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MORINAGA & CO., LTD.

Q&A Session at Results Briefing for First Half of Fiscal Year Ending March 31, 2022

(held November 11, 2021)

Q. What is your outlook for domestic raw material prices and how do you plan to respond? Is the confectionery industry as a whole moving toward raising prices amid the rising prices of raw materials such as sugar and wheat? Can you tell us how you plan to cover the additional costs and provide some quantitative estimates of raw material price increases for the next fiscal year?

A. We have been affected by rising prices of wheat, oils and fats, dairy products, and sugar. With our initial forecast we assumed that we could compensate for rising market prices, but in our revised forecast we now assume a 0.91 billion yen increase in raw material costs. We expect this trend to continue for some time. Basically, we must always consider revising our sales prices on an ongoing basis. That being said, it's important to strike a balance between a product's value and its price, and ultimately, it all depends on whether consumers accept that they are receiving value commensurate with the price they are paying. We have made no such decisions at this stage but please understand that price revisions are always being considered. We don't have any information about the intentions of other confectionery companies at this point in time.

Q. In your explanation of the US business, you mentioned in relation to ingredients and distribution expenses that you will consider raising prices if cost increases cannot be absorbed. What specific figures are we talking about?

A. We raised the price of *HI-CHEW* last year. Unlike in Japan, the US has a high rate of inflation, which means all companies in the confectionery industry, not just Morinaga, revise sales prices in response to the operating environment at the time. We are aware that we must always be prepared to take such actions. According to media reports, the cost of marine shipping containers has increased tenfold, and we have obviously been impacted by this. I can't put a specific figure on "cost increases that cannot be absorbed," but basically, we want to make sure that we add value in proportion to any price increase. Our understanding is that our operating environments in Japan and the US are also somewhat different.

Q. Please tell us about current topline earnings and the source of your robust performance. I believe second quarter topline earnings exceeded pre-pandemic levels, although the accounting standard revisions make it difficult to make accurate comparisons. My impression is that you adapted well to changes in the market to drive topline growth despite overall weakness of the confectionery market. I feel that you have adapted to market changes better than your competitors. What is the source of your strength?

A. I appreciate your kind words, especially "source of your strength." This is my third year as president, and during this time, we have experienced many major events including the COVID-19 pandemic. I do feel that, we are quick to recover and take action when such events happen. One of our strengths is that we have substantial market share in various product categories. As we noted in our growth strategy presentation earlier, as a category leader, especially with *in Jelly*, we believe the entire jelly drink market recovered as a result of our various initiatives. It's important that we continue to take action to drive market growth. That being said, *HI-CHEW* continues to struggle, highlighting the differences between successful and unsuccessful categories. We will continue to work on strengthening our business to lift topline earnings of the four areas of business positioned as focus domains in our 2030 Business Plan.

Q. You say that you estimate a roughly 0.9 billion yen increase in raw materials-related costs. Do you think that raw material prices will jump up even further in the next fiscal year?

A. We will discuss our earnings plan, which reflects raw material prices, at the full-year results briefing in May next year. At present, the prevailing view is that the upward trend in raw material prices will likely continue. We are preparing for a variety of potential responses, including the use of alternative ingredients.

Q. You've refreshed the brand identity of *DARS* for the first time in 20 years. Are you aiming to improve the profitability of *DARS*, which I believe has been a long-term challenge?

A. Part of the capital investment in *DARS* and *Carré de chocolat* was to upgrade aging facilities for *DARS*, but of course we must increase sales to recover this investment. We are therefore taking steps to increase sales by strengthening the product range and doing marketing that mainly targets Gen Z rather than working to improve profitability. *DARS* is a long-selling product, and we believe it has significant brand value. We are working on growing sales of the *DARS* and *Carré de chocolat* brands.

Q. Does the percentages of stores selling *HI-CHEW* in the US on page 8 of the briefing materials include convenience stores and major retailers? What is the target for the percentage of stores selling *HI-CHEW* that you need to reach in order to attain sales in the US business of 30 billion yen by 2030?

