Investor Briefing on Acquisition of AOC Q&A Summary

(October 28, 2024)

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

Q1	I believe the acquisition will bring significant financial benefits and enhance the geological diversification of the portfolio. Do you foresee creating additional synergies in areas like technology, distribution networks, and customer composition? I understand there is a customer base overlap, especially within industrial coatings. Could you provide details on the expected synergies and the projected profit contribution from this acquisition in quantitative terms?
A1	We are committed to pursuing synergies, yet our acquisitions are structured to ensure safe EPS growth even without them. This acquisition is projected to increase EPS by 15-17 yen per year with high confidence. Companies under private equity ownership are often held to strict financial discipline and short-term exit plans every three to five years. As part of our Group, which takes a long-term approach to asset retention, AOC can now focus on extended initiatives like medium-term strategies, bolt-on M&A, and optimized capital allocation. We believe this will support further growth for the company. We do not focus on whether there is overlap in customer bases. A key attraction of this acquisition is the potential for significant EPS compounding, even without factoring in synergies. Let me clarify our approach to evaluating synergies. Imagine two acquisition targets: one could deliver synergies adding 10 yen to EPS three years after acquisition, while the other could contribute 15 yen to EPS from year one, with room for further growth. When deciding where to allocate capital, we found this acquisition to offer substantial advantages. Additionally, our choice was influenced by the company's close alignment with our familiar adjacencies areas and its capital-light operations. In summary, our focus is not solely on acquisitions with immediate synergy potential. Instead, we are committed to pursuing additional value by actively seeking synergies after the acquisition.

Q2	AOC is a highly profitable and attractive company. I assume there were other bidders involved in the acquisition process. What factors led AOC to ultimately choose Nippon Paint?
A2	I won't go into specific negotiation details, but I can share that our discussions didn't start only when the company was listed for sale. Since AOC was owned by a private equity fund, a future exit was expected, and we proactively initiated contact. Throughout our negotiations, we emphasized our strategic vision and the assured benefits AOC would gain by joining our Group. Moreover, the seller and AOC's management team strongly aligned with our principles of Maximization of Shareholder Value (MSV) and our Asset Assembler model. We believe these factors played a key role in AOC's decision to partner with us.

◆ Questions from Tomomi Fujita, Millennium Capital Management Asia Limited

Q1	Nippon Paint has pursued M&A beyond the paint sector, including areas like adhesives. How far into adjacent sectors do you plan to expand? What criteria guide your selection of companies to join the Group? Could you share your M&A strategy regarding target business areas?
A1	As outlined in our Medium-Term Strategy Briefing on April 4, 2024, and detailed in our Integrated Report, we have stated that "We impose no restrictions on M&A target areas, regions, or scale, provided they are low-risk and offer good returns." Key considerations include the risk-return balance, valuations, risk assessments, cash flows, and the quality of the target companies' management teams. Although many factors influence our M&A decisions, we avoid imposing unnecessary restrictions to achieve MSV. However, we exclude certain sectors, such as regulated industries like banking, and find chemical companies with high capital expenditure requirements to be less attractive. AOC was chosen from a broad list of companies across various sectors and operates in an area that closely aligns with our core businesses. I cannot share specific details of our evaluation process for this acquisition, but today's announcement reflects that certain key criteria have been met, including the strength of the management team. While we remain open to expanding into upstream sectors through M&A, companies with profits that heavily fluctuate with market conditions do not align with our business model. It's essential that our M&A activities are carefully assessed to ensure they are well-received by the capital markets. This approach goes beyond merely growing EPS; we also aim to enhance our PER. Achieving MSV depends on how effectively we can pursue "enjoyable" profits by leveraging our platform and expertise. Although we consider a wide range of factors in our M&A evaluations, I believe the companies we ultimately acquire will be those that are compelling to the capital markets. Our M&A targets are not confined to the paint business, as demonstrated by our management of DuluxGroup's SAF (sealants, adhesives, and fillers) business and Betek Boya's ETICS (external thermal insulation composite system) business since their acquisition, and Alina's dry-mix mortar business in Kazakhstan. These companies have growth potential that can be amplified through our platform, including our financing capabilities. Even when potential synergies are not obvious, we prioritize acquiring companies with strong profit growth, robust cash flow generation, and exceptional management teams.

