

Q2 Financial Results Briefing for the Fiscal Year Ending March 2023 Q&A

[Date]	November 25, 2022
[Time]	10:00 – 11:00
[Speakers]	Kenji Asakura Representative Director, President and CEO Masaya Ikemoto Representative Director and Managing Executive Officer
[Contents]	FYE March 2023 Second Quarter Results and FYE March 2023 Earnings Projection Medium-Term Management Plan ACE 2.0 Prinova Group: Business Overview and Growth Strategy

[Q1]

You mentioned that the semiconductor business is doing well, but I think the growth of the semiconductor industry has been slowing down recently. How do you see this affecting your company's semiconductor-related business in the future?

[A]

(Asakura): Regarding your question about semiconductors, we are convinced that the semiconductor industry will grow over the medium to long term.

Currently, there is a slowdown in some fields where semiconductors are used, and there are reports of production adjustments at some semiconductor manufacturers. However, there are still many fields that will continue to grow in the years to come, such as the automotive and telecommunications industries, and we will continue to focus on these markets.

We cover the entire supply chain of semiconductors, from wafer-related processes to back-end processes. As you know, there are various types of semiconductors, from the most advanced ones to those with slightly advanced technology to ensure reliability.

For example, it seems that China does not yet have the technology to produce cutting-edge semiconductors. Thanks to the support of our customers, we are expanding our business year by year, covering the entire supply chain.

We have several products for cutting-edge semiconductor production plants, including our epoxy products.

In addition, in our Functional Materials segment, aside from the Electronics & Energy segment, we handle a large number of materials that are upstream from the materials used in the semiconductor process.

This is an area in which Japan has the largest share of the global semiconductor market. We will of course try to expand our own products, but we will also work together with suppliers to create a global strategy.

In answer to your question, although there are reports that the semiconductor market has slowed down, we are still bullish on the market.

In response to the question about semiconductors, I would like to make a report on one more topic, as I myself have been involved in semiconductors for a long time. Recently, Ministry of Economic, Trade and Industry announced a new semiconductor manufacturing company called Rapidus Corporation.

This is a very encouraging project that aims to manufacture state-of-the-art semiconductors in Japan after an interval of 10 years since attempting to do so in the past. The executive officer of NAGASE is scheduled to leave our company for this project, and will be transferred to fulfill a certain role in the project.

We would like to support this major project as a company.

[Q2]

In your presentation, you mentioned examples of contracted products. For which product categories does Prinova Group receive the highest volume of contracts: pre-, intra-, or post-workout?

[A]

(Ikemoto): [Explanation provided while showing the actual pre-workout and post-workout products.]

As you saw in the photos in the document, both of these products are Prinova Group's specialty. Intra-workout products include an energy drink type product. We do not produce energy drinks themselves, but we provide ingredients for them as part of our Solutions business.

As you can see, the size of pre-workout product is completely different from the size of post-workout product, but the price is the same. If the price of pre-workout product is JPY20 per gram here, the price of post-workout product is about JPY7 to JPY8 per gram here. The post-workout protein is the one with the larger quantity. Pre-workout products contain more ingredients and require more skill in formulation.

Therefore, we believe that it is the protein products through which we produce profit through quantity and the pre-workout products through which we produce profit through technology. Prinova Group's strategy is to grow both businesses in a balanced manner.

[Q3]

You explained that the main reasons for the weak performance of the Advanced Materials & Processing segment in H1 were the stagnant office automation and game markets, and the weak performance of color former. Could you break down the factors behind the decline in profit by price, volume, and cost? Also, when do you expect the performance of this segment to turn around?

[A]

(Asakura): As you saw in the presentation, the Advanced Materials & Processing segment has been very sluggish compared to the previous year. As to your question about the details of price and volume, there are many types of resins we handle, and prices vary widely. The price of polycarbonate resin, for example, which is in a certain volume zone, has been decreasing significantly.

On the other hand, the price of engineering plastics, a field we are particularly focusing on, has been on an upward trend since last year. The price is slightly lower than the highest level of the previous fiscal year, but it is still at a very high level.

