Wednesday, February 5, 2025

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Financial Results Briefing Q&A Session Overview for FY 3/2025 Q3

[Time and Data] Wednesday, February 5, 2025
[Speaker] Takashi Yano, Executive Officer and CFO

Performance

Q. Could you update us on the progress against the company plan? I believe there was a ¥4.0 billion positive variance in the first half, but a ¥4.0 billion negative variance in Q3. Does this mean the surplus is now gone?

A. Although Q3 was behind the plan, we still have a cumulative positive variance of about ¥1.0 billion We have specific measures in place for Q4, especially in the U.S., and we expect to achieve the initial plan.

Q. What was the main reason for the Q3 shortfall against the plan? Is it correct to understand that the progress in Q4 depends on the U.S.?

A. The primary reason was an unexpected drop in sales volume due to shelf space reduction in a U.S. distribution channel. Additionally, the price of domestically sourced palm oil in Brazil has surged beyond international market levels, but we addressed this with a price revision in this February. Furthermore, the Brazilian real has weakened against the yen, causing a divergence from the Q3 plan in yen terms. Another factor contributing to the negative variance against the plan is that NISSIN FOOD PRODUCTS has been spending more on promotional expenses to encourage a shift to higher-priced products in the domestic market.

Overseas Business

Q. The Americas segment saw a YoY ¥1.3 billion decline in Q3. Could you break down the extent of the decline for each country?

A. About half was in the U.S., with most of the remainder in Brazil. Although volume in Brazil are increasing, the weaker real and higher material costs have negatively impacted the results.

Q. Was the main reason for the U.S. decline in Q3 due to a reduction in volume, even after accounting for last year's special factors (consulting fees for the third plant)? Also, what was the core operating profit margin in the U.S. for Q3?

A. The main factor was indeed a reduction in volume, even though costs for paper cups, external warehouse usage, and ocean freight increased. The core operating profit margin remained in the mid-10% level.

Q. The volume in the U.S. decreased by a high single-digit percentage in Q3 compared to the previous year, largely due to a decline in major distribution channels. Could you provide the outlook for the full-year quantity? Is it achievable?

A. For the full year, we expect a low single-digit percentage increase, with a high single-digit percentage growth in Q4. We have strong distribution in club and value channels, and the initial shipments for promotions to these channels in December and January have positively contributed. According to the Nielsen data provided by Mr. Ihara, it appears there was a significant decrease in volume. However, some club channels are not included in the market data, so the actual sell-in has not declined to that extent.

Q. How are the new products HOTPOT and Ramen Bistro performing in the U.S.?

A. HOTPOT will be launched around this February and has received positive feedback from distributors. We have high expectations as it is a new type of product. Ramen Bistro had a weaker start than expected, partly because of reduced shelf space in the distribution channel.

Q. What is the channel-wise breakdown of instant noodle sales in the U.S.?

A. Walmart and grocery stores account for 60%, club channels 20%, and value channels 20%.

Q. Do you perceive the expansion of Korean brands as a threat?

A. While there are differences in product concepts, and we need more analysis to determine if they are direct competitors, the fact that young people are willing to pay higher prices is positive as it expands the previously minor instant noodle demand. While some may feel that Korean brands have suddenly appeared in the U.S., we have been competing with them in various Asian countries for years. We also launched a competing product called "Geki" a few years ago. Our products are also expanding steadily in Asia, and Korean products are not necessarily dominant in every country. This was evident during last year's market visit to Thailand. Korean brands focus on exports and set higher prices in overseas markets to compensate for low domestic margins. In contrast, we set appropriate price points, and in some countries, we have an advantage over Korean brands. With this experience, we believe we can compete effectively in the U.S. as well, leveraging our strength in the global instant noodle business.

Q. Are Korean brands currently occupying the main instant noodle shelves?

A. We recognize that Korean brands have entered the main shelves, but only in certain distribution channels.

Q. Could you provide details on the volume trends excluding specific distribution channels mentioned earlier? Also, how were the base and premium segments in Q3?

A. Excluding specific channels with shelf space reductions, Q3 volumes decreased by mid-single digits. Across all channels, volumes decreased by high single digits, with the base segment decreasing by double digits and the premium segment by high single digits.

Q. Which category, base or premium, was more affected by the loss of shelf space in specific distribution channels?

A. Comparing the base and premium products, the base products experienced a larger decline. However, for the base products, while shelf space was reduced in existing stores, the number of stores carrying our products in areas with high demand for instant noodles, where we previously had no distribution, has increased. For the premium products, although some shelf space has been reduced due to the entry of Korean brands, we are strengthening our efforts by launching new products for other channels such as club stores.

Q. How was the U.S. market in Q3 alone? Will it turn positive going forward?

A. In terms of sell-out, the market saw a low single-digit decline in volume but a positive growth in value. Considering the current macroeconomic environment in the U.S., we believe that the demand for premium products, which can be consumed as meals, will continue to grow. Currently, Korean brands are leading this trend, but we are enhancing our presence by launching new products.

