FY2024 3Q Financial Results Conference Call Q&A Summary

November 14, 2024

◆ Questions from Takashi Enomoto, BofA Securities Co., Ltd.

Q1	The operating profit for the third quarter was approximately 45 billion yen, excluding one-off factors such as a positive contribution of 3.5 billion yen from subsidies in China and a negative impact of 1.7 billion yen due to hyperinflationary accounting. Looking ahead, the fourth-quarter operating profit is projected to be around 42–43 billion yen, reflecting an estimated year-on-year growth of approximately 15%. Despite the third quarter's notably weak performance, I expect the typical decline from the third to the fourth quarter to be less significant this year. Could you provide further insights into the fourth-quarter outlook, including expectations for one-off items and seasonal trends?
A1	Previously, our fourth-quarter guidance was calculated by subtracting the nine-month results from the full-year guidance. However, as illustrated on page 5 of the presentation, we have now included a year-on-year comparison for the fourth-quarter guidance. Several factors are expected to drive fourth-quarter results above the previous year's levels. One key factor is the contribution from new consolidations. We anticipate that the two India businesses will begin contributing to consolidated earnings in the fourth quarter. Additionally, Alina's consolidation will positively impact results, as it was not included in the fourth quarter of the prior year. We assess that NIPSEA China's operating profit margin for the third quarter was unusually low in certain aspects. This was primarily due to insufficient returns on advertising expenses incurred in response to the sluggish market conditions. For the fourth quarter, we plan to take a more balanced approach to align expenses with returns more effectively. As a result, we are confident in our ability to restore profit margin levels. At this stage, we are not accounting for any one-off items, nor do we view the impact of hyperinflationary accounting at Betek Boya as temporary. Each region remains committed to strengthening earnings to meet the full-year guidance, and we anticipate seeing some positive results in the fourth quarter as a result of these efforts.

Q2	With respect to your outlook for demand recovery in China, do you foresee an improvement in the fourth quarter, supported by stimulus measures, compared to the subdued demand levels experienced in the third quarter?
A2	Our outlook for demand recovery in China remains cautious. As illustrated on page 6 of the presentation, we have revised our full-year revenue forecast for the TUC segment from +10–15% in the August projection to +5–10%. For the nine-month period, revenue growth was approximately +7%. While we expect fourth-quarter year-on-year revenue growth to exceed the +1% seen in the third quarter, we do not foresee a substantial improvement in market conditions. Given the typical seasonal decline in demand toward year-end, we project revenue growth to be in the mid-single-digit range.

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

Q1	You mentioned that NIPSEA China's third-quarter earnings were impacted by an imbalance between advertising expenses and the resulting demand. Could you provide further details on the factors behind the decline in the operating profit margin, from 13.2% in the third quarter of last year to 8.8% this year? Specifically, I'd like to understand the impact of advertising expenses and changes in price/mix

	in driving this decrease. Additionally, could you elaborate on the effects of one-off items and provisional advertising expenses on the fourth-quarter operating profit margin outlook?
A1	The third quarter typically experiences seasonally strong demand; however, our performance was affected by prior investments, including advertising expenses, as well as price reductions made in response to soft market conditions. Additionally, revenue growth in Tier 3-6 cities outpaced that in Tier 0 and Tier 1-2 cities, contributing to changes in price/mix that also impacted results. Looking ahead, we anticipate the operating profit margin for the fourth quarter to reach approximately 10%, achieving double-digit figures, and we are not observing any signs of margin deterioration. Moving forward, we will focus on achieving growth while maintaining a balance between revenue and profitability.

Q2	Revenue growth in the TUC segment was modest at +1%. Am I correct in understanding that the decline in the operating profit margin was primarily due to the negative impact of price/mix changes, driven by stronger revenue growth in Tier 3-6 cities compared to declining revenue in Tier 0 and Tier 1-2 cities, combined with the effect of higher advertising expenses?
A2	Revenue growth in Tier 0 and Tier 1-2 cities was slightly positive, while growth in Tier 3-6 cities was modestly higher. Despite the challenging economic environment in China, including subdued consumer sentiment, we are not overly concerned. This confidence stems from our strong long-term competitiveness and our ability to consistently generate cash.