In terms of volume, the situation differs from one field to another. From our point of view, the OA and game markets, which I mentioned earlier, were particularly affected by the lockdown in H1, and I think it is fair to say that the volume has decreased by several tens of percentage points.

In the Advanced Materials & Processing segment, especially in the resin business, the price of resin continued to rise sharply last year. As a result, last year's resin-related performance was unexpectedly strong, and can be said to have been too strong.

We have analyzed the situation in 2018, 2019, 2020, and last year from a medium-term perspective, and our market share and volume have increased.

We regret to have reported very weak figures in terms of numbers compared to the previous year. However, we are now focusing our efforts on how to increase our market share even in this trend.

Unfortunately, we do not expect this market to turn around significantly in H2.

We believe that the market will gradually pick up around the spring of next year and beyond.

As for color formers, competition with Chinese products is intensifying. In short, our color formers are inevitably facing competition from low-priced products.

In addition, the impact of COVID-19 continues to be somewhat negative in this market. For example, the need for various types of tickets has not yet returned to the 2018 or 2019 level on a global scale. We are struggling both in terms of the market and our competition because of this.

[Q4]

What were the main reasons for the strong Q2 operating income in the Mobility segment? Also, what is your outlook for the profitability of the Mobility segment, assuming that the number of automobiles manufactured will recover in the future?

[A]

(Asakura): We expect that Mobility segment will continue to perform well in H2. As I mentioned earlier, resins are one of the core components of our automotive business. Especially in the Mobility segment, we handle a large number of highly functional engineering plastics.

The unit price of engineering plastics is still high, and we expect this trend to continue in H2.

In addition, although I cannot share the details, we expect that sales of parts and materials used in EVs will definitely grow in terms of volume.

We have direct business relationships with some of the top runner manufacturers, and we expect orders for EV-related products to increase further.

As I mentioned earlier, in recent years we have been focusing not only on sales of resins and raw materials, but also on value-added components. We expect such functional parts to grow in the future.

Going forward, we intend to expand our lineup of products with even higher added value so that we can grow our business in tandem with changes that occur in the car industry.

[Q5]

Thank you for your detailed explanation of the strengths of the Prinova Group, which has already achieved a significant increase in profit of JPY2 billion in H1. In particular, the operating income plan of the Ingredients business for the current fiscal year is already expected to far exceed the medium-term target for the fiscal year ending March 31, 2026. Please tell us about the background to this strong performance exceeding the medium-term plan and the outlook for the future.

[A]

(Ikemoto): There are two main reasons for the growth of Prinova Group's ingredients business in Q1.

One is the unit price itself, which has been rising since last year, and has reached its peak in Q1. Q1 reflects figures for the period from January to March, not the period from April to June in Japan. This is because Prinova Group's fiscal year is between January and December.

Another reason is the expansion of market share. As the president explained earlier, we have been working very hard to maintain the supply chain for materials coming mainly from Asia. We have been taking various steps, such as those related to inventory control, procurement speed, and market readiness. As a result, we have earned the trust of customers, and this has helped Prinova Group to increase its market share.

The figures for Q2 will change from Q1 and there is also an element of anticipating demand. Against this backdrop, we are taking a cautious and bold approach to our future outlook.

[Q6]

The flavors and sports nutrition handled by Prinova Group have the image of being luxury products among food products. Are the products handled by Prinova Group resistant to recession? Or are they susceptible to economic fluctuations?

[A]

(Ikemoto): I believe your concern is about the impact of economic fluctuations. We believe that the market will be affected to some extent by economic fluctuations in the short term. However, the sports nutrition market itself is growing very fast in the US and Europe. Therefore, we believe that the market will grow steadily over the medium term in a span of several years. This is as I explained earlier.

In terms of products, we have three major product categories: pre-, intra-, and post-workout products, and we are seeing a variety of needs in each of these markets.

In the early 2000's, demand for these products was concentrated in sports-related users. But now, the market has expanded from there. The market for sports nutrition is much larger now than before. There are users of all ages, both men and women, and people who play light sports are also consuming sports nutrients. The user base is also expanding with various characteristics, including the elderly or those with some degree of physical handicap to improve their health.

