

FY2024 Second Quarter Financial Briefing Q&A

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[Time] 10:00 – 11:00

[Speakers] Representative Director, President and CEO Hiroyuki Ueshima

Representative Director, Senior Managing Executive Officer Masaya Ikemoto

Director, Managing Executive Officer Masatoshi Kamada

Executive Officer, General Manager of Corporate Planning Dept. Koichi Sagawa

Executive Officer, General Manager of Corporate Management Dept. Kazuhiro Hanba

[Contents] FY2024 Second Quarter Results and FY2024 Earnings Projections

Medium-Term Management Plan **ACE 2.0**

[Q1]: Regarding the full-year operating income plan, you have left the forecast of JPY36.5 billion unchanged for the Company as a whole, but by segment, the downward revision of JPY5.2 billion in the life and healthcare segment alone is to be offset by upward revisions in the remaining four segments. What are the factors behind the downward revision of the Life and Healthcare segment?

The revised full-year plan for the Life and Healthcare segment is JPY4.2 billion, with JPY1.9 billion in H1 result and JPY2.2 billion plan in H2. Can we consider this profit forecast level as a bottom? Also, please tell us how you plan to improve profitability in the future.

Ueshima [A]: First of all, the full-year plan has been revised upward in four segments, but in one segment that was revised down, Life and Healthcare, the downward revision is almost entirely attributable to the Prinova Group's manufacturing business. Also, at Nagase Viita, sales of functional materials for cosmetics were not as strong as expected in H1. In particular, the Chinese market as a final consumption market did not grow as much as expected. These are two major factors. We do not expect it to get any worse by any means, so I think it is fine to consider it a bottom.

We are naturally looking for ways to improve profitability in the future, and for the Prinova Group, we are thinking about developing new customers or improving efficiency by introducing new products to increase capacity utilization at the Utah plant. As for Nagase Viita, the season for sales of functional materials for cosmetics has already ended, so we are preparing for the next fiscal year and are also working to retain new customers.

[Q2]: The full-year operating income plan is JPY36.5 billion, with H1 results being JPY21 billion and the H2 plan JPY15.5 billion. The difference between the first and second halves is JPY5.5 billion, so the H2 plan looks quite conservative. The decline in H2 from H1 by segment is as follows: Functional Materials, JPY2.2 billion; Electronics & Energy, JPY1.2 billion; Advanced Materials & Processing, JPY1.1 billion; and Mobility, JPY800 million. Are the four segments whose full-year plans were revised upward still conservative after the revision?

Ueshima [A]: In the past, Nagase would announce a revision to its full-year forecast if the revision was up or down by approximately 10% or more from the plan during the fiscal year. Since it was below that range this time, we left full-year forecast unchanged.

On the other hand, there are also a considerable number of unstable factors, such as the rapidly fluctuating exchange rate, the uncertain outlook for crude oil prices, the continuing economic stagnation in China, and the situation in the Middle East, which makes it difficult to see trends in petrochemicals. In addition, the rise of Chinese manufacturers has been greater than we had anticipated, and exports to China have been switching to domestic products, or there has been an offensive to sell cheap products overseas in order to increase capacity utilization rates in China. In addition, there has been prolonged disruption in marine transportation, and we see soaring logistics costs as a cause for concern.

On the other hand, I have visited various countries in Europe and Asia to obtain information on the ground. From the state of logistics and payment delays, we have a firsthand sense that product and intermediate inventories are rising among our customers, and we expect to enter an adjustment phase sooner or later. We expect that this will be around Q4. In addition, credit risks are increasing, and it is difficult to assume that H1 will be as smooth as H1, so we have decided to leave our forecast unchanged.

[Q3]: Once again, please tell us what is arising in the Prinova Group. Are there structural problems with allowance for doubtful accounts and declining market share of major customers?

Ikemoto [A]: I am sure you are very concerned about the situation of the Prinova Group, and I would like to briefly explain the situation.

