

# FY2024 First Quarter Financial Briefing Q&A

**[Date]** August 8, 2024

**[Time]** 10:00 – 11:00

**[Speakers]** Masaya Ikemoto Representative Director, Senior Managing Executive Officer

Masatoshi Kamada Director, Managing Executive Officer

Tamotsu Isobe Director, Executive Officer

**[Contents]** FY2024 First Quarter Results and FY2024 Earnings Projections

[Q1]: Operating income in Q1 progressed to 29% of the full-year target. Please tell us about the possibility of outperforming the full-year plan based on three factors: the existence of one-time positive factors in Q1, the seasonality of quarterly results, and risk factors expected in Q2 and beyond.

Ikemoto [A]: First, regarding one-time positive factors, in the Functional Materials segment, there was a one-time profit from an overseas transaction. We are not able to disclose the details of it, but the impact on operating profit was approximately in the mid-single-digit hundreds of millions of yen. After Q2, there will be no such one-time factor, so this is just for this 1Q.

The seasonality of quarterly performance varies slightly by business, but in the case of the resins business in particular, the performance of functional material resins generally grow throughout the year from Q1 to Q3 and remain strong. However, in Q4, it generally slows down, partly due to the Chinese New Year. The resin business will be weak in Q4 due to these factors.

We are also engaged in cosmetics-related businesses, including Nagase Viita and other business divisions, which usually peak in Q1, when customer start preparing for the summer season. Q1 was a little slower this year, I think we may struggle a bit.

The execution rate of expenses increases toward Q4, so please consider Q1 to be relatively low. Profits, on the other hand, will rise in the first, second, and third quarters, and this is why Q1 to be the most advantageous, when the cost execution rate is low. In particular, since Q4 of the fiscal

year is the period in which repairs and maintenance expenses are incurred in the manufacturing business, the figures for Q4 of each fiscal year tend to be lower every year in various ways.

As for risk factors, our business is strong overall, but I am wondering how well our measures to recover from Q1 difficulties in the Prinova Group and Nagase Viita businesses will work.

At Prinova Group, we have implemented various improvement measures as I mentioned earlier, and the effects of these measures are gradually beginning to emerge. We will ensure that these measures are implemented, and we will also implement reforms and measures that will serve as a reliable growth engine for the next fiscal year and the next fiscal year.

We are not sure how the factor of stronger yen will change in the future, and as you can understand from the fact that our overseas transactions account for more than 50% of our total transactions, we will keep a close watch on the yen's appreciation to ensure that we understand the situation.

On the other hand, on the positive side, we have high expectations for the semiconductor industry. As I explained earlier, we believe that Nagase ChemteX's materials are at a level where they are regarded as de facto standard in the back-end process. In particular, liquid molding compound, and, although I have not explained it earlier, from liquid to seat molding compound is a very unique technology that is attracting a great deal of attention in the field of cutting-edge semiconductors.

We believe that this and the recovery of the semiconductor industry will drive sales and profits significantly from Q2 onward into the next fiscal year.

[Q2]: The Functional Materials segment has a large increase in profit. Please tell us the ranking of the three positive factors listed on page eight in terms of the largest amount. These three are: sale of coating materials for automotive industry, sale of raw materials to the electronics industry, and loss reduction of color formers. Also, please tell us whether this profit level can be maintained in Q2 and beyond.

Isobe [A]: In Q1 of last fiscal year, there were disruptions in logistics, as well as disruptions in the supply chains of the semiconductor and automobile industries.

Under such circumstances, inventories of each customer as well as intermediate inventories were piling up significantly. As a result, in Q1 of last year, our sales themselves were very low, and we had to rely on our customers and distributors to cover the consumption of our inventory.

In particular, sale of raw materials to the coating industry, which is one of the most affected industries in our business, and sale of raw materials to the electronics industry, including semiconductors, were greatly affected. From this situation, we understand that there has been a gradual recovery since the end of last year and inventories are on a downward trend.

In such circumstances, you are asking factors in the order of large impact. The first is coating materials for the automobile industry, which has a large impact on profits. While semiconductors are expected to continue to grow in the future, the factor that has the second largest impact is the sale of raw materials to this electronics industry. The reduction of loss of color former, which was also explained earlier, is the third largest impact in the Functional Materials segment.

To be more precise, the one-time gains mentioned earlier occurred in the sale of raw materials to the electronics industry. In response to the question as to whether this level will continue in Q2 and beyond, we expect it to decline somewhat as the impact of this trend disappears. However, we believe that performance will remain strong given the current situation and the fact that the overall industry as a whole is recovering. It is not a simple fourfold increase, but we believe it will remain at a high level.

[Q3]: Please tell us how the expansion of Nagase ChemteX's LMC, liquid molding compound, production line will affect gross profit.

