently seen its margins increase year after year. During a recent investor meeting, we were asked, "Given that your Chinese business holds the top market share, shouldn't you consider raising prices to enhance margins, similar to your U.S. competitor?" While we do hold the largest market share in China, it currently stands at 25%, and we do not yet view this as market dominance. We consider a market share of around 50-60% as a benchmark for achieving market dominance. However, the concept of dominance can vary by region. In

	some markets, a 50-60% share provides the leverage to control prices and improve margins, while in others, this may not apply. Our strategy is to achieve market dominance in the medium to long term, focusing on steadily increasing profit before tax while carefully managing margins throughout the process.

End