As the President explained earlier, the reason for the downward revision of the forecast is due to the poor performance of the Prinova Group's manufacturing operations, especially the new plant in Utah and the plant in Tennessee, which is also involved in the nutrition business.

As I explained in Q1, we are now moving forward with the improvement plan for these two factories and manufacturing bases at a rapid pace. We are still struggling to match productivity and customers, although some major surgeries, including restructuring, are underway. Although we are making our utmost effort to establish a revenue-generating structure within this fiscal year, it may take a bit longer.

On the other hand, the manufacturing industry other than the nutrition business, which we call solutions and which has a larger volume, has been performing well and has successfully achieved profitability. The profit increased compared to the previous year as well. We also expect that sales of materials will be strong in H2, at about the same level as in the previous fiscal year, including the budget level. The outlook is also very positive.

As a whole, in Q2 of 2022, the average unit price of materials was at the USD9 level, and now, in Q2, it is at the USD5 level. The average unit price per kilogram, which is in the USD5 range, has recently begun to recover slightly and is expected to enter the low USD6 range. Therefore, we expect that the recovery of our sales volume and unit price will further improve the total figure. In any case, during the current fiscal year, we are focusing on re-starting the Manufacturing business, but in other areas, the Prinova Group is performing well, and we see no decline in its basic strength.

[Q4]: The US presidential election has been decided on Trump. How do you expect this to affect the future growth potential of the Prinova Group?

Ueshima [A]: Now that the President of the United States has been elected, we are in a situation where we need to keep abreast of various situations. Ikemoto will explain about the Prinova Group later, but I am hopeful that the economy as a whole will improve.

Ikemoto [A]: Mr. Trump has made various promises during his presidential campaign, and we are concerned about some of them. One is import tariffs, and the other is a reduction in corporate taxes. We are watching to see how these factors will affect the US consumer economy.

In particular, food ingredients, perhaps half to 60% of the US as a whole, rely on imports, so that, with the exception of flour, 60% to 70% of so-called nutritional ingredients are imported. In addition, China has a very high weighting among them. We are paying close attention to how the increase in tariffs on Chinese products will affect us. Nutritional ingredients are hardly produced in the US. Increasing tariffs will affect consumer prices directly and become one of the factors of inflation. We believe that the product has those elements.

The Prinova Group imports, sells, or blends and sells these products, and one of the key points is how the end consumer will accept the cost of these products. We have no choice but to pass it through to selling price, so we will eventually do so. It is also said that the economy will improve in various ways as a result of the corporate tax cut, but how will general consumers behave in their consumption at that time? We are particularly interested in how sales of sports nutrition, which is a relatively luxury item from the high end of the market, will fare. During the last Trump administration, this area expanded enormously. Again, we have high expectations that these items will sell even more as the US basic economy becomes stronger in the future.

In summary, there are positive and negative aspects or both depending on how you think about it, but these are the points we are concerned about.

[Q5]: Please tell us about your relationship with Rapidus. You will be contracted to procure raw materials for Rapidus, but I don't think this is the case with many existing semiconductor manufacturers. Since Rapidus is a new company, they outsource these things. Is that what it is?

Also, while the front-end processes are mainly made by major suppliers, such as wafers and resist, the back-end processes use a variety of materials and suppliers will be diverse. Will your company's strengths be better demonstrated in this way? We would also like to ask for your thoughts on the possibility of not just being a trading company, but also developing material production or M&A.

Kamada [A]: First of all, we would like to explain why we were selected for Rapidus. Various chemicals they handle includes hazard items, which cannot be carried in Seikan Tunnel. Therefore, the most important issue was how to efficiently transport the various chemicals together by ship, and there was a competition among several companies to create a coordinator. NAGASE's strong network in chemicals and track record in the semiconductor industry were highly evaluated, and as a result of the competition, NAGASE was selected through the Board of Directors of the other party. We would like to build a solid team to support them.