Ikemoto [A]: LMC, liquid molding compound, has been very well received and demand is expected to increase. The impact on gross profit is not disclosed in terms of details or figures, but I hope you understand that it is a driving force for profits in the semiconductor-related business.

In terms of future growth, the market share gained by LMC, liquid molding compound, and new technologies for the next generation, we are also developing the supply of a-SMC, Advanced Sheet Molding Compound, sheet materials, which I mentioned earlier, and this will continue to be a major driving force in our business.

Kamada [A]: Since LMC is manufactured by our own company and we have our own technology, we naturally position it as a high value-added business. Naturally, we are aware that the generative AI will continue to grow, and we recognize that our sale of material will also expand in the future.

[Q4]: What is the background of the increase in Prinova Group's selling, general and administrative expenses, especially labor costs?

Ikemoto [A]: We had a lot of difficulty increasing our workforce in the manufacturing business, from last year to Q1 of this year and up to the present. The initial reason for the increase in personnel was the delay in setting up the automated production line, which is now finally in place.

Demand for sachet packaging has been strong, and we have made considerable progress in automating lines and reducing personnel, and labor costs at the Tennessee plant have begun to decrease significantly.

However, in the case of the Utah plant, the business mix was not well matched to the production line, and the customers were changing more rapidly than we had expected, resulting in small-lot, high-mix production.

While taking the measures I mentioned earlier, we must now break away from small-lot production of a wide variety of products and acquire businesses that are more efficient and profitable. We are accelerating our activities, including this pipeline, and we intend to ensure that this will be the case in H2 of the fiscal year.

In such a situation, we are having a hard time meeting the double-digit annual increase in labor costs in the US, although there are some exchange rate differences between the US and Japan.

We will continue to further promote this personnel cost reduction without loosening up.

[Q5]: Please tell us about the Electronics and Energy segment. The business is strong with operating income in Q1 achieving JPY2.7 billion against the full year plan of JPY8.6 billion. Please tell me which businesses are performing better than planned, such as the expansion of sales of materials for semiconductors and the expansion of product sales like LMC by Nagase ChemteX. And what is the future outlook?

Ikemoto [A]: The business of Nagase ChemteX's LMC materials are growing in particular. In addition, we expect the semiconductor industry to continue to do well this year and next year, exceeding our expectations. We expect strong performance to continue.

Regarding LMC's future product strategy, especially including semiconductors used in the periphery of generation AI, which we call high-end servers, I believe that our material, LMC, has secured a near-de facto status.

At the very least, we understand that we are the industry leader in this liquid molding compound technology. Since this is our in-house product and we have secured a profit margin, we have high expectations for this product and future technologies. We believe that the growth of the semiconductor industry and the growth of the AI business will further boost our figures, and we will do our best to achieve this.

[Q6]: The sheet molding compound, a-SMC, Advanced Sheet Molding Compound is very attractive considering the recent direction of semiconductor back-end processes. Please tell us more in detail about the background of it getting attention.

Ikemoto [A]: As I explained earlier in the section on semiconductor-related movements, if you look at the picture on the left that says LMC, you can see that a sludgy liquid or liquid-like substance is packed here in a syringe-like container. In the past, there were various methods, some using powder, some using liquid, and such technology was used for semiconductors. In the picture on the right, you can see something like a black role. This is seat molding compound, processed as sheet, not powder or liquid.

The technology of semiconductors has become very complex in recent years. The so-called nano wars are being waged in which semiconductors are being miniaturized to 10 nano, 7 nano, 5 nano, 2 nano, etc. On the other hand, the structures of semiconductors themselves are becoming more and more complex, three dimensional, and larger. We expect that our Advanced Sheet Molding Compound will be used to meet such needs that cannot be met with conventional technologies.

We are expanding the line for LMC, liquid Molding compound, and we have already established a mass production line for manufacturing a-SMC sheets. The remaining issue is how to make a progress in the development with the customer, which is already underway. We will continue to work hard in H2 of the fiscal year and into the next fiscal year.

Kamada [A]: As Ikemoto just mentioned, a-SMC, Advanced Sheet Molding, is one of the major solutions to the technological advances such as 3D, chiplet, and PLP, which are becoming larger

and more complex, and it can greatly improve productivity. From the customer's point of view, we believe that it can greatly reduce costs.

In fact, we have been in discussions with various major companies, and we feel that we are getting a good response, so we would like to continue to move forward with this.

[Q7]: Regarding the mobility business, production and sale of Japanese automakers in China have been sluggish. Do you have any countermeasure against it? Also, what is the status of price pass-through in your business for OEMs?

Kamada [A]: Regarding your question about countermeasures against the stagnation of Japanese manufacturers in China, the NAGASE Group has established a specialized division for Chinese automobiles in China. Although we have continued to expand over the past several years, mainly with three Japanese companies, we are currently facing a very difficult situation, especially in China.

