FY2024 1Q Financial Results Conference Call Q&A Summary

(May 15, 2024)

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

Q1	Can you please explain how NIPSEA China's TUC segment managed to achieve a 15% increase in year-on-year revenue, despite the downward trend in sales data for both new and existing housing in the Chinese property market? Please also give us details including the growth rate by city tier.
A1	The performance of the TUC segment is not significantly influenced by the market trends in new and existing housing, as it deals in products and services akin to consumer goods. Currently, with a 25% market share in the TUC segment, approximately 75% of the market remains untapped with potential for growth. Given that it's unlikely for the demand constituting this 75% to drastically decline due to a downturn in the property market, our strategy focuses on expanding our market share to drive growth. The primary reason we can continue to expand our market share is the strength of our brand. TUC operates primarily as a brand-oriented business, and our success is largely due to the effective branding strategies we have implemented. Currently, our sales in Tier 3-6 cities are significantly lower than in Tier 0 and Tier 1-2 cities, indicating substantial potential for growth and market share expansion in these larger markets. In these cities, we have increased our market share by offering more budget-friendly versions of our products with different packaging, leveraging our brand strength without compromising it. Consequently, some competitors in Tier 3-6 cities have either withdrawn entirely or partnered with us as OEM partners. Thanks to our asset-light strategy, which involves outsourcing production to OEM partners, we've been able to sustain growth while maintaining our profit margins. This accomplishment is a testament to the strength of our local team in China. Although the growth rate in Tier 3-6 cities is high, we're also experiencing substantial growth in Tier 0 and Tier 1-2 cities, which are core markets for the TUC segment. This consistent growth across all tiers allows us to deliver solid results for TUC as a whole, even if there is a surge in sales of our budget-friendly products or if we implement price reductions on certain items in Tier 3-6 cities. Our on-the-ground teams are continuously working to enhance the user experience. This involves making minor adjustments to improve user interactions, leveraging digital transformation strategies, and providing integrated services that allow customers to easily arrange paint orders and painting services with a simple phone call. These ongoing enhancements not only strengthen our brand but also give us a competitive edge.

Q2	Based on the light green color indicated for the TUC market in the first quarter, as seen on page 5 of the presentation, is it reasonable to ask whether this suggests that the TUC segment has outperformed the market by approximately 15%?
A2	You're mostly correct. However, the light green color represents a market growth range from -5% to +5%, which doesn't automatically mean zero growth. We actually estimate that the TUC market experienced growth between 0% to 5% in the first quarter. At the same time, the TUC segment enjoyed significant volume growth, though there was a minor deterioration in price/mix. As a result, I believe we have successfully expanded our market share in the TUC segment.

◆ A questions from Yasuhiro Shintani, SMBC Nikko Securities, Inc.

Q1	NIPSEA China's TUB segment experienced a 15% year-on-year revenue decline in the first quarter, marking a significant downturn after a period of consistent growth up to 2023. Could you please provide more detailed insights into the current conditions of the TUB segment? I am particularly interested in understanding the business environment, the effects of diversifying our customer base, and the status of provisioning.
A1	Our provisions have markedly declined compared to the same period last year, reaching a level that no longer requires disclosure. In the TUB segment, we prioritize cash collection in our business operations. While we cannot entirely dismiss the possibility of future increases in provisions, we plan to continue our cautious approach. The TUB segment still heavily relies on the new build market, and the current downturn in this sector has indeed affected our performance. The market conditions are represented by a dark blue color, indicating a decline of 10-15%. In line with this, our revenue in the TUB segment has also decreased by 15%. Given these factors, we do not believe that our market share has significantly decreased. We are actively working to diversify our customer base; however, the first quarter is traditionally slower, partly due to seasonal factors like the Chinese New Year. Therefore, we believe it is difficult to determine a long-term trend based solely on the performance in the first quarter. Historically, our decorative business composition has been approximately 70% TUC, 20% TUB, and 10% other segments. Recently, due to strong performance in TUC and a more cautious approach in TUB, this distribution has shifted. TUC now represents about 75%, TUB has decreased to 15%, and the other segments remain at roughly 10%. It is important to note that we do not intend to intentionally downsize the TUB segment. Nonetheless, as our operations are fundamentally focused on securing margins, we do not plan to significantly expand this business either. Our initial guidance for the TUB segment, which projected a revenue growth of 0% to 5%, remains unchanged. It's important not to be overly pessimistic based on just our first quarter results. As we have repeatedly emphasized, our current strength lies in the TUC segment, and we will continue to focus on this area. For TUB, our strategy is to maintain robust margins and concentrate on areas where we see potential for growth.