As for the back-end process, as in the newspapers, they have officially announced a tie-up with a German research institute called Fraunhofer Institute. Although we have not yet received any specific product specifications, we have begun to propose Nagase ChemteX's post-processing materials to them. We also believe that there are various business opportunities in the back-end process stage centered on these products, and we would like to build business by proposing various commercial products after establishing a firm pipeline with them.

One more thing, we believe that we will be able to network with quite a few new suppliers this time around. We will utilize this newly established network in our future activities. For example, in the US and India, there is now a movement to newly manufacture semiconductors in their own countries. We hope to make new proposals in such areas through such partnerships.

Finally, in terms of M&A possibilities, we are always looking for M&A opportunities based on our growth strategy. I cannot give specifics yet, but we would like to aggressively pursue M&A if the opportunity arises.

[Q6]: What is the status of Nagase ChemteX's Liquid Molding Compounds? I believe you commented that you expect the same level of shipments from H1 to H2, but I wonder if this will be a temporary leveling off. If so, what do you think are the contributing factors? Also, when will growth re-accelerate?

Ueshima [A]:My explanation may not have been appropriate, but I made the comment that it would be the same level meaning that it will remain steady. As I mentioned earlier, we have already completed the installation of the next new line and will further increase the capacity of production starting in H2. We are also considering adding more lines in the future, so we expect continued growth.

On the other hand, there is talk here and there that the market for high-end servers in the AI market, such as ChatGPT, will hit a plateau around 2027, but on the other hand, new markets such as the Metaverse and automated driving are expanding. Therefore, we expect encapsulating material for high-end semiconductors to continue to grow.

On the other hand, technological innovation is also progressing, and we are currently developing the Advanced Sheet Molding Compounds, epoxy molding compound in sheet form, to respond to this trend, and are proceeding with spec-in activities for high-end customers.

Recently, I have been hearing that EVs are doing very poorly, especially Chinese-made EVs that are accumulating inventory in Asia, and there is a considerable movement among them to utilize new software, in other words, to use automobiles in a smartphone-like fashion. They call it SDV, Software Defined Vehicle, and the trend is quite advanced in China. As with automated driving, a significant portion of this will require data centers at the edge, and we believe that the market will continue to expand in the future, including in this area.

[Q7]: Please tell us how you viewed the business environment at the beginning of the term.

Ueshima [A]:As for the slight deviation from our initial assumptions, as I mentioned earlier, we thought that semiconductors were on a steady recovery track. On the other hand, as you all know, the production of automobiles has been declining in H1 due to various troubles and accidents at Japanese automobile manufacturers. There is talk that the total production volume of the six major companies will recover to 100% of the previous year's level for the full year, but the business environment is slightly below the expectation, taking into account whether it will reach that level.

On the other hand, in the OA and game industries, we had an image that OA production, especially in China, would not come back easily, but the inventories of OA manufacturers have been cleared considerably, and we have received orders for raw materials. However, as I mentioned earlier, we expect orders to proceed steadily until Q3, but we expect production adjustments to proceed in Q4 or so, and our order volume is expected to decline.

Also, we had expected a slight recovery for cosmetics, but as I mentioned earlier, our functional materials are used in high-end cosmetics for Western brands for the Chinese market, but demand for these products has not recovered, partly due to the relationship between the US and China. Also, I think the fact that Chinese consumers are starting to purchase Chinese products is a very difficult situation, which is a point that was less than expected.

[Q8]: Was there some kind of tailwind in the financial results this time other than currency factors? Or were the results in line with your true ability?

Ueshima [A]: I apologize if my answer is too abstract and vague, but since last year we have been using the term ROIC, especially among the management team, to promote ROIC management. In the field we have been analyzing the profitability of each transaction in order to improve the gross profit margin, which is a factor of ROIC calculation, and for those transactions that are unprofitable or have low profitability, we ask for cooperation from manufacturers and customers, or return the commercial rights. From a cash flow perspective, we have been working all along to reduce inventories.

