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Morinaga & Co., Ltd.
Q&A Session at Results Briefing for Second Quarter of Fiscal Year Ending March 31, 2025
(held November 13, 2024)

Q. In your U.S. Business, *HI-CHEW* has been underperforming in the non-chocolate candy market. *HI-CHEW's* recognition rate has not increased greatly, and the store stocking ratio has remained flat. Can you tell us what is behind this situation? Last month in the U.S., I did not see any *HI-CHEW gummies* on the shelves in stores and hardly any *Dessert Mix*. I know this is an issue that Morinaga is working on, but I do not think your strategy to expand in this area is bearing fruit. Can you tell us what your thoughts are on this business and whether you will be able to accelerate growth solidly into the next fiscal year?

A. We believe that our strategies are bearing fruit, and it is because of this that our U.S. Business has been able to grow to ¥19 billion (actual net sales in FY2023). However, while recognition rate and store stocking ratios increased significantly over the past few years, I feel that they have reached a bit of a plateau. We consider this is due to the supply of products not yet being fully aligned with marketing costs and channels, and we believe we have some measures to take in the future.
HI-CHEW gummies were launched in spring this year, and we expect that they will actually start hitting the stores this fall/winter and into next year. Unlike Japan, the U.S. market is characterized by the fact that retailers only change their stock about once a year and, given the vastness of the country, it takes some time between launching a product and it hitting the shelves.
In terms of our different sales channels, convenience stores in the U.S. have been struggling with sales recently, and this has affected us because convenience stores account for a very high percentage of our sales. In the mass retail channel, strong competing brands are earning substantial sales by discounting their products to coincide with events, but we have not yet been able to take such bold action due to manufacturing capacity issues and profit considerations. We have strong sales of stick-format products (which are often sold at convenience stores), and as a result, convenience stores account for a high percentage of our sales. In the food channel, we have achieved double-digit growth over the past year. We are considering initiatives to ensure that this growth continues in the future.
Our most recent store stocking ratio is 77.5% (Circana data), but the number of SKUs distributed to each store is currently unknown. While carefully analyzing our sales by channel and by product, we will proceed to expand the number of SKUs at our second U.S. factory (scheduled to begin operations in January 2027) by modifying product content and format to suit the channel. For this reason, although it is unclear whether we will be able to make a giant leap forward from the current plateau, we will work to raise the baseline as much as possible in the lead up to next year.

Q. I get the feeling that the key to genuinely competing with rival brands in the mass retail channel in the U.S. is to get the new factory up and running. Do you have any other actions you can take in the meantime?

A. Products are being supplied from Japan as well as from Taiwan and China, and we are working hard to do what we can now until the new factory starts operations. We also have an OEM arrangement in place for the manufacture of *HI-CHEW gummies*.
We are also supplying and selling Japanese salted caramels from Japan under the brand *HI-SOFT*. Our Chief Representative for the U.S.A. has assured us that there is still scope for the introduction of Japanese brands as we have secured shelf space in the candy section of the U.S. channel and there are opportunities to negotiate business. We are expanding our business.
While building on various initiatives over the past couple of years, we are currently considering product development in and after 2027 when our new factory begins operations. There is still another 20% more room for growth in our store stocking ratio. We would also like to raise the recognition rate of the *HI-CHEW* brand by another 30% or so (from the current 57%), and we believe there is scope to do so. All of Morinaga is committed to working together to achieve these goals.

Q. Turning to your global initiatives for *HI-CHEW*, you say that the European market is comparable in size to the U.S. market, but what is your potential there? I understand that *HI-CHEW* has most recently been introduced to major retail chains, but how big are your current sales in Europe? Also, given that it took close to 10 years to turn a profit in the U.S., can you generate a profit more quickly in Europe? Can you give us an idea of the scale of sales and profits you are aiming for in the medium to long term through to 2030?

A. Internally, we are working hard based on a plan for net sales and operating income, but at present, we are not at a level of disclosing actual results and targets. As sales in Europe are included in “China, Taiwan, exports, etc.,” I hope you can appreciate that the growth in this item is, in part, due to the influence of Europe.
As for our potential in the European market, we believe that if *HI-CHEW* can penetrate the whole of Europe as much as it has in the U.S., we can achieve sales of about ¥20 billion. However, retail outlets in European countries are dominated by a few large companies even more than in the U.S. We have started to consider how to use agents in each country and how to tailor our efforts to each country.
In terms of the rollout in each country, in London, *HI-CHEW* is sold in the imported confectionery section, similar to how it is sold in the Asian section in the U.S. And in France, we have managed to get *HI-CHEW* displayed in front of cash registers in a major retail chain. It took a long time to get *HI-CHEW* on shelves in the candy section in the U.S., so we think it will take several years in Europe too. However, at the same time, we intend to increase sales through marketing efforts. We will spend on

marketing to appeal to consumers, but we also need to consider how to adapt our marketing approach to suit the European market. Our plan is to focus on a specific country, establish an example of success there, and then to extend that to other countries. Given that, at present, even without spending on marketing, stock turnover in stores is at a level that our products will not be cut, we believe that there is fantastic opportunity here.

