Morinaga & Co., Ltd.

Q&A Session at Results Briefing for Second Quarter of Fiscal Year Ending March 31, 2024

(held November 13, 2023)

Q. Can you tell us your thoughts about profit growth for next fiscal year (fiscal 2024) and beyond? You previously commented that you want to quickly return to an operating income level of JPY 20 billion. With various cost increases expected in fiscal 2024 and beyond, including soaring raw materials prices and rising logistics costs, can we assume that you will be able to return to this JPY 20 billion level in fiscal 2024?

A. We are currently putting together the 2024 Medium-Term Business Plan (MTBP). One of the key points in this is how to allow for soaring raw materials prices. When formulating the 2021 MTBP three years ago, it was right at the time of COVID-19. Given this, we were expecting a rise in prices of several hundred million yen over the three years of the MTBP, but in reality we are now expecting a rise of JPY 14 billion. Nevertheless, while some raw materials will rise substantially in price, others will have less of an impact, so we will incorporate these factors into our profit structure. In the 2021 MTBP, there have been areas where the fruits of our investments are being reflected in the figures, so we are now looking at business plans with a firm determination to clear not just JPY 20 billion, but record-high operating income of JPY 21.2 billion during the 2024 MTBP. For fiscal 2024, we would like to aim for more than the current period forecast of JPY 18.7 billion. We are currently working on the plan, based on the assumption that raw materials prices will increase substantially in the future.

Q. The 2030 Business Plan includes targets of JPY 300 billion in net sales and an operating income margin of 12% or higher. Given that you are aiming for operating income of JPY 36 billion in 2030, this target may not be reached unless you achieve JPY 21.2 billion as soon as possible. When will you achieve JPY 21.2 billion? Will more progress for the 2030 target be made at the back end? And how do you feel about the speed of profit growth?

A. We are currently formulating the 2024 MTBP and hope to restore operating income as soon as possible. The net sales target of JPY 300 billion was set by backcasting from our vision for 2030. While it was a high target at the time, we are making steady progress, including through price revisions. Nevertheless, it is also true that progress in operating income has been slow due to the impact of soaring raw materials prices being greater than expected. Based on an extension of current conditions, achieving the operating income target of JPY 36 billion will be very difficult. We intend to achieve our targets for 2030 including through business in the U.S. and other foreign countries, inorganic growth, and new endeavors in exploration and research domains. Therefore, while we cannot say at this time when we will reach JPY 21.2 billion, we would like to return to this level as soon as possible.

Q. Slides 39–42 (Supplementary Materials) show your balance sheet approach. Can you share with us your thoughts on balance sheet management? What kinds of investments and cash allocations are you considering for the next MTBP? As part of this, will you return profits to shareholders? And what changes do you expect by adopting ROIC management from three perspectives?

A. Implementing ROIC management will be a key point in the 2024 MTBP.
(Slide 42) We will use ROIC management as a lever to optimize the balance between capital efficiency and business growth, aiming to sustainably improve profitability and achieve growth over the medium to long term, rather than the short term. The left side of slide 42 shows our financial strategy during the three years of the 2021 MTBP, and the right side shows the direction of our measures in the 2024 MTBP. In implementing ROIC management, we will formulate a companywide plan from the perspective of capital efficiency and optimize our business portfolio, and in each business, we will proceed to clarify points for capital efficiency improvement by using an ROIC tree. Individual investments will also be strictly managed from a perspective of capital efficiency. I think your question points to the need for quantitative indicators for these. ROIC management has been a topic of discussion since last year, and I believe that calculating ROIC for each of our businesses and taking steps, including structural reforms, to address the different environments and issues faced by each business will be one of the key points of the 2024 MTBP. We are currently working on the details, so would appreciate a little more time.

Q. Regarding the 2024 MTBP, will we be in a position to have a conversation about ROIC and the balance sheet based on quantitative figures, such as ROIC and business-specific WACC?

A. Once the ROIC and WACC have been indicated for each business, the most important thing will be how we respond. I plan to explain this point in some way in the 2024 MTBP.

Q. Given the slow progress in operating income margin, can you tell us what structural reforms will be required? Unless bold structural reforms are implemented in conjunction with ROIC management in the next MTBP, I do not see the target operating income margin of 12% being reached. Could you please tell us about your will and determination in this respect?

A. Targets for 2030 are not in any way being lowered. I think the most obvious place to achieve our targets is in the Confectionery & Foodstuffs business, but without structural reforms, we will not see any significant improvement in profit. Moreover, the Confectionery & Foodstuffs business alone will not be enough for us to reach our targets. We will have to create something new, something extra, something with an X factor, in all our businesses. It is in this direction that we will move with a resolute commitment.

Q. Could you tell us the background behind the JPY 0.1 billion downward revision to the full-year forecast for operating income in the United States business? Operating income margin was more than 20% for the first half of this fiscal year, but is projected to be less than 10% for the second half. You explained that you will significantly increase advertising investment, but hasn't the recent sales situation been worsening? Also, could you tell us the background behind the timing of this increase in advertising investment and what the objectives are?

A. In the United States business, we raised *HI-CHEW* prices by about 15% last November, and looking at changes in net sales, it is true that sales have slowed somewhat recently compared to the growth in sales volume two or three years ago. Not that there are any concerns about a significant slowdown: sales are still growing. As for operating income, the first half of this fiscal year saw significant contributions from the impact of price increases in particular as well as lower shipping costs compared to last year, resulting in a significant increase in operating income and an increase in operating income margin.
Our United States business, including *Chargel*, is still at the investment stage. *HI-CHEW* still has growth potential in terms of recognition rate, store stocking ratio and market share. Our market share is currently about 1.2%, but I hear from our US subsidiary that this could be extended to about 2%. Despite a sense of uncertainty about the future of the US economy, we will increase spending on advertising and conduct aggressive promotional activities in the second half of this fiscal year ahead of the 2024 MTBP. While operating income margin will temporarily decline, we will continue to invest solidly in marketing and work on expanding business scale.

