Business Results Meeting for the Fiscal Year Ended March 31, 2024: Main Questions and Answers

[FY2024 Business Results Forecast]

Business environment (General)

Q1: In the 2025 mid-term business plan, in which strategic investments will be made to establish revenue foundations and to expand business areas, the profit plan may be difficult to achieve partly due to the business environment in fiscal 2024. From the viewpoint of selection and concentration, what do you think of the progress made towards establishing revenue foundations?

A1: Under NOF VISION 2030, we are discussing business development toward the goal of the Corporate Vision for FY2030. The themes of this business development are the three fields of “Life/Healthcare,” “Environment/Energy,” and “Electronics/IT.” By proactively making investments during the 2025 mid-term business plan period, we will expand our business in those fields. As a result, we will be at the stage of developing new businesses in new fields and profiting from them during the 2028 mid-term business plan period. As for the current status of the 2025 mid-term business plan, in establishing and strengthening the revenue foundations of less profitable products, we have promoted foundation strengthening through reorganization and consolidation of less profitable products. As for future development, by expanding the business areas through further differentiation and solution proposals, we will move forward to the next stage.

Q2: For expansion to new business areas under the 2028 mid-term business plan, we assume you are working extremely actively with startup companies and sowing business seeds. What is the blueprint for new business areas, if any, at this point?

A2: We consider that in terms of fields, the new businesses will fall into the three fields of “Life/Healthcare,” “Environment/Energy,” and “Electronics/IT.” As an example business area, in addition to conventional sales of raw materials only, we will develop our businesses under a concept of solution-based business development by turning slightly toward the retail business. We will discuss the specific direction in the days ahead, but we plan to incorporate developments that differ from the conventional business model into the 2028 mid-term business plan.

Q3: Although we forecast that operating income will decrease in fiscal 2024, the actual result for the previous term was better than the forecast. Despite your explanation of the background to your forecast predicting a decrease in operating income during this term, some investors may regard this forecast to be conservative and think that there is room for an increase. What do you think about this opinion?

A3: While there may be many views regarding our forecast, it shows a published value based on predictable ranges for the business environment and exchange trends at this point in time. Furthermore, as stated in the explanation of fixed costs as a factor that affects the results, we will continue to proactively make strategic investments, so this is our forecast at this point in time.

Q4: The forecast for net profit during this term of fiscal 2024 is at a higher level with respect to ordinary profit. Should we consider that at the point at which the forecast value was determined, it includes the profits from the sale of cross-shareholdings?

A4: This term’s net profit includes the profits from the sale of cross-shareholdings.

Q5: Concerning forecasting of sales and operating income in fiscal 2024, no interim forecast has been published. Is my understanding correct that the second half will play a greater role, as is usually the case?

A5: This is the plan for the entire year, and we do not have any particular reason to think that the second half will play a greater role.

Q6: Concerning the direction of the sales/operating income forecast for fiscal 2025, what are the preconditions that can be assumed at this point, such as an increase in depreciation and amortization?

A6: We will closely examine the forecast for the next term while monitoring progress made during this fiscal year, but amid proactive strategic investments, we will assume an increase in depreciation and amortization of a certain scale during the 2025 mid-term business plan period. We will also assume an increase in sales due to the development of various measures by business divisions. Foreign exchange rates will also affect us. We consider these to be the main points regarding preconditions.

Business environment (Functional Chemicals segment)

Q7: While according to your plan cosmetics-related products will grow in fiscal 2024, how do the growth of the market itself and the growth of the ODM business, in which NOF is making efforts, and other businesses subject to self-supporting efforts contribute? In other words, will the growth of cosmetic-related products in fiscal 2024 be at the same level as market growth or exceed it due to the effects of self-supporting efforts, including facility investment?