Outside of Europe, sales are also strong in Oceania. In New Zealand, the *HI-CHEW* brand is well established, with brand recognition even higher than in the U.S. In Australia, too, *HI-CHEW* has been taken up by the major supermarkets. However, the Oceania market is not all that big. Not surprisingly, the U.S. and Europe are the two major markets. Now that we have paved a way to certain success in the U.S., we will work to expand our business to Europe. Our goal is to achieve a certain degree of tangible results by 2030.

Q. Regarding the profitability of the chocolate category in your Confectionery & Foodstuffs Business, with cacao prices soaring to such a high level, I imagine that profitability has declined significantly. I understand that chocolate is one of Morinaga's original businesses, but does it make sense to stay in the chocolate business in perpetuity?

A. Continuing our chocolate business makes a lot of sense. Our chocolate technology goes beyond just chocolate confectionery. It has led to the creation of unique products in other businesses and categories, such as *Ita Choco Ice* and *in Bar*, and is one of our company's strengths. Of course, we cannot continue a business that is not profitable, so while implementing reforms, we will consider how to change the profit structure of the chocolate business or how to extend those technologies to other businesses throughout Morinaga.

Q. In the Confectionery & Foodstuffs Business, you have set a target ROIC of 8% in FY2026 and a target operating income margin of 10% in 2030. Can you tell us, in the midst of such a severe business environment, is it possible to increase the profit margin of chocolate? Also, have you brought forward internal discussions to consider drastic profit improvement measures?

A. Concerning the profitability of chocolate, the Confectionery & Foodstuffs Business accounted for about 70% of the hikes in cacao-related raw material prices this fiscal year, with chocolate being the most affected. While the progress of ROIC has not been disclosed this time round, internally, business plans have been formulated by business managers with ROIC improvement front of mind, and efforts are being made throughout Morinaga.

To improve profitability, we have been working on implementing price revisions, shifting toward high-profit products, and managing profit margins on an individual product basis. We implemented a price revision in September, and they must still form part of our considerations in order to ensure profitability.

While it will be difficult to improve profit margins to the level of *HI-CHEW*, we will make the category a meaningful one by creating solid profits.

As for our asset-light strategy, we have many production lines, many of which are aging. Discussions are proceeding at a rapid pace regarding a fundamental review of renewal investment, consolidation of production lines, and consideration of any consequent product mix. It should be noted, however, that this consideration is for beyond the period of the 2024 Medium-Term Business Plan, rather than during it.

Q. You currently export *HI-CHEW* products from Japan to supply your U.S. Business. How much capacity do you have in the U.S. as a whole? Also, I believe that future imports from outside the U.S. will be at risk of tariffs. Can you tell us about any internal discussions you have had about the domestic production volume and import volume in the U.S. during the period until the new U.S. factory starts operations in 2027?

A. Concerning exports from Japan, they were in part carried out due to the weak Japanese yen in order to cover the supply volume when demand in the U.S. surged and sales grew. We do not intend to increase the volume of supply from Japan in the future.

We are aiming to grow *HI-CHEW* at a CAGR of 116% during the period of the 2024 Medium-Term Business Plan. In order to manage that level of sales expansion before the new factory comes on line in 2027, we envisage some supply from Taiwan and China and through OEM, and we have the capacity for this. I cannot tell you exactly how much production capacity we have at our first factory in the U.S., but I can say that there is still scope to increase sales given the slight slowdown in sales recently.

Once our new, second factory comes on line, we plan to manufacture products with different package sizes for different sales channels. In the past, issues with supply capacity meant that we were sometimes unable to make aggressive sales, but going forward, we expect to be able to offer our products through a variety of channels, including at events.

For this reason, our basic approach will be to strengthen local production and local sales in the U.S. However, since there will not be a production line for stick-format products in the U.S., these will be imported from Taiwan and China. In addition, since there are concerns that imports from China will face higher tariffs under the Trump administration, we expect to increase imports from Taiwan.

Q. What percentage of your imports are from China?

A. Supply from China has been greatly reduced. We do not expect any impact from reduced exports to the U.S., however, as current rising demand for *HI-CHEW* within China means we will be able to increase domestic sales.

Q. Regarding future raw material cost increases and price revisions, I think you are considering additional price revisions this fiscal year, but your projection for the Confectionery & Foodstuffs Business is for a second-half decline in income. While the overall top line of your Confectionery & Foodstuffs Business is performing well, it seems that you have not been able to cover cost increases with price revisions. How do you see raw material costs increasing next fiscal year, and how do you expect to cover the increases with price revisions?