Q. Could you tell us the background behind the downward revision to the full-year forecast for operating income in the "in-" Business and also your vision for future growth? I understand there have been many negative factors in terms of profit this fiscal year—including a drop in demand from the previous fiscal year for products due to COVID-19 and a surge in raw materials prices—but will you be able to get back on a growth trajectory of increased sales and increased profit in fiscal 2024 and beyond? Could you also please tell us about the measures and ideas you have for achieving this?

A. In my view, we must put the company on a path of increased sales and increased profit in fiscal 2024. Regarding demand for *in Jelly* by consumers suffering ill health due to COVID-19, while we understand the volume of products supplied directly to local governments and other such buyers, it is difficult to ascertain the sales volume at retailers and wholesalers in numerical terms. What I can say, however, is that the recoil from last year's exceptional demand is likely to continue until the third quarter. There will also be a tall hurdle to get over from the increase in demand last November that was experienced prior to the price revisions implemented last December.

According to SRI data, in-store sales have continued to grow by double digits, and the expansion of consumption situations and targets, such as for *Energy Glucose Boost* and *Full-o-Fruit*, has also led to growth in purchase rates.

Although we face an uphill battle in terms of shipment value this fiscal year, our plan is to switch to the offensive in the fourth quarter and to make additional advertising investments. With *in Jelly* as a core brand of the “in-” Business—one of our focus domains—we will work hard to bring about a solid increase in sales and profit in fiscal 2024 and beyond.

Q. In the next MTBP, can we again expect the launch of products like *Energy Glucose Boost* and *Full-o-Fruit* that capture new needs?

A. We will continue to roll out products to expand our target and promote consumption situations. Convenience stores currently have about three shelves of squeeze pouch jelly drinks, of which our *in Jelly* products account for 1.5 to just under two shelves. We are trying to cater to needs that are yet unmet by our products, for instance, products for children and complete nutrition products that contain a variety of nutrients. We have many products that we are testing to capture new demand, and we hope to bring them to market.

Q. On the subject of cost increases and measures to combat them in fiscal 2024 and beyond, I am aware of the current difficult cost situation due to soaring cocoa and sugar prices and the impact of a weakening yen. How do you currently see the scale of cost increases for fiscal 2024, and while I think price revisions will be inevitable, what measures do you intend to take?

A. Hikes in raw materials prices are uncertain and very difficult to predict. It varies depending on the raw material. Prices of cocoa beans and sugar are rising, but are easing for flour, fats and oils. Also, since there is a time lag until the impact of foreign exchange is reflected in our business results, the impact of the depreciating yen will also be a headwind for fiscal 2024. We are currently estimating the scale of cost increases for each of these ahead of planning for fiscal 2024.

As for price revisions, these are one of the measures that could be taken in response to soaring raw materials prices, but no decision has been made at this time. Until now, we have implemented price revisions within a certain range, such as for confectioneries as a whole. But with a general sense of slowdown in consumption being observed, we believe we will need to be flexible in our approach, including taking partial measures, in light of the competitive environment and cost situation.

Q. Could you give us a slightly more concrete picture of the structural reforms you have planned for the Confectionery & Foodstuffs Business?

A. We are planning to disclose ROIC for the Confectionery & Foodstuffs Business in the 2024 MTBP. I think disclosing ROIC will help shed light on the issues. Our target operating income margin for the Confectionery & Foodstuffs Business is 10% in 2030, and we expect it to be 3.8% this fiscal year. Based on an extension of current conditions, it is clear that achieving this goal will be difficult, so I believe that drastic reforms will be necessary. Specifically, not only will we consider increasing net sales through selection and concentration, but we will also consider reforms from an asset-light perspective. We are not lowering our 10% target operating income margin, and we intend to make significant changes.

Q. Prior to COVID-19, the operating income margin of the Confectionery & Foodstuffs Business was around 6–7%. What level do you think you will be able to achieve in the next MTBP?

A. We are currently estimating the extent of cost increases, including for raw materials, so we are unable to give specific figures at this time. We will explain specific structural reforms and targets for the Confectionery & Foodstuffs Business when we announce the 2024 MTBP.

Q. Even in such a tough external environment with soaring raw materials prices, you have aggressively invested in advertising and grown your top line. Do you think the strength of your brands and competitive advantage will continue to stay strong?

A. One of our competitive advantages is our technological advantage. At our R&D center, we have concentrated resources and conducted diverse research on three core technologies: the gelation technology of *in Jelly*, the soft candy technology of *HI-CHEW*, and the *Monaka* ice technology of the *Jumbo Group*. Our superior and unique technologies are hard for other companies to emulate.
Other advantages include our brands and differentiated quality. Take *Morinaga Biscuits* for example. Sales have been strong with the launch of new high-priced products, and we set a record high in the moving annual total of net sales at the end of September. I think this demonstrates that the *Morinaga Biscuits* brand is well accepted by our customers. Not surprisingly, we will continue to focus on strong brands and differentiated products.

Q. Is it correct then to think that you will continue to make investments, reap returns and make further investments to increase the competitive advantage of each of your brands and create a situation where competitors cannot keep pace?

A. Yes. We established our 2030 Business Plan and formulated the 2021 MTBP by backcasting from our vision of where we want to be. Having set targets for 2030, all our employees are aware of them and act accordingly, and we recognize that we will make the necessary investments to achieve those targets. In this process, we will respond swiftly to changes in the external environment, such as surging raw materials prices.