

Business Results Meeting for the Second Quarter of the Fiscal Year Ending March 31, 2024: Questions and Answers

[FY2023 Business Results Forecast]

Business environment (General)

Q1: We would like to ask about the difference in operating income between the first half and the second half in the company's plan on a segment basis. The expected operating income of the Functional Chemicals segment is 10.0 billion JPY in the first half and 11.8 billion JPY in the second half, an increase of 1.8 billion JPY. What improvements do you expect will contribute to this increase? Meanwhile, the operating income of the Pharmaceuticals, Medicals and Health segment is expected to decrease from 10.5 billion JPY in the first half to 9.3 billion JPY in the second half. What is the reason for this decrease?

A1: The Functional Chemicals segment was, as explained on page 6 of the "Financial Results For the Second Quarter Ended September 30, 2023," facing an extremely severe environment during the first half with a decline in shipments. Going into the second half, the business environment is expected to improve, although this is expected to be a gradual improvement. Therefore, we expect operating income to increase in the second half compared to the first half. As for the Pharmaceuticals, Medicals and Health segment, taking into consideration the fact that shipments were slightly concentrated during the first half in the DDS business as well as the expected increase in fixed costs due to our strategic investments, we expect a decrease in the second half compared to the first half.

Business environment (Functional Chemicals segment)

Q2: What specifically in the Functional Chemicals segment do you expect will improve in the second half?

A2: The recovery of general industrial products is still slow across all industries, but automobile production is gradually recovering. Given these circumstances, the commercial stocks accumulated in some businesses during the first half and our shipments were affected, but we expect this problem to be gradually resolved during the second half. Demand for toiletries (soap, detergent, etc.) remains sluggish, but we think that shipments of our cosmetics materials (skincare and haircare products) will remain steady from the first half into the second half.

Q3: Due to restrained purchasing by Chinese consumers, cosmetic manufactures' financial results are severe. Has NOF been affected by such conditions?

A3: Cosmetics-related businesses are increasingly affected by restrained purchasing as the second half nears. However, our cosmetics business, which includes ODM businesses, has been steady mainly in the domestic market.

Q4: Almost six months have passed since the integration of the former Oleo & Speciality Chemicals Division and the former Functional Chemicals & Polymers Division as part of organizational restructuring. Have any good results been achieved in terms of exploiting new markets or developing new products thanks to this integration?

A4: In the organizational restructuring that we implemented in April, the former Oleo & Speciality Chemicals Division and the former Functional Chemicals & Polymers Division were integrated into the Functional Materials Division for a fresh start. The former Oleo & Speciality Chemicals Division was known for its capability of providing various products for a broad customer base. Meanwhile, the Functional Chemicals & Polymers Division was good at producing differentiated products and known for its deep involvement with specific customers. Due to the integration of these business divisions with different characteristics, the new division is increasingly achieving synergy effects. As one example of such synergy effects in the first half, we put non-fluorine-based water-repellant-related products on the market. We aim to expand our income by continuously generating synergies.

Business environment (Pharmaceuticals, Medicals and Health segment)

Q5: We recognize that the DDS business performed strongly in the second quarter as well. We understand that during the first half, the DDS business performed well even when excluding the transient influence of products for the COVID-19 vaccines. Is our understanding correct? Specifically, which products have performed well? Have sales of marketed products greatly increased, or have sales of products for R&D and clinical tests greatly increased?

A5: In terms of shipments, the DDS business generally performed as planned. Until last year, the DDS business performed well partly because of shipments of products for the COVID-19 vaccines. During this fiscal year, such shipments have slowed down. Meanwhile, thanks to the steady performance of PEG modifiers and the influence of foreign exchange rates (depreciation of the yen), the DDS business's performance is expected to be steady this fiscal year as well. Currently, marketed products account for approximately 80% of the entire DDS business, while products for R&D and clinical tests account for approximately 20%. Going forward, we expect that the share of marketed products will continue to gradually increase.

Q6: In the May meeting, you explained that net sales in the DDS business are expected to remain on the same level as the same term of the previous year or to increase slightly. Have you changed your view that the biopharmaceutical market will grow at an annual rate of approximately 10%? In the latest earnings forecast, you revised the foreign exchange rate forecast for both the Euro and the U.S. dollar toward a yen depreciation of over 10%, but we think that the DDS business, which boasts of a high export rate, will make a positive contribution. In the revisions made to the latest earnings forecast, have you greatly changed your view on annual net sales in the DDS business compared to your previous view?