Q2	It appears that this acquisition was chosen because AOC, as a petrochemical company, shares similarities with your business, particularly in terms of raw materials. However, is it correct to interpret that your M&A strategy is open to any sector if conditions are favorable, and that the alignment of this acquisition with your current business areas is simply coincidental?
A2	We evaluated numerous potential deals, but our decision on this acquisition was influenced by the order in which we engaged with targets and the outcomes of our negotiations. Due to the significant cost of this acquisition, pursuing multiple deals simultaneously was not practical. We prioritized accordingly and concluded that this acquisition was the most suitable choice.

Q3	Considering the significant scale of this acquisition, discussing the next M&A opportunity may be premature. However, the high valuations of listed companies currently limit the pool of potential targets, and similar large-scale opportunities may be harder to find in the future. With this in mind, could you share your expectations for future M&A activities, particularly the potential for identifying attractive targets in sectors beyond the core paint business?

A3	As outlined on page 19 of the presentation, “transaction funded by debt with planned de-leverage to bring to current level within 2 to 3 years,” we expect our leverage to return to its current level within that timeframe. We also mentioned that “a substantial list of similar assets is under study.” While I won’t disclose the exact number of target companies, we are evaluating a significant number of potential deals. Given that M&A transactions depend on various factors aligning, including valuations, we cannot make concrete commitments. However, executing a major transaction like this one every one to two years is essential to advancing our Asset Assembler model. As I’ve mentioned before, we do not exclude the possibility of equity financing. However, we believe it’s feasible to complete an M&A deal valued at several tens of billions of yen, even with a focus on debt financing. We will carefully evaluate our ability to proceed with such transactions, while remaining committed to ongoing M&A activities in pursuit of MSV.

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

Q1	Could you clarify the acquisition price shown on page 3 of the presentation? Based on the note regarding the equity value basis, is it correct to interpret that the actual acquisition price may differ from the amount listed?
A1	The equity-based price is nearly final, though AOC’s assumed debt amount may vary slightly before closing. However, we have a clear agreement with the seller on debt allocation, and we expect the acquisition price to remain around USD 4.35 billion, based on enterprise value. Post-acquisition, we plan to refinance AOC’s debt, with NPHD as the holding company securing the necessary funds. We have already obtained a commitment letter from a domestic financial institution.

Q2	Is there a possibility that the enterprise value-based acquisition price of USD 4.35 billion (JPY 630.8 billion) could fluctuate? Additionally, have you already secured funding from domestic financial institutions?
A2	The enterprise value-based price of JPY 630.8 billion is calculated at an exchange rate of JPY 145 to the dollar, meaning the price may vary slightly with future exchange rate movements. However, we have agreed on the core terms and conditions with the seller, so we do not expect any significant changes other than those resulting from exchange rate fluctuations. We have also secured a commitment letter from a domestic financial institution. While we will use a portion of our cash reserves, the acquisition will primarily be funded through debt financing from financial institutions.

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

Q1	AOC’s EBITDA margin appears to be notably higher than that of your existing businesses. Is this high margin primarily driven by proprietary technology that provides a competitive edge, by the fact that approximately 70% of their sales come from customized products, or by having a high-quality customer base? Could you elaborate on the key factors contributing to AOC’s strong profitability, particularly in comparison to your existing businesses?
A1	AOC’s business model is fundamentally similar to the paint business, as it involves blending raw materials to create products for customers. While certain details remain confidential, I can share the key points with you. Firstly, AOC’s customer relationships are a key factor. AOC specializes in