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

Q1	Earlier, you mentioned that leaders in regions not meeting expectations have initiated corrective actions. Could you provide insights into the regions that are exceeding their original plans, as well as the strategies planned for regions that are falling short of their original performance targets?
A1	While I will not delve into detail, the performance in Indonesia, as well as DGL (Pacific) and DGL (Europe), has been somewhat lackluster. DuluxGroup has faced challenging market conditions in Europe and Australia. Although they achieved modest growth through small-scale acquisitions, their overall performance, including profitability, has fallen short of expectations. DuluxGroup's CEO, Patrick Houlihan, is acutely aware of these challenges and is actively making necessary adjustments to stay on track with their annual plan, responding to ongoing progress. In Europe, particularly in France, the market has experienced a downturn for the second consecutive year, with the first quarter showing a further decline of around 5%. Although our performance has been relatively good, we have not fully met our targets, prompting the implementation of measures to enhance cost efficiency and profitability. Nevertheless, our confidence in DuluxGroup remains strong, bolstered by their consistent track record of delivering solid results in Australia. In Indonesia, our performance was impacted by the presidential election and an

	unusually early holiday schedule, particularly in March. Despite this, we are planning for a recovery in the second quarter. While our key local competitors achieved positive growth in the first quarter, we have consistently outperformed them without engaging in price competition. Therefore, we will continue to pursue our strategy focused on medium to long-term objectives. Regarding immediate actions, Co-President Wee is taking the lead, collaborating closely with the local management team. Performance in other regions has generally been strong.

Q2	The overall improvement in profit margins seems significant. Are your results slightly exceeding your initial projections?
A2	Although our profit margins are not unsatisfactory, we are not content with them. We consistently set ambitious internal targets, viewing our guided benchmarks as the bare minimum we aim to surpass. Given the uncertain global conditions, such as fluctuations in raw material prices, we recognize the importance of maintaining a balanced perspective. While the first quarter showed reasonably good results, we are committed to sustaining this positive momentum into the second quarter and beyond.

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

Q1	Page 4 of the presentation notes that you expect a more challenging environment for raw materials starting in the second quarter. I assume this situation will differ by region. Could you provide some insights into the trends in raw material prices from the first to the second quarter, their implications, and any adjustments in product pricing for regions like Japan, China, and others?
A1	In Japan, due to our reliance on imported raw materials, a continuing weakening of the yen may necessitate an increase in product prices or the adoption of cost-saving measures. In other countries and regions, should there be a decrease in some raw material prices, competitors might react by reducing their product prices. While a well-established brand can help maintain prices, in economically challenged regions like China, an overemphasis on preserving prices might result in losing market share to competitors. It's challenging to generalize trends, as they vary based on the type of raw materials, such as oil-based or titanium-based. Nonetheless, we do not expect a significant deterioration in our raw material cost contribution (RMCC) ratio on a consolidated basis. With price fluctuations varying by region and raw material type, our gross profit margin improved by 0.2 percentage points quarter-on-quarter and 1.5 percentage points year-on-year in the first quarter. At present, we do not anticipate a continuous rise or fall in our gross profit margin; this is our overall outlook at the moment.

Q2	Is it correct to say that, overall, we shouldn't be overly concerned about the impact of raw material prices as we head into the second quarter?
A2	While we remain vigilant, there are currently no immediate signs of concern. Considering that price fluctuations are to be expected, we have consistently made appropriate price adjustments to date. One of our strengths lies in our ability to maintain a stable margin level, barring situations where certain countries experience accelerated inflation or require provisions.