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

Q1	In the DGL (Pacific) segment, the third quarter traditionally sees strong demand, with earnings growth typically outpacing that of the second quarter. However, this year, third-quarter earnings growth was weaker than usual on a quarter-on-quarter basis. Furthermore, the full-year guidance has been revised downward from the August forecast. Could you share insights into the current market environment in Australia, along with the earnings improvement measures and brand strategies planned for the fourth quarter?
A1	The DGL (Pacific) segment is demonstrating strong performance. However, Australia faces a challenging market environment, with the housing sector remaining weak due to the lack of interest rate cuts. Despite these headwinds, the segment has consistently delivered growth, with an improvement in its operating profit margin during the third quarter. The brand renewal, the first in a decade, is progressing well, although market conditions inevitably have some impact. Within the chemical sector, the paint industry generally exhibits the lowest volatility and maintains relatively stable demand. However, as is the case in many regions, consumer sentiment in Australia is unlikely to improve significantly without interest rate reductions or the introduction of stimulus measures. Despite these challenging conditions, both the overall DuluxGroup and the DGL (Pacific) segment have demonstrated steady growth over the nine-month period. We encourage the capital markets to assess their performance based on long-term trends rather than placing undue emphasis on quarterly fluctuations. The third-quarter performance for the DGL (Pacific) segment faced greater challenges than expected. However, they are actively working towards meeting the initial full-year guidance, and we remain confident in this segment's overall stability. In contrast, the DGL (Europe) segment, particularly in France, continues to face tough market conditions, with revenue declining by 5% for two consecutive years. Although we have undertaken cost management and expense reviews, the benefits of operating leverage remain elusive without a market recovery to drive volume growth. The signs of market recovery mentioned in August have been limited, and the Paris Olympics did not provide the expected

	boost to market conditions. As a result, the DGL (Europe) segment continued to face significant challenges in the third quarter.

Q2	Do you anticipate fourth-quarter demand in the DGL (Pacific) segment to remain consistent with third-quarter levels?
A2	In Australia and New Zealand, market conditions for the fourth quarter are expected to remain largely consistent with those of the third quarter. Our strategy focuses on sustaining market share while maintaining strong margins.

Q3	Is it reasonable to assume that market conditions for the DGL (Europe) segment in the fourth quarter will remain stable and not deteriorate further compared to the third quarter?
A3	We expect market conditions for the DGL (Europe) segment in the fourth quarter to weaken compared to the third quarter, primarily due to seasonal factors. As outlined on page 7 of the presentation, the operating profit margin for this segment was initially projected to improve slightly in 2024 compared to 4.4% in 2023, as forecasted in August. However, we now anticipate the margins will be slightly below last year's level.

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

Q1	I have a question regarding the business environment surrounding NIPSEA China. B2C competitors experienced steady sales during the July–September quarter compared to the same period last year. However, their sales surged by 40–50% year-on-year in October and November, with projections indicating approximately 20% year-on-year growth for November–December. This growth is attributed to increased government subsidies introduced in late September, encouraging trade-ins and replacements of construction materials in preparation for China's National Day. Considering the shift of some September demand to October and the anticipated impact of these stimulus measures in November and December, do you also foresee a recovery in sales during the fourth quarter?
A1	Our performance in September deviated noticeably from typical trends. Of the three months in the third quarter, September's results were particularly below expectations. At this stage, I cannot confirm whether demand has shifted to October. While the National Day of China may have had some influence, we remain cautious about the likelihood of a significant demand recovery in the October–December quarter. For the TUC segment, we anticipate sales growth in the mid-single-digit range, unlike the 1% growth recorded in the third quarter. While the implementation of stimulus measures is welcome, the nature of paint as a consumable product means such measures may have a limited impact when overall market sentiment remains weak. Over the long term, per-capita GDP growth is anticipated, though the outlook varies depending on the potential effects of economic policies. Our focus remains on achieving sustainable, profitable growth by continuing to optimize operational efficiency and eliminate inefficiencies, rather than relying on stimulus measures or a rapid market recovery.

Q2	Can it be assumed that year-on-year revenue growth and margins in the fourth quarter will improve compared to the third quarter?
A2	Yes, we expect both year-on-year revenue growth and operating profit margin to improve in the fourth quarter compared to the third. The operating profit margin is projected to exceed the 8.8% achieved in the third quarter, with revenue growth anticipated to reach the mid-single-digit range.