	semi-finished materials tailored to specific customer needs, with a strong capability to deliver technologies and services through direct, localized communication. Unlike companies dealing in general-purpose products, AOC is highly valued for offering uniquely customized solutions based on its proprietary formulation expertise. Secondly, AOC offers significant convenience to customers. While it faces competition from peers and specialized material companies, such as those in epoxy, AOC's products stand out for their consistent performance. This reliability, along with AOC's strong reputation for technology, product development, and innovation, is reflected in its favorable market pricing. Additionally, the cost of AOC's products represents a relatively small percentage of customers' overall expenses. Similar to the paint industry, the product cost is a minor component of the total construction cost, making it essential to set prices appropriately. AOC's high profitability reflects a careful evaluation of these factors. We have thoroughly evaluated whether AOC's high profitability is temporary—occurring just before the private equity fund's exit—or sustainable over the long term. Since AOC has low capital expenditure requirements, its profitability is not the result of reduced depreciation from cutting back on investments prior to the exit. We have confirmed that an outstanding management team is capable of enhancing profitability, giving us strong confidence in moving forward with this acquisition.

Q2	Since AOC operates within a B2B business model, passing on price increases to customers can be challenging. However, given AOC's competitive advantages, is it feasible to adjust prices appropriately even in the face of rising raw material costs?
A2	As you mentioned, passing on price increases is challenging. However, AOC's track record shows that it successfully navigated demand cycles and raw material price fluctuations from 2021 to 2023, even during periods of rising costs and rapid inflation. This demonstrates AOC's strong pricing power as well as its capability to manage demand cycles effectively. Notably, AOC owns its formulation information and does not require customer approval for changes, allowing their products to consistently deliver the expected performance. In contrast, many of our products require customer approval for formulation adjustments, making AOC's operations potentially more flexible.

◆ A question from Yifan Zhang, CLSA Securities Japan Co., Ltd.

Q1	As noted on page 9 of the presentation, AOC's end-markets contracted from 2021 to 2023, yet its EBITDA margin rose to 20-35%. Could you explain the factors contributing to this improvement? Furthermore, can we assume that the company holds potential for additional growth if the market expands in the future? I have another question regarding valuation, with an EV/EBITDA ratio of just over 8 times, which might appear low for a paint company. However, AOC's business aligns more closely with fine chemicals and petrochemicals. Could you provide an overview of valuation and margin trends in comparison to competitors in these sectors?
A1	The increase in EBITDA margin isn't solely market-driven. As mentioned earlier, key factors include the effective implementation of business systems and the added value provided to customers. Market growth alone doesn't

	guarantee margin improvements, underscoring the strength of a specialty formulator. In 2021, the market experienced a surge in demand following the pandemic. Subsequently, demand softened due to inflation and supply chain disruptions. AOC's resilience is evident in its ability to sustain margins despite these challenges, leading us to view their margins as sustainable and not solely dependent on market growth. Unlike the capital-intensive petrochemical sector, AOC's operations require minimal capital expenditure and are therefore classified as a specialty chemical business. Considering all factors, we estimate their valuation at approximately 10 times. While I won't comment on whether this valuation is low or high, it's clear that the private equity fund selling AOC is realizing very high investment returns. Considering these factors, AOC's ROIC, based on a straightforward calculation, significantly surpasses our consolidated WACC of 6% from the first year, making this valuation quite reasonable in our view. Additionally, we expect AOC to contribute 15-17 yen annually to EPS growth, supporting safe EPS compounding. I'll leave it to the capital markets to assess whether this valuation is high or low.

◆ Questions from Takashi Kaneko, The Chemical Daily Co., Ltd.

Q1	Could you provide a brief overview of AOC's history? According to the presentation, the company was founded around three years ago. Was it originally a spin-off from a chemical manufacturer?
A1	The current AOC was formed through the merger of AOC and Aliansys, both with long histories dating back to 1960 and 1947, respectively. Initially, both companies operated as family-owned private businesses. After being acquired by the private equity fund CVC, they merged in 2018 to become AOC Aliansys. In 2020, AOC Aliansys rebranded to AOC, and in 2021, its ownership shifted from CVC to Lone Star. The present entity, LSF11 A5 TopCo LLC, was established during this transition. This evolution underscores AOC's rich and extensive history.