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

Q1	I have questions regarding NIPSEA China's performance in the TUC and TUB segments. Notably, the TUC segment showed significant improvement in the first quarter. However, is there a risk that this situation could worsen in the second quarter? For example, I understand that your company adopted strategies such as restocking certain items and engaging in price competition to regain market share from competitors during the first quarter. Do you expect the impact of these restocking efforts to diminish in the second quarter and beyond? Could you also share insights into the potential re-emergence of price competition with competitors? Additionally, while your competitors made provisions in the fourth quarter of 2023, your company did not report any in the first quarter of 2024. Is there a possibility that you might need to make provisions starting from the second quarter?
A1	Regarding the outlook for the TUC and TUB segments, we project a revenue increase of approximately 15% for TUC and between 0-5% for TUB in 2024. Although there might be some fluctuations moving forward, we do not expect any significant changes. Their first-quarter results were indeed within our projections. TUC deals in consumer goods, and while there are elements of unpredictability, our products continue to perform well due to strong market demand. In fact, our market share has reached 25%. Despite potential fluctuations from other factors, our strategy remains centered on expanding our market share. For TUB, we are projecting modest revenue growth of 0-5%. To mitigate any potential impacts, we are diversifying our customer base. We are meticulous in engaging in transactions that secure margins and minimize bad debt risks. While our revenue projections may experience fluctuations, we expect them to remain within the 0-5% growth range. There may be a divergence in our provisioning approach compared to that of our competitors, as they have made provisions while we have not. However, we are not overly concerned with their actions. In consultation with our auditor, we have made adequate provisions in the past. Notably, we made significant provisions for major property developers in 2022, and in 2023, we took legal actions and set aside provisions for developers with collection concerns. These provisions have been properly accounted for and are not manipulated to maintain margins. In our business operations, we conduct cash-on-delivery transactions with high-risk business partners, having already set aside necessary provisions. We continue to do business with entities such as government-affiliated developers, whom we consider reliable. While this approach does not mean we are completely free of risk, we believe we have allocated sufficient provisions to cover potential risks. The slowdown in TUB's market share growth in 2022 was partly a result of our deliberate choice of business partners. Therefore, we do not expect provisions to become a significant concern moving forward.

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

Q1	While revenue growth for NIPSEA China's TUC segment slowed in 2023, there was an improvement in the first quarter of this year. Could you share insights into the changes in market trends and the strategies implemented in the first quarter? For instance, are the improved margins a result of past OEM utilization? Or are there changes in the market landscape that are influencing these results?
A1	Our asset-light strategy, as outlined by Co-President Wee during the December 2023 small analyst meetings with Co-Presidents, is gradually showing results rather than immediate impacts. We've observed a decrease in competition in Tier 3-6 cities. However, in Tier 0 and Tier 1-2 cities, we face stiff competition from both premium international brands and local players, where brand strength is crucial.

	Currently, our brand is distinguished as a strong national contender, a position we are effectively capitalizing on. This underscores our proven resilience in challenging economic environments. In assessing revenue growth, we find that a year-on-year comparison is more informative than a quarter-on-quarter analysis, largely due to seasonal variations. In 2023, the TUC segment achieved a 13% year-on-year revenue growth, which aligns with our initial forecast of a 10-15% increase. We are not disappointed by this result and do not view it as a significant concern from a long-term perspective. While it's important to maintain a realistic view on economic sentiment, we are observing indications of a potential turnaround, particularly in major cities like Shanghai. Our on-the-ground assessments suggest that we may be nearing a bottom, rather than continuing a downward trend. Factors such as outperforming competitors or their exit from the market have contributed to our solid performance. As we enter the second quarter, we remain committed to achieving our ambitious internal targets.

Q2	Could specific factors, such as inventory buildup, have positively influenced your results in the first quarter?
A2	There haven't been any specific factors such as inventory buildup. One potential explanation could be that market inventory levels were unusually low, which may have contributed to stronger results in January. However, given that we deal in consumer goods, it's challenging to confirm this hypothesis. I want to clarify that we have not engaged in any practices to artificially boost our customers' inventory levels. Our achievements can be attributed solely to our company's strengths. Various innovative initiatives on the ground have yielded positive results. Achieving a 15% revenue growth in the TUC segment during the first quarter was no small feat. The key challenge now is to sustain this positive momentum moving forward.

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