Gross profit margins have actually improved, and unprofitable transactions and businesses with impairment concerns have also improved, moving from losses to profits. We are still working on some businesses or group companies, but we are moving forward to thoroughly implement this in the future. Efforts are also being made at the site to lower the SG&A ratio, and they are also working to improve the efficiency of operations, etc. In any case, I am aware that the Company has made progress in internal efforts other than foreign exchange, and has become a fairly muscular company.

[Q9]: Are there any signs of improvement in the declining market share of the Prinova Group's main customers in the manufacturing sector? Also, when do you expect the new customer acquisition you are currently working on in the new category to contribute to earnings?

Ikemoto [A]: As for the decline in market share of our major customers, we have entered this industry and since the acquisition of the Prinova Group, we have expanded our relationships with a variety of customers. We have several customers, especially large ones. Among these, we are seeing a significant number of emerging brand-name manufacturers entering the market with respect to the work being done by our major clients. Since the market that had been taken by one

company is now divided up among several companies, the work is inevitably divided up one by one, and in this sense, there is a situation in which the companies are beginning to compete with each other in the market in various ways.

However, the overall size of the market is expanding, so it remains to be seen who will be the winner in this sense, but we believe that the overall market situation is still positive.

There is one of our major customers who is in the sports nutrition industry, at the number 1 or number 2 level. You would know who that is if I say they are soft drink manufacturer, as there are only three major companies in that area. Recently, the companies as this one have shown interest and some have recently announced acquisitions. We are hopeful that if these major soft drink manufacturers incorporate these brands, it will lead to a different product development and sales development.

In addition, as you have pointed out that it is a new category, the image of the sports nutrition market is changing from the one that it is restricted to sports to the one that it is for health nutrition.

What is attracting the attention in particular is the new nutrition using plant-based materials. For example, the same protein, but soy, not the so-called protein from milk. The beans called pea protein, and vegetables, leafy greens, and root vegetables, which are added to beans, are increasingly being used as nutrients in dry powder form. These markets are still emerging market and it has not yet established the presence in the market this fiscal year. However, we expect that this market will be recognized and expand next year and the year after that, and we are developing new markets to capture these customers. We are still in such a situation at the moment, but we will further strengthen our activities in these markets from next year.

[Q10]: I would like to ask a basic question about semiconductor materials. Is it correct to understand that your encapsulant materials will also be used for MR-MUFs used in HBM manufacturing? It would be good if we can also confirm the share.

Kamada [A]:As to your question about whether it is used for HBM or for MUF, I cannot go into details at this time because of confidentiality and customer matter. I'm sorry. However, there is no problem in saying that we have a proven track record with HBM. Another thing I hope you understand is that all of the overmolding in the final creation of the generated AI is also applied.

[Q11]: Why is the target regarding strategic shareholdings reduced rather than zero?

Ueshima [A]:Regarding strategic shareholdings, we have set a goal of selling JPY30 billion in shares during the ACE 2.0 mid-term management plan that is currently underway. We will continue to make reductions going forward. The Board of Directors is currently discussing the next target

values to incorporate them into the next medium-term management plan. I hope you would understand it.

[Q12]: Please tell us about your efforts in the semiconductor field on page 28 of the document. I am very grateful to you for disclosing the forecast of gross profit of the semiconductor business for FY2024 and the numerical image of the business around 2030 by dividing it into two areas: the focus area and the base area.

In the current semiconductor market, I believe that the demand for semiconductors for high-end servers, such as generative AI, is growing remarkably. Do you envision that the gross profit growth in the focused areas, where encapsulation materials for cutting-edge semiconductors are the driver, will continue to grow linearly between FY2024 and FY2030?

Ueshima [A]:We expect semiconductors to grow at a CAGR of around 8.9%, of which our focus areas, especially manufacturing functions, are expected to grow at a CAGR of around 10%.

On the other hand, as I mentioned earlier, the overall market is currently growing steadily, but there is talk of a slowdown in the market by 2027 or so. We are looking to continue our 10% growth in this area as we continue to replace our product line.