Q. Was the shelf space reduction in major distribution channels due to specific reasons related to our company or the impact of overseas competitors?

A. The overall width of mainstream shelves in stores has increased, with Korean brands moving from Asian shelves to these spaces. The significant reduction in space is for our base products, with Japanese competitors' base products filling the gap. The impact on premium products from Korean brands is limited. Although we were initially unable to distribute base products to these major channels, we gained distribution during the pandemic when competitors faced supply constraints. This may have caused some reversion. However, we have increased the number of stores carrying our products in high-demand and high-population growth areas where we previously had no presence, and expanding in these areas is a future challenge.

Q. Given that the U.S. has not met the planned volumes in each quarter this fiscal year, how accurately have you been able to grasp the situation in the U.S.? Was there a delay in response due to a lack of understanding? If so, was it due to delays on the U.S. side or communication and response issues between the U.S. and HD? What are the management challenges in the U.S.?

A. Shelf space reductions are not notified in advance, and changes do not happen all at once on a specific day, so it took time to grasp the changes and situation in major distribution channels' stores. This may have been an issue.

Q. You mentioned aiming to achieve the profit plan for the full year by cutting costs. However, this could imply that previous spending was wasteful. Is there a possibility of reducing promotional activities in the future? Please explain your approach to cost control and spending for the next fiscal year.

A. Some of the expenses that were temporarily incurred last year have contributed to this year's profit growth. We do not believe that last year's spending was wasteful. In Q4, we will implement necessary measures in preparation for the next fiscal year, but we will review and minimize non-essential and non-urgent expenses as much as possible. The importance of generating profits is well recognized by the management, including the heads of our business corporations.

Q. Would volumes have grown in the U.S. without the shelf space reduction in major distribution channels? You mentioned a recovery in December; was it due to large initial shipments?

A. Excluding the impact of major channels, volumes in October-December decreased by mid-single digits (including major channels, volumes decreased by high-single digits). The growth in December was due to initial shipments to club channels, but January also saw strong shipments, so it is not just a temporary factor. We aim to achieve the plan by maintaining this momentum.

Q. The U.S. has maintained a high profit margin, but how should we view margins going forward? Given the current situation, additional expenses may be necessary. Will you accelerate efforts even if it sacrifices margins?

A. We expect an operating profit margin in the mid-10% level this fiscal year. Next fiscal year, we will face increased depreciation burdens from the new plant in addition to ongoing promotions, so maintaining a 10% to mid-10% level will be a challenge. We are currently examining the actions of Korean brands, but their aggressive push has revitalized the instant noodle market, providing opportunities for us to expand sales.

Q. Does the U.S. promotion activity include price promotions?

A. Yes, it includes price promotions as well as in-store and social media promotions.

Q. Do you know the import ratio in the North American instant noodle market, particularly from China? Does your company import from China?

A. We recognize that some Korean competitors import partially or entirely. Chinese imports have not been a significant topic. We import some packaging materials from China, but it is limited, and we can switch to domestic production in the U.S.

Q. Your company seems to perform well at the beginning of each quarter due to initial shipments but tends to lose momentum towards the end. Is it different this time? How do you feel about the measures targeting club channels starting in Q4?

A. The initial shipments have started well, and January is also performing well. We are promoting both base and premium products, not just premium new products. We have received positive feedback on premium new products, and while it is difficult to predict sustainability at this point, we are working to maintain the current momentum.

Q. Mexico is struggling with exports, resulting in weak volumes. How is the domestic sales situation?

A. We are working to strengthen distributors for exports. Domestically, traditional channels (TT) are performing well, but we are losing competitors in modern channels (MT). Competitors have increased supply due to improved production systems, and the price revisions we implemented in September-October may also have had an impact.

<u>**Domestic Business**</u>

Q. Could you explain the pricing strategy by area? Given the various cost increases, is there a need for price revisions in Japan next fiscal year?

A. We have not decided on a price increase in Domestic instant noodle business at this time. While wheat prices are falling, rice prices are rising, so we have already announced price revisions for rice products. We aim to cover the costs with volume growth and mix improvements. As wages rise, we expect higher-priced products to be purchased. If necessary, we may consider price revisions during the fiscal year. In the U.S., we are not in a position to lead price revisions. Our products are locally produced, so the impact of President Trump's tariff policies is limited. However, other companies, such as Korean brands that rely on imports, may be affected. We will monitor the situation closely. We have no plans for price revisions in China, given the uncertain economic outlook. However, we will record some impairment in China including Hong Kong this fiscal year, reducing the depreciation burden on fixed assets from the next fiscal year, which will be a factor for increased profits. The impairment amount is approximately ¥2.7 billion, and the reduction in depreciation burden from the next fiscal year will be in the low single-digit billions. Recently, we implemented price revisions in Brazil in July last year and February this year, and in Mexico from September to October, to address increased material costs.

Q. Is there a set level of profit at which you determine the necessity of price revisions?

A. There is no specific level set. We aim to increase volumes and improve the mix, and will consider price revisions flexibly based on the situation.