In this regard, we take measures of allocating human resources appropriately. Since we engage in the business globally, we will quickly allocate human resources to the US, Mexico, and other regions with potential. We have also been working for many years on a strategy to penetrate Chinese semiconductors and local customers in China other than Japanese companies. We are pleased to report that we are taking such action, as we are gradually seeing the results of our efforts.

As for price shifting, we are passing on the cost after having a thorough conversation with OEM manufacturers. Please be assured.

Ikemoto [A]: The mobility and automotive industries are very broad, and there are coating materials for automobile, and of course resins, and among the parts there are resin parts, and electrical and electronic parts. In addition, semiconductors are used for various new functions such as car automation, so our mobility business covers a very wide range.

We believe there is still room for growth in this business in China, the US, Europe, Japan, ASEAN, and other regions, and we will see growth in various forms and replacements within the scope of our business. As a whole, we have high expectations for this business, and we will continue to respond to it, including the use of cutting-edge technology.

[Q8]: Regarding Prinova Group. As the first point, the graph on page 15 shows that sales volume increased significantly in both the trading and manufacturing businesses, and furthermore, the yen has depreciated. What is the reason that sales in Q1 fell below the previous year's level despite these factors? Secondly, what is the outlook of SG&A expenses in Q2 and beyond, which increased significantly in Q1 from the same period of the previous year? Please tell me about it.

Ikemoto [A]: First, regarding sales, the decline in material prices, which has continued since last year and the year before, is quite serious. The price of some materials has been reduced to less than half of what they used to cost. For instance, what used to cost USD7 or USD8 per kilogram is now less than USD2 per kilogram. This is happening to many materials. Market prices have experienced the largest decline in decades over the past two years.

China's share of global production is high, with some materials accounting for 70% or 80% of the global market share. These Chinese manufacturers have continued to increase their production capacity, and even though the market is considered to be very mature, they have made new entries into the market.

This was fine as long as it was sold within China, but eventually, along with China's recession, it had to be sold outside the country, causing the market to decline. Even in the US and Europe, where Prinova Group's business is centered, we have been affected by this trend, and even if we increased the volume by 10% or 20%, the increase would be offset in the monetary value.

As we have seen in the first and second quarters, some major manufacturers have begun to cut back or withdraw from production.

As a result, market price is recovering for some materials, and although we are not sure how far it will go back to normal level from H2 of this year to next year, we believe the market has bottomed out. Expert opinions indicate that we cannot continue to sell at prices below marginal profit any longer. Therefore, we believe our sales will increase along with the sales volume once the price recovers.

The other thing is the small-lot, high-mix production mentioned earlier. We had a tendency to give priority to so-called "high unit price" items that are not sold in large quantities. This is part of the background that we fell in the small-lot, high-mix production. For these products, even if the unit price is high, the impact on the overall revenue is not so large. If they are not prospective, we would like to replace them. You can expect that we will have more products that can earn the profit with the volume, even if the unit price slightly falls.

Regarding the outlook of SG&A expenses in Q2 and beyond, the labor cost ratio is steadily declining. In particular, we have been replacing personnel or streamlining the organization and production lines quite drastically at our plants in Chicago and Tennessee. We are also beginning to see the effects of automated lines, so we expect the labor cost ratio to go down. We also believe that the labor cost ratio can be lowered if the current business at the Utah plant is replaced.

There is some concern about the extent to which the sharp rise in labor costs in the US will continue, but for now, the rate of increase is not as high as it was last year or the year before, and we expect to be able to reduce our SG&A expenses once the situation settles down.

Meanwhile, the cost of logistics is certainly rising again. At one time during the COVID-19 pandemic, the ocean freight, or shipping rates, went up tremendously. It is not that high currently, but the closure of the canal is giving negative impact. When we ship to Europe from China or Japan, the ship goes around the Cape of Good Hope, so it takes 40 to 50 days for a shipment that used to take 20 to 30 days, and the container is not returned.

In the US, in addition to unloading on the West Coast and transporting by truck, the Panama Canal has now run out of water and large vessels cannot pass through, so all cargo to be brought to the east is all unloaded on the West Coast. When we unload on the West Coast, there is an increase in stacks, or stagnation, at ports, and from there, logistics, land-based, such as trains and trucks, take it to the southern part of the East Coast. Then again, the container will not be returned from there.

Against this background, logistics costs are rising. Although there will be some time lag, we will ask our customers to pass on the cost of these changes to the selling price, and we are proceeding with this with their understanding. Therefore, with regard to SG&A expenses for Q1, we will continue our efforts to reduce them and improve efficiency in order to secure a profitable structure for the current fiscal year.

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