A. The percentages include all channels. *HI-CHEW* was initially sold at Japanese supermarkets and in the Asian food sections of general supermarkets, but today it has established a position in the general candy sections of US supermarkets, which has led to strong sales. US sales of *HI-CHEW* are now close to 10 billion yen, but market share has only just topped 1%. Leading products have a market share of around 5%, which shows that 10 billion yen in sales is just a milestone and there is plenty more room for growth.

We have not disclosed a breakdown of the US sales target of 30 billion yen by 2030, but we plan to grow sales of *HI-CHEW*, establish a market for jelly drinks, and launch a third mainstay product. We have positioned the US business as a focus domain and are working to raise Morinaga's profile in the US market.

Q. Although you posted record profit in the first half, you sharply revised down your second half forecast. Which of those figures reflects your true capability? Should we consider the second half to be an investment phase?

A. First, there is the matter of advertising expenses, which only went up by 0.23 billion yen year on year in the first half, but are likely to increase by 1.15 billion yen in the second half. We shifted part of the first-half budget to the second half because of the extended state of emergency, but also resolved to invest in the Direct Marketing business at a time when it is attracting new subscription customers at a fast rate. Some intangible investment such as spending on R&D and DX was also postponed to the second half. As a result, expenses were more or less flat in the first half and are estimated to increase by 0.60 billion yen year on year in the second half. The difference between the first and second half is 1.6 billion yen for advertising expenses and intangible investment alone. Another factor affecting profit in the second half is the difference between the sales growth rate and marginal profit ratio. Sales in the first half were up 10% or 8.5 billion yen year on year, but our forecast for the second half is that sales will be up 3% or 2.5 billion yen, so there's a big difference when you compare them. Both the first-half and second-half figures reflect our true capability in our view, but we do think that now is the time to take a wide range of steps to ensure that we achieve the targets in our 2021 Medium-Term Business Plan and 2030 Business Plan. If you only look at the second half, profit margins are smaller, but the second half should be seen as a period of investing for the future.

Q. You say one of the factors contributing to the downward revision of your second-half earnings forecast is spending on advertising in the Direct Marketing business. I get the impression that you won't be spending the full amount that's been budgeted for. The expenditure appears excessive when you consider that you are forecasting a 2.8 billion yen year-on-year operating profit decline in the second half.

A. Advertising spending in the Direct Marketing business is upfront investment. We are spending aggressively on advertising, because the customer count is steadily increasing, and the business model is one in which increases in subscription customers generate profit over subsequent fiscal years. While I understand the point that you are making, I ask for your patience and understanding while we resolutely pursue investment and initiatives with an eye to the future.

Q. Your US sales forecast for FY2021 is 9.864 billion yen, an increase of 36% year on year. I understand that *HI-CHEW* is manufactured in China and Taiwan. Does this forecast take the impact of shipping disruptions into account?

A. We have been impacted by shipping disruptions, and the forecast takes this into account. We have been fortunate so far, because products have never failed to arrive. Results will also fluctuate as a result of forex movements.

Q. Please tell us about the sales and channel strategies that led to the strong first half performance of *in Jelly*.

A. Convenience stores account for a large share of *in Jelly* sales. Sales halved last year because of the pandemic, but we managed to keep *in Jelly* on convenience store shelves. Convenience store sales recovered in the first half of fiscal 2021, because the increased movement of people from the first half and other factors meant that conditions were distinctly different from conditions during the states of emergency in 2020. We will continue to work with each convenience store company. We are also focusing on making sure we have sufficient space on supermarket shelves so that we can roll out the new *in Jelly* products with fruit-like textures, which we have already launched at convenience stores. Sales of *in Jelly* have recovered in all channels as a result of our proactive measures and thanks to help from external factors.

Page 17 of the briefing materials covers our growth strategy for *in Jelly* and shows the products that have been launched early, or that are undergoing test marketing, at convenience stores. Since *in Jelly* has the top share of the jelly drink market, we plan to take a variety of different steps to ensure that *in Jelly* products are available at all stores.