A7: To briefly explain the current status of the market for cosmetics-related products, concerning the domestic cosmetics market during the previous year, while inbound demand showed a general increase, total demand was sluggish. Among cosmetics products, shipment of skin-care products, mainly from large cosmetic manufacturers, was sluggish. On the other hand, hair-care products, centering around products at the mid- to high-price ranges that we shipped, remained at a high level. Looking at the Chinese market, with local manufacturers emerging, we and other Japanese manufacturers faced a difficult struggle.

Given these circumstances, we are focusing on the development of original products made of natural materials as well as the development of functional cosmetics which mix in such original products at high percentages, and we are launching many new products to expand sales. Furthermore, we are also focusing on the development of ODM businesses that use our own raw materials. In this fiscal year as well, we plan to launch many new products. Thus, we will try to further increase sales and, keeping market growth in mind, continue to focus on more profitable ODM businesses to increase sales.

Business environment (Pharmaceuticals, Medicals and Health segment)

Q8: According to your forecast, demand for raw materials for DDS drug formulations in the Pharmaceuticals, Medicals and Health segment will go through a soft patch this fiscal year due to inventory adjustments by some customers. Should we regard this to be a transient factor? In fiscal 2025, can we expect growth of around 10%, which is equivalent to that of the biopharmaceutical market, or growth exceeding this? In September 2025, the construction of a new plant at the Aichi Works is scheduled to be completed. Conversely, do we have to worry about an increase in the depreciation burden?

A8: As I explained earlier, we think that demand for raw materials for DDS drug formulations will go through a soft patch for a time, and will be down versus the strong performance of the previous fiscal year. Toward 2025 onwards, as shown on pages 20 and 21 of "Management Overview," with both clinical and launched products growing steadily, we will continue to make efforts with the aim of exceeding the biopharmaceutical market's growth of 10%.

From fiscal 2025 onwards, increases in depreciation and amortization, labor costs, and other costs are expected, but by steadily proceeding with business expansion, we think we can continue to achieve growth while absorbing these increases in fixed costs.

Q9: Is there any possibility that the influence of inventory adjustments by customers will become greater or, conversely, smaller?

A9: We have closely examined the forecast based on the information available at this point in time and incorporated it into the plan. If some change occurs in the future, we will review the plan as needed and provide you with the relevant information as necessary.

Q10: We heard from a pharmaceutical manufacturer that sales of marketed drugs that use PEG modifier are strong and have exceeded expectations. What is making the customers conduct inventory adjustments given these circumstances? For example, are you expecting a soft patch in demand for a time because those drugs were products in a larger quantity than the demand immediately after their release, which caused them to conduct inventory adjustments in large quantities, and they will place orders to NOF for raw material procurement in accordance with actual demand while monitoring the inventory transition? Please provide a supplementary explanation of this issue.

A10: In fiscal 2023, shipments of raw materials for DDS drug formulations were strong following the launch of products from multiple customers in Europe and the U.S. While the customer drug manufacturers forecast that sales will grow steadily, our shipments of raw materials for DDS drug formulations will decrease slightly in quantity in fiscal 2024 because we shipped a large amount for the initial lots in order to be in time for the release. We will go through a temporary demand soft patch this fiscal year, but we think that demand will steadily recover. Multiple customers, not just one, are experiencing the same inventory adjustment situation; therefore, we forecast a decline in both sales and profits this fiscal year.

Q11: When will inventory adjustment of raw materials for DDS drug formulations end? Can you forecast whether it will end in six months or one year? We also heard that the collaboration with Phosphorex is in the nucleic acid medicine field. When do you forecast that will take effect?

A11: Inventory adjustment differs from customer to customer, but we consider it will influence us throughout all of fiscal 2024, not just a six-month span. We will grasp the circumstances while continuing to emphasize communications with our customers. In the collaboration with Phosphorex, while we have been continuously providing samples of functional lipid, there have been challenges, including an inability to synthesize and adjust LNP. We have conducted technical follow-up concerning conversion to LNP, but thanks to the collaboration with Phosphorex, a CDMO with abundant knowledge of LNP production, we think we can provide further strong support. Although full-fledged adoption of functional lipid in released products will still take time, to increase sales, we plan to conduct an accelerated follow-up.