Although there may be a temporary impact, we believe that the market as a whole will achieve stable growth. Prinova Group is committed to ensuring a steady supply of products to this market, and through these efforts, we believe it will ensure future growth.

[Q7]

You mentioned that you are reviewing your KGIs and KPIs. Will you be considering upwardly revising your operating income and ROE targets for FY2025?

[A]

(Asakura): Although we are unable to state a definite figure at this time, we are expecting an increase in the operating income target.

As for ROE, we are in the process of examining various factors. It is very difficult for us to give a large target because of the nature of our business. Our primary objective is to make 8% the norm. Various considerations will be made regarding this topic as we move forward.

[Q8]

Quarterly operating income in the life & healthcare business declined significantly from Q1 to Q2, most likely due to Prinova Group. Could you explain the reasons for this decline?

[A]

(Asakura): Ikemoto will later give a brief explanation of the situation at Prinova Group.

This segment is not the type of business where goods are shipped regularly, every month or every day. For example, for pharmaceutical raw materials, we receive a certain amount of orders on a spot basis. In H1, we had a good amount of shipments. We expect a certain volume in H2 as well, but we expect a slight decrease in spot orders. This is one factor.

The other factor is that in the manufacturing industry, including Hayashibara, expenses tend to be skewed to H2. This is especially the case in our life & healthcare segment.

(Ikemoto): I would like to provide some additional information on Prinova Group.

As mentioned earlier, Prinova Group's Q1 is from January to March, while its Q2 is from April to June. In H1, there was great confusion in US supply chains.

Not only was there a shortage in the number of marine freight from Asia, but there were also worker strikes on the West coast, including truck drivers. The shortage of drivers caused disruption in trucking distribution. Normally, we are able to procure goods in about two months, but during that time, it took up to six months to procure some materials. Customers were also well aware of this situation, and during the January to March period, there was some stockpiling by customers in anticipation of the ongoing supply chain disruptions.

In addition to the inventory adjustment, we also expect a slight moderation in unit prices. Q1 was thus characterized by higher-than-usual profits due to stockpiling and high unit prices.

We expect this trend to moderate in Q2 and Q3 as business operations head toward normalization. The outlook for H2 is thus based on this expectation of business normalization.

[Q9]

Please tell us about the reasons for the increase in profit in the Solutions and Armada businesses. I understand that you expect higher sales and income in both businesses due to reinforcing their production capacities. However, I would like to know your expectations for supply and demand as well as the competitive environment in the future. Do you think that fiercer competition will lead to lower prices?

[A]

(Ikemoto): We expect both the Armada and Solutions businesses to continue to grow. As you have pointed out, our outlook for growth is based on the new construction of the Utah Plant, which is larger than our existing plant and will increase our production capacity.

There have been many customer inquiries in response to the greater production capacity at Prinova Group. Some customers have commented that we are one of their few partners who have the capacity to meet their new sales and investment plans.

In addition, in the Solutions business, we are expanding the target market through the adoption of new technologies and refinement of existing technologies, and expanding the applications of the Solutions we offer. We are convinced that the business will continue to grow in the future, supported by the expansion and reinforcement of manufacturing and technological capabilities.

[Q10]

Various materials used in semiconductor manufacturing processes are expected to see a sharp increase in demand heading toward 2030. However, do you see any risks or challenges in terms of upstream raw materials procurement? Please tell us the current status and any measures you intend to take.

[A]

(Asakura): No major risk has materialized in the business areas associated with the Group at this point. However, as you all know, there are various geopolitical risks and risks linked to US-China relations. Thus, there are constantly risks that could materialize, and some of the materials we procure are from China.

These are risks that are outside of our control, but we understand that we must continue to pay close attention. At the same time, it should be noted that these geopolitical risks will likely boost demand even more for semiconductor production in Japan and the US. Our supply chain is currently focused on Japan, China, Taiwan, and Korea, but we believe it is an urgent issue for us to strengthen operations at our local subsidiary in the US and establish our supply chain there.

[END]