A. Increases in raw material costs are higher than expected, with a revised forecast of ¥6.4 billion, compared to an initial plan of ¥4.8 billion. Prices of cacao-related raw materials have risen sharply, and I believe that every manufacturer that uses cacao raw materials has been affected. Our plan is to offset these increases, including with future price revisions, to realize a company-wide increase in profits. In the Confectionery & Foodstuffs Business, there is a slight time lag before any price revisions take effect, and the full impact of price revisions implemented this fiscal year will not be seen until next fiscal year. If raw material prices rise again in the future, while our basic approach next fiscal year will again be to cover the increases by revising prices or product specifications, we are committed to responding in a way that is supported by our customers.

Q. In other words, the second-quarter (July–September) decrease in profit in the Confectionery & Foodstuffs Business was unexpected from your viewpoint, but am I correct in saying that the increases in raw material costs during this period will be offset next fiscal year?

A. It is true that profits in the Confectionery & Foodstuffs Business and on a consolidated basis decreased in the second quarter, but our original consolidated forecast at the beginning of the period was for a first-half decrease and a second-half increase in profit. Last year, we achieved an increase in second-quarter profit of nearly ¥3 billion, with unexpected values—especially in Frozen Desserts—contributing to the increase. This fiscal year, however, we had a grim plan for a first-half profit decrease of ¥0.8 billion. Consequently, first-quarter results were slightly higher than planned, and while profit did decrease in the first half, it landed better than initially planned and is within our expectations. Since quarterly results may vary from the previous year due to a difference in timing, we ask that you appreciate we are managing operations throughout the fiscal year. On a full-year basis, we are positive in our assessment of the fact that we expect record-high profits, covering a gap of +¥1.6 billion from our initial plan due to soaring raw material prices.

Q. I understand that the slump in sales of *in Jelly* in the first half of the year was in part due to people exercising less because of the extremely hot summer, but can you give us your specific thoughts on measures to stimulate demand in order to realize higher sales growth in the second half? Also, can you tell us what is behind your forecast for a large increase in profit relative to the increase in sales?

A. In the first half of the year, data also showed a behavioral change in people having fewer opportunities to go out. Just as sales of *in Jelly* halved early on in the COVID-19 pandemic, we were reminded once again of the extent to which inactivity impacts sales of *in Jelly*. Furthermore, we believe that our focus on sports-themed marketing this fiscal year was ultimately a mismatch. One of the challenges for next year will be how to capture summer demand.

In the "in-" Business, we forecast a 6% increase in sales in the second half of the year. *in Jelly* is Morinaga's highest profit contributor, so our sales departments are prioritizing efforts to expand sales of this product.

Centered on our mainstay products, such as *Energy*, *Energy: Glucose Boost*, and *Multivitamin*, we have prepared various measures, such as appealing to students preparing for entrance exams. In addition, we are determined to achieve high growth, including with the development of new product lines planned for next spring, although these have not been announced yet.

As for profit, at the start of the 2024 Medium-Term Business Plan, we revised the basis for allocating operating expenses. This has consequently affected year-to-year comparisons between businesses, so a certain amount needs to be subtracted when looking at profit.

Q. Is it fair to say that you expect growth in the second half of the year to be centered on existing products and new products to contribute mainly in the next fiscal year and beyond?

A. We are conducting trial launches of *in Jelly* with the aim of dominating all genres in the jelly drinks market, but these are not expected to bear substantial fruit anytime soon. The second half will be centered on the growth of mainstay products through new initiatives and steady growth of *Full-o-Fruit* and *Growth Support*.

Q. Your sales growth in the Confectionery & Foodstuffs Business for the second half of the year is 2.5%, which seems conservative in comparison to the first-half results. While I imagine that you will achieve solid growth in the future even with price increases, are you concerned about any changes in consumer behavior and so on?

A. We expect that the confectionery market as a whole, including inbound demand, will continue to be strong. We have no particular concerns.

When considering the profit structure of the Confectionery & Foodstuffs Business, it is important to build up sales with profitability. While the impact of the September price revisions is subsiding, there are some additional considerations that require us to be a bit more ambitious, so our plan incorporates the impact of those actions.

Q. You mention that you are aware of the need to advance discussions of ROIC improvement in the Confectionery & Foodstuffs Business more quickly, but from an outside perspective, I feel that not much progress has been made. How should we perceive the time frame for your presentation of specific policies?

A. It was a considerably bold decision to disclose ROIC results and targets for each business segment. Having drawn up business plans for the 2024 Medium-Term Business Plan with an eye to ROIC targets, managers of each business have recently been reviewing them for the next two fiscal years, demonstrating a definite rise in awareness of ROIC among management within Morinaga. We determined, however, that there is little point in disclosing interim progress to external parties and will instead explain the current status within the business plans for next fiscal year. We hope you will get a sense of the level of our commitment to ROIC management when we announce our business plans in May next year.