A6: We expect that the biopharmaceutical market will grow at an annual rate of approximately 10%, and we have not changed our view. We also have not changed the sales forecast from the forecast we made in May. However, due to having a large amount of sales to Europe and the U.S. in foreign currencies, the yen depreciation serves as a positive factor for net sales and operating income.

Q7: The Ministry of Economy, Trade and Industry has announced a support project for next-generation DDS technologies. Is NOF's DDS business involved in this?

A7: Concerning support from the Ministry of Economy, Trade and Industry, many national-level projects concerning the development of new vaccines and new materials have been launched. Among these is a project on lipid nanoparticles, and we are participating in that project.

Q8: You said that NOF is participating in a project on lipid nanoparticles. Does this mean that you will make broad contributions that incorporate other technologies as well, such as modification technologies and ligands?

A8: Your understanding is basically correct. With regard to the project, however, we are participating in the part concerning lipid nanoparticles.

Q9: In the "value provision" explained on page 6 of the material "Initiatives for Sustainability Issues," monodispersed PEG is the first pharmaceutical ingredient to be described. What is the intent behind this?

A9: Monodispersed PEG is highly likely to be applicable to antibody drugs, which is a category of next-generation drugs. In parallel with lipid nanoparticles for nucleic acid drugs, we are developing and proactively selling monodispersed PEG. This is the intention behind listing monodispersed PEG first.

Q10: Concerning antibody drugs, we recognize that monodispersed PEG can be used for the linker of antibody drug conjugate. Do you mean that for this reason, NOF is able to continue providing value—in other words, that it is promising?

A10: That is correct.

Business environment (Explosives & Propulsion segment)

Q11: Concerning the Explosives & Propulsion segment, a statement on page 19 of the "Financial Results For the Second Quarter Ended September 30, 2023" says that the impact of the Taketoyo Plant accident on our consolidated business results for the current fiscal year is negligible. Are there any risks from the next fiscal year onwards? We assume that when accidents have occurred, extraordinary losses to compensate for the damages inflicted on the surrounding area have sometimes been posted. Did the accident at the Taketoyo Plant cause damage to individuals or the neighborhood?

A11: Regarding the accident that occurred on September 14, we are deeply sorry that we caused you worry. We are now summarizing the final report of our investigation into the causes of the accident. We are responding to the accident under the advice of experts, and we plan to restore the facilities by the end of this fiscal year. As stated in the explanatory material, the accident's impact on our business results is insignificant. The extent of the accident's impact is restricted to an extremely limited area. We will make efforts so that the accident will not affect our profit and loss next fiscal year or thereafter.

Fixed costs

Q12: According to page 18 of the material "Financial Results For the Second Quarter Ended September 30, 2023," as the breakdown of the increase in fixed costs of the Pharmaceuticals, Medicals and Health segment by 2.3 billion JPY in comparison to the previous year, a cost increase of 0.8 billion JPY during the first half and a cost increase of 1.5 billion JPY during the second half are expected. On the other hand, according to historical trends, fixed costs have been almost the same for the first and second halves during most years. What factor led you to expect a greater cost increase in the second half of this fiscal year?

A12: The largest factor behind the difference between the first and second halves is our strategic investments. This fiscal year, there are more investments that generate costs in the second half than in the first half. The above forecast means that the change in fixed costs is expected to occur due to such investments. In addition, fixed costs also include expected increases in operating costs, transportation and storage costs, repair costs, and other costs due to increasingly active sales and production activities.

Q13: Until the previous fiscal year, fixed costs related to strategic investments were not generated, making the difference in such costs between the first half and the second half small. Should we recognize that from the next fiscal year onwards, fixed costs will differ between the first and second halves?

A13: As we mentioned at the May meeting, we will continuously make strategic investments during the period of the 2025 mid-term business plan. With strategic investments of approximately 70 billion JPY, the yearly fixed costs for each of the three years to come will, compared to the increase in fixed costs associated with conventional investments, vary depending on the startup conditions of facilities at the respective points in time. From the next fiscal year onwards, how fixed costs are generated will differ between the first and second halves.

Q14: The fixed costs in the Explosives & Propulsion segment presented on page 19 of the material "Financial Results For the Second Quarter Ended September 30, 2023" decreased by 0.4 billion JPY to 1.1 billion JPY from the initial forecast of 1.5 billion JPY. However, as the fixed costs increased or decreased by around 0.1 billion JPY in previous years, the increase in fixed costs of 1.1 billion JPY this fiscal year seems to be great. What lies behind these costs?

A14: Strategic investments for the Explosives & Propulsion segment are included in the current mid-term business plan. We will mainly make human investments and R&D investments.