[Q13]: First, please tell us about the shareholder return. The Company has now decided to increase its dividend plan for the fiscal year ending March 2025 from JPY85 to JPY90. Since the net income plan is unchanged and the target total return ratio is 100%, the total shareholder return remains the same, but the fact that you have increased the ratio of dividends, which is more stable under your policy of continuous dividend increases, means that you have more confidence in your company's ability in earning operating income?

Also, judging from the Q2 results, will there be an increasing likelihood that all five segments will increase profits for the next fiscal year?

Ueshima [A]:We intend to continue our policy of continuously increasing dividends. On the other hand, we have increased interim dividend and some may say that this is done despite that full-year forecast remain unchanged. However, as I mentioned earlier, we have gained considerable confidence in our growth prospects as we move forward with ratio-focused management and launch new and unique businesses as Nagase. We will continue to specialize in improving our gross profit margin while increasing our true ability.

We continue to see growth in our four segments next year, and we hope to see a revival in Life & Healthcare, especially in the Prinova Group, in FY25, but we hope you understand that it may take some time.

[Q14]: You have included contributing to supply chain sustainability in your new materiality. I understand that your company has a wide range of supply chains, such as food, natural resources, water, etc. What areas are most important to your company?

Sagawa [A]: As you mentioned, our contribution to supply chain sustainability is wide-ranging, including food, natural resources, and water. We are seeing a growing trend in responding to legislation of due diligence of human rights and environment for supply chain started in Europe and disclosing obligation associated with that, which we consider important. We are increasingly being requested to respond to questionnaires, consent forms, and memorandums by business partners. This is one of the reasons why we have added this new materiality.

As for external disclosure, we currently have an internal procurement policy, but its effectiveness is weak, so we are currently working to establish new supply chain management guidelines.

[Q15]: Following TCFD for climate change measures, I believe that the response to TNFD for biodiversity issues are becoming increasingly important. What is your perception on the progress of your company's preparation?

Sagawa [A]: As for natural capital and TNFD initiatives, we are currently working on biodiversity, water resources, and other initiatives through our formal membership in the RSPO or through our response to the CDP. We are working on natural capital with the recognition that it is something that we must address not only in our business, but also in the supply chain as a whole.

Although we are not currently able to endorse or disclose our endorsement of TNFD, we participated in the TNFD Forum in August 2022. We intend to continue our efforts to assess and disclose our dependence on and impact on natural capital in accordance with the TNFD framework.

[Q16]: I would like to know more about the current inquiries for Liquid Molding Compounds and future demand trends. And why might next-generation products replace sheet-material encapsulants?

Kamada [A]: Regarding the current demand trend for Liquid Molding Compounds, we have business with semiconductor manufacturers engaging all types of generative AI and are receiving new inquiries constantly. We are confident that the demand is still strong and varied.

One more thing, why the next generation. This is because our sheet, our a-SMC, I think, has been highly evaluated by major semiconductor manufacturers for its ability to solve their problems and increase productivity in the midst of major technological changes such as the shift to PLPs, increased complexity, and larger sizes. We are now in the process of being evaluated by various companies and we believe that when the time comes, we will actually be adopted. It is highly likely and I hope you will look forward to it.

[Q17]: Regarding the Advanced Functional Materials business, you are aiming to become the de facto standard for sheet Molding Compounds, the Advanced Sheet Molding Compounds. Please tell me the time frame in your best scenario and current situation. Could you also tell me to the extent you can future sales expansion scenarios for Liquid Molding Compounds?

Kamada [A]: Regarding the best-case scenario time line and the current situation, I would like to report that the best-case scenario is that the adoption will be decided in 2025 and mass production will start in 2026.

Also, regarding future sales promotion of sheet Molding Compounds, since the demand for generative AI is extremely strong, we will deal with that first. We are also developing applications for various other electronic components. We cannot give any more details here, but we are considering horizontal expansion to other electronic components.

[END]