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

Q1	You estimate that AOC's acquisition will drive annualized EPS growth of 15–17 yen starting from the first year, representing an approximate 30% increase in EPS due to the acquisition. However, the maximum stock price increase following the announcement was 20%. I believe there is room for further stock price appreciation if the capital markets develop greater confidence in your EPS growth projections. Could you elaborate on the potential risks that could lead to either exceeding or falling short of the projected EPS impact of 15–17 yen?
A1	The exact impact of the acquisition on EPS in 2025 may vary slightly depending on the timing of the closing. Assuming a full-year contribution in 2024, we anticipate an EPS increase of 15–17 yen, representing approximately a 30% increase compared to our 2024 EPS forecast of just over 50 yen. The acquisition, announced on October 28 during our quiet period, has elicited diverse reactions from investors. However, we have not yet had the opportunity to engage with investors in individual or small group meetings to discuss the details. We believe that as investors gain greater confidence in the acquisition, it will receive a more favorable evaluation. In addressing the risks of either exceeding or falling short of the projected EPS growth contribution, we approach acquisitions based on our Asset Assembler model, pursuing the assembly of high-quality, reliable assets. We understand that investors may be concerned about the sustainability of AOC's significantly improved margins in recent years, as well as the possibility that its financials were optimized by the private equity fund prior to the sale. However, our thorough due diligence has confirmed that these margins are sustainable, with additional improvements expected, particularly in Europe. Furthermore, considering the potential for a near-term recovery in market conditions, we are confident not only in the sustainability of the margins but also in the possibility of exceeding the projected EPS growth. We firmly believe that delivering tangible outcomes through our post-acquisition initiatives is essential. At this stage, we have conducted a rigorous and comprehensive evaluation, held in-depth discussions with AOC's management team, and made the acquisition decision with full confidence. Additionally, we are confident that the acquisition was secured at highly reasonable valuations. Looking ahead, we anticipate mid- to high-single-digit EBITDA growth as a potential upside. Unlike private equity funds, which typically aim for an exit within a few years, our approach as a long-term shareholder is to enable AOC to fully realize its potential within our Group. AOC's management shares this vision and is strongly aligned with our goals, demonstrating high motivation to drive sustained profit growth. Regarding downside risks, while there are technical uncertainties related to assumptions around PPA and other factors, our acquisition decision was made following thorough examinations and due diligence. Although the possibility of a significant downturn in market conditions cannot be entirely ruled out, the reduced likelihood of tax increases, stemming from the outcome of the U.S. presidential election, is expected to have a positive impact on our earnings. We acknowledge that various policy measures introduced by the new administration may have mixed effects, but we do not anticipate that all of them will negatively affect our business. After a careful and thorough evaluation of various factors, our decision to move forward with the acquisition was made with confidence. Our goal is to showcase how AOC can achieve further growth as part of our Group, with Nippon Paint Holdings serving as its dedicated asset owner.

◆ Questions from Yasuhiro Shintani, SMBC Nikko Securities Co., Ltd.

Q1	NIPSEA China's TUC business experienced slower revenue growth in the third quarter. However, since competitors also reported revenue declines, this might suggest that Nippon Paint has continued to outperform the market. That said, according to the heat map on page 6 of your presentation, NIPSEA China's third-quarter performance appears to align with the market. Does this indicate that your assessment of its growth is consistent with overall market trends? You have frequently mentioned that small and medium-sized players are exiting the market. In light of the highly challenging market environment, are you still observing this trend?
A1	Revenue for the TUC segment grew by 1% in the third quarter, while overall market growth remained approximately flat. Although there are regional variations, this growth is not substantial enough to conclusively state that our performance outpaced the market. Compared to our results in previous quarters, we cannot confidently claim to have outperformed the market in this period. Given that competitors are also facing challenges, we are not underperforming relative to market growth. We will continue to execute our sales promotion measures in a balanced and effective manner. Our strategies remain consistent, and we are steadfast in our commitment to pursuing sustainable and profitable growth.

Q2	With the Chinese government introducing various stimulus measures, the market appears to be gaining momentum, partially driven by the withdrawal of some competitors and other factors. As the market recovers, Nippon Paint, with its increased market share, seems well-positioned to strengthen its competitive edge. How do you evaluate these opportunities, and what potential impact do you foresee on your business?
A2	Our core strategy recognizes that financially weaker companies often exit the market during challenging conditions, while stronger players tend to solidify their positions during periods of recovery. Although we are the clear No.1 in China, full market dominance remains a goal yet to be achieved. We cannot afford to be complacent until we reach a market share of 40–50%. Our team in China is operating with a strong sense of urgency, and, as seen in other regions, there is a high probability that dominant players will continue to strengthen their positions as they pursue market leadership.

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

Q1	I have a question regarding the Indonesia business. According to page 22 of the presentation, revenue grew by approximately 8% in the third quarter. However, as shown on page 32, nine-month revenue increased by only 1.2%, reflecting a slowdown compared to the previous year's growth of just over 10%. Are there any specific measures you are planning to implement to reignite growth in the Indonesia business from the fourth quarter through the first quarter of 2025?
A1	The Indonesia business faced a revenue decline in the first quarter and remained relatively flat year-on-year in the second quarter. In this context, achieving 7.9% revenue growth in the third quarter was a notable accomplishment. Market conditions remain challenging, and competitors are also navigating a tough business environment. It's not just us facing difficulties; significant growth is challenging to achieve under these circumstances. However, we have already launched aggressive sales promotion initiatives targeting both premium and economy products, and we are optimistic about growth gaining momentum as we move toward the fourth quarter. We anticipate full-year revenue growth in the range of 0–5%, lower than the 10% growth achieved last year, but we are committed to maintaining solid margins. Our

	strategy prioritizes balanced growth, ensuring profitability is not sacrificed in the pursuit of revenue expansion. The Indonesian market continues to offer significant growth potential, with per-capita GDP expected to rise steadily. We will focus on driving growth while staying attentive about local competitors.