Business environment (Explosives & Propulsion segment)

Q12: The forecast for the Explosives & Propulsion segment in fiscal 2024 states that sales will grow but operating income will remain at the same level. Looking at the analysis, it shows a decrease due to the influence of inventory stocktaking. Concerning the explosives and propulsion business, as the inventory accumulated by the end of the previous term is usually delivered at the beginning of the next term, we can assume that the profit turns negative at this point. However, as this is repeated, it seems that the inventory is ultimately accumulated in the fourth quarter again and, due to the influence of inventory stocktaking, the profit will turn positive during this fiscal year as well. What is the reason for posting the decrease? Concerning defense-related products, what yearly growth rate do you forecast for growth over the medium to long term?

A12: The influence of stocktaking is exhibiting the trend that you describe in your question, but this fiscal year is subject to the influence of the inventory level at the end of March 2024, which was slightly higher than average. While additional accumulation of inventory will basically be conducted at the end of March 2025 as usual, we estimate that the inventory level is lower than that at the end of March 2024. Therefore, a negative value is posted.

We think that the influence of the increase in the defense budget will become greater basically in accordance with government policy, but as there is still some uncertainty regarding this policy, the above influence is in a fluid situation. We plan to reflect it in our plans for fiscal 2025 onwards.

Facility investments

Q13: The amount of facility investments in fiscal 2023 shown on page 24 of "Management Overview" is smaller than the initial estimate. The facility investment amount was initially supposed to be 25.6 billion JPY, but it turned out to be 18.7 billion JPY. What kind of deviation occurred? And allow me to first confirm whether there is any possibility of further deviation in the current mid-term plan?

A13: As you point out, the facility investment amount decreased in comparison to the plan. Currently, we are proceeding with various facility plans, but due to the difficulty of securing equipment vendors and postponing machinery delivery dates, in fiscal 2023, the investment amount decreased slightly with respect to the plan. However, at this point in time, we are not planning to make any changes to the total investment amount during the 2025 mid-term management plan period, and we will proceed with facility investments as per the plan.

Q14: Concerning the strengthening of fatty acid derivatives in the Amagasaki Plant described in the main facility investments on page 25 of "Management Overview," which has been postponed until the 2025 mid-term plan period or later, what kind of product capability strengthening is it?

A14: We plan to strengthen the capabilities of ester-related products.

Capital policies

Q15: The explanation of cross-shareholdings in this material is very easy-to-understand. However, from the goal of a net asset ratio in cross-held stocks of 15% or below, there is still a gap. In the first place, a value of 15% or below still seems relatively high. Do you plan to decrease the value to 10% or below? Please tell us whether you plan to proactively reduce the cross-shareholdings further.

A15: First of all, we plan to achieve a net asset ratio in cross-held stocks of 15% or below within the 2025 mid-term management plan period. Concerning the value thereafter, we will discuss it after achieving the above goal.

Q16: In order to reduce the net asset ratio in cross-held stocks to 15% or below within fiscal 2025, we think it is necessary to accelerate the reduction rate over the next two years. In addition, in comparison to the cash flow allocation that was determined at the time of development of the 2025 mid-term management plan, we think that the cash margin has become substantially large. In consideration of these points, are you temporarily considering a share repurchase that exceeds the goal value of a total return ratio of 50%? Please allow us to re-confirm how you are thinking about the cash allocation.

A16: As the price of owned stocks has risen, the net asset ratio in cross-held stocks during this fiscal year has risen from that of the previous year, which was 17.5%. However, we are steadily decreasing the number of held stock names year by year. We set a goal of a total return ratio of around 50% as a guide, and we are not changing our thinking on this. However, we recognize your finding, namely that we have a large amount of cash and cash equivalents, to be correct. By promoting strategic investments while making efforts to enhance returns to shareholders, we will conduct our business operations while keeping capital costs in mind toward achieving the optimum cash allocation in the form of dividends or share repurchases.