Q2	Am I correct in understanding that AOC supplies raw materials for coatings and adhesives?
A2	AOC provides formulations for semi-finished products used in adhesives and coatings. As shown on page 9 of the presentation, its addressable markets are closely related to general-purpose products, with non-custom conventional composite formulations making up 70% of this market. However, AOC places strong emphasis on customized composite formulations. By retaining proprietary formulation information and adding unique value, the company is able to supply products directly to customers on an individualized basis. AOC primarily works with raw materials like unsaturated polyester and vinyl ester, focusing on formulation technology rather than producing unique products. In this way, AOC's business closely resembles our paint and coatings operations, as both add value, color, and functionality through the blending of various raw materials.

Q3	May I assume that AOC has successfully entered specialized sectors, such as automotive parts?

A3	AOC and Nippon Paint operate in distinct sectors. Specifically, AOC does not supply coatings for automotive bodies, which would overlap with Nippon Paint's offerings; instead, it supplies coatings for automotive parts. AOC's customer base is highly diversified, with about one-third of sales from its top 10 customers and the remaining two-thirds from other clients. By providing customized products to individual customers, AOC can operate independently of reliance on any particular industry. Although global economic downturns can affect AOC's business, its products are often used in repairing and protecting aging infrastructure, such as in the U.S., where infrastructure deterioration is a concern. AOC stands out for its ability to meet customer needs by providing high-performance, durable solutions. As a result, we believe there are few major companies that compete directly with AOC.

Q4	I understand that the specialty chemical industry faces challenges due to high-mix, low-volume production and the advanced skills required. Do your businesses have compatibility in manufacturing processes, including the use of digital technology?
A4	AOC's operations are defined by high-mix, low-volume production while maintaining lean and efficient factory processes. Though their manufacturing is similar to coatings production using reaction vessels, their emphasis is on the efficient operation of well-maintained equipment rather than aggressively pursuing automation. As a result, their capital expenditure needs are very low. When production facilities are well-maintained, extensive digitization isn't always necessary. For example, similar to how AI is used in the tinting process of paint manufacturing, AOC integrates AI into their processes as needed. However, I believe that fully digitizing the entire process or overhauling the manufacturing system with digital technology isn't essential.

◆ Questions from Shunta Omura, UBS Securities Co., Ltd.

Q1	Will AOC focus on driving sales growth now that it has joined Nippon Paint Group? Have cost reduction measures already been fully implemented under the private equity fund's management? Could you share your future plans for further enhancing AOC's profitability?
A1	Improving profitability is an ongoing process without a fixed endpoint. As AOC's CEO, Joe Salley, has noted, there are still areas where streamlining efforts are "unfinished." While the adoption of business systems is well advanced in the U.S., he sees considerable potential for further implementation in Europe. The U.S. market was initially prioritized due to its larger size, but we expect positive impacts in the European market moving forward. Additionally, he has mentioned potential bolt-on M&A opportunities, especially in Europe. As outlined on page 9 of the presentation, while the exact timing is uncertain, we are confident the market will eventually recover from downturns. Although rapid growth may not be immediate, we anticipate moderate market expansion over the next five years. Within this context, AOC aims to deliver added value, focusing not only on sales growth but also prioritizing profit growth as its primary metric. We fully expect to achieve mid-to-high single-digit profit growth. Even without a market recovery, there remains substantial potential for operational improvements. We are confident that we can at least sustain the current total margin level.

Q2	Are the business system improvements focused on enhancements in soft elements?
A2	They are taking a comprehensive approach to improving business systems. For example, when developing new products, teams responsible for raw materials and procurement collaborate closely to explore alternative materials. Additionally, the production division quantifies each step of the process with an emphasis on short delivery times, ultimately enhancing value creation. This approach is based on the Toyota Production System (TPS). While it is well-established in the U.S., we will now concentrate on promoting its implementation in Europe.

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