Q2	In my view, the local management team in Indonesia is navigating challenging market conditions effectively and is actively assessing strategies for the coming year. In contrast, market conditions in Europe, particularly in France, have remained highly difficult. Could you share insights into your discussions with the local management team in Europe and whether there is any consideration being given to replacing the management team?
A2	The Indonesia business is making commendable efforts, but Co-President Wee consistently challenges the local management to aim for higher performance and excellence, emphasizing that mediocrity is never an option. As our products are consumables, not all outcomes align perfectly with plans, as the business is influenced by consumption trends. Nevertheless, the local management team actively engages in thorough discussions with Co-President Wee, reviewing achievements and identifying areas that require further action to drive progress. Cromology is primarily overseen by DuluxGroup. As a result, rather than directly interacting with the local management team, Co-President Wee, Mr. Goh, and I oversee DuluxGroup's management in our capacity as Directors. During Board meetings, we review reports on European operations, discuss strategies for improvement, and develop long-term initiatives aimed at enhancing profitability through optimized supply chains, cost structures, and brand management. We currently hold the second-largest market share in France and have recently seen a modest increase in our share, rather than losing ground. While improving profitability has been more challenging than initially expected, we are steadily advancing in managing fixed costs. NPHD’s Board looks forward to an early market recovery and is closely tracking Cromology's progress. The Board is actively engaged in extensive discussions to drive sustainable growth for the company while avoiding excessive cost-cutting measures.

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

Q1	NIPSEA China's third-quarter performance has been notably weak, raising concerns about the situation, including the impact of sales price discounts. While the National Day holiday may have caused some demand shifts, I would like to hear your outlook and any potential positive factors you foresee for 2025.
A1	Regardless of the capital market's expectations or the flow of news from China, we encourage investors to avoid overreacting only to negative news flows. Between 2020 and 2021, as the Project (TUB) segment expanded, some debts became uncollectible. In response, we pivoted our focus to the DIY (TUC) segment, implementing a strategy to leverage our brand for stable earnings, which secured our current strong market position. Since then, we have successfully reduced debt associated with TUB customers, while the TUC segment has grown faster than the market. This strategic shift has enabled NIPSEA China to achieve autonomous growth, generate robust cash flow, and strengthen our confidence in the business. Our strategy emphasizes balancing sales and profits in response to evolving market dynamics. The nine-month results highlight strong growth for NIPSEA China, and we are confident that our competitive advantages will become increasingly impactful as market competition wanes. With reduced reliance on the Project segment and a significant decrease in long-term debt, we now see NIPSEA China as a stable, secure business with the capacity to generate consistent cash flow over the long term.

	As mentioned earlier, the third-quarter operating profit margin of 8.8% falls short of our expectations, as we are targeting double-digit margins. However, we believe NIPSEA China has established a strong foundation for sustainable growth. We are committed to enhancing operational efficiency, addressing inefficiencies, and delivering greater value to customers—not just within NIPSEA Group but across the entire Nippon Paint Group. We remain confident in our ability to drive profitable growth in the future.

Q2	You mentioned having modest expectations for China's economic measures. While these measures may have limited influence on consumer goods, do you also believe they won't contribute to a roughly 5% increase in TUC sales?
A2	While the economic measures could indeed be beneficial if they have an impact, we believe it is not prudent to base our expectations on this assumption. Our strategy is to drive robust business growth independently of any potential effects from these measures.

Q3	Given the ongoing low growth in the Chinese market and continued price competition with major competitors, the 2025 outlook for TUC appears challenging. What specific short-term cost control measures do you plan to implement to achieve double-digit margins?
A3	Cost control measures are certainly being considered. Given the extensive scale of our operations, we can focus on various areas, such as optimizing marketing expenditures. While there have been fluctuations in the past, we have consistently maintained double-digit margins and believe that achieving margins in the low to mid-double digits is a realistic goal. Let me reiterate that our goal extends beyond simply improving margins. We aim to strike a balance between sales growth, profit growth, and market share. While setting a 15% margin target for full-year 2025 all at once may not be realistic, as it assumes rapid and significant margin improvement, we encourage the capital markets to recognize our ongoing efforts toward this objective as we closely monitor market conditions.

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