August 2024

Financial Results Briefing Q&A Session Overview for FY 3/2025 Q1

[Time and Date] 4:30 p.m. to 5:30 p.m., Tuesday, August 6, 2024
[Speaker] Takashi Yano, Executive Officer and CFO

Performance

Q. Why is the initial plan for FY 3/2025 so conservative when the core operating profit of existing businesses is on an upward swing in Q1?

A. Q1 results exceeded our initial plan. This plan leaves room for an upward swing for the full year if we maintain such levels. Previous quarterly profits have varied widely, but we plan to have no significant differences in quarterly profits for this fiscal year.

Q. Are there any risks or assumptions that we should be aware of given this potential upward swing in the initial plan for FY 3/2025?

A. It is difficult to say at this time given the unclear future exchange rates and their effects on rising material costs, converting overseas profits into yen, and numerous other uncertainties. If we use fewer expenses than anticipated, leftover funds could be applied to long-term investments, like marketing activities

Q. Please provide more details by segment on profit upswings, downswings, and performance in line with expectations, given the favorable progress in Q1 compared to the initial plan. Also, what is your outlook for Q2 and beyond?

A. Profits in all segments exceeded our internal plan, with significant increases in our domestic business segments and EMEA in particular. While the Company has a history of losing significant profits in Q4, our current plan will generate profits more evenly throughout the fiscal year.

Q. You mentioned that operating profit in Q1 exceeded the internal plan. Please provide more details by segment on amount levels and details of the upswings.

A. Overall profits exceeded the internal plan by several billions of yen (approximately 3-4 billion yen). By business and region, the Domestic Instant Noodles, Confectionery / Snack, and Chilled / Frozen Foods Businesses and the EMEA region increased to similar degrees. The upswing in the Americas and Asia was a bit smaller, and profits in China were in line with the plan. Overseas, profits increased mainly due to a general decline in material costs and positive impacts in foreign currency translation. On the other hand, domestic material costs were nearly in line with the forecast, and the delay of certain expenses in other categories also affected this profit increase.

Q. You mentioned that the proportion of quarterly profits will differ from previous plans and will not necessarily fall significantly in Q4. Does this mean you plan to use expenses proportionally? Or have you made significant changes to Company policies?

A. We have not made any policy changes. The overseas plan in the U.S., for example, is more heavily weighted toward the second half of the year. Overall, we are planning for more profits in the second half of the year than in the first half. However, Q4 profits in Japan will remain smaller in Q4 compared with other quarters, as in the past.

Domestic Business

Q. Please provide an analysis of the profit fluctuations for NISSIN FOOD PRODUCTS.

A. Increased profit due to higher sales offset the impact of raw material costs, distribution costs, and General and administrative expenses, resulting in a 500 million yen increase in profit.

Q. I understand the April-May revenue increase reported by NISSIN FOOD PRODUCTS to be the result of the upward price revision, compared to the year-ago results prior to the revision. To this end, I expected the Company to forecast an increase in sales if volume is level year on year. Why does the forecast not seem to reflect these numbers? Is the difference due to the use of selling expenses?

A. We experienced a last-minute surge in demand before the price revision last April-May, resulting in slightly weak sales for the same period this year due to the rebound from such demand. I think this appears a slightly weak positive impact on revenue, as sales volumes were flat after the recovery in June. Given our leading position in the market leader, our product mix is improving steadily, despite the use of certain selling expenses to recover from price-conscious products to regular products.

Overseas Business

Q. Overall profit for the Americas decreased by 200 million yen, but how much did profit fluctuate and what were the profit margin levels for the U.S., Mexico, and Brazil, respectively?

A. Profits in Brazil increased by high single-digit billions of yen, while profits in the U.S. and Mexico decreased, amounting to a 200 million yen total decrease for the Americas as a whole. The profit margin in the U.S. remained just under 20%, a high level compared to the prior years. The profit margin in Brazil also reached double digits. Mexico reported a mid-single-digit profit margin due to weak sell-ins stemming from an increase in temporary distribution inventories. The profit margin for the Americas as a whole amounted to about 15%.

Q. Profits in the U.S. decreased in Q1 year on year, but did the profit margin improve?

A. While the profit margin may appear weak due to lower profits, we have maintained a high profit margin compared to previous years, and the actual margin of Q1 exceeds plans. Unit prices also declined temporarily in Q4 of the previous fiscal year due to enhanced sales promotions but have been recovering since. Sales volume has remained almost at the same level year on year, despite the slight decrease due in part to higher sales promotion expenses.

Q. The Q1 core operating profit margin is about 20% in the U.S. Why is the profit margin so high, and do you think it can be maintained at this level going forward?

A. The profit margin is high due to the downward trend in raw material price and lower-than-expected costs of converting to paper cups compared with our initial plan. We also used fewer sales promotion expenses and other certain costs than anticipated in our initial forecast, which may contribute positively to future profits. However, tariffs on imported materials may rise depending on the outcome of the U.S. presidential election. Such tariffs may hurt profits and require close monitoring.

Q. How is the growth performance of the premium products being strengthened in the U.S.?

A. Demand for base products tends to be extremely strong due to the challenging environment of the U.S. economy. To this end, we are building up inventories of premium products in preparation for the increased demand stemming from back-to-school shopping in Q2. Sales are trending upward as of July, and we assume premium products will further increase from August.

Q. Why are sales of premium products weak in the U.S.? These weak sales do not seem to be in line with market expectations. Is the actual demand slowing?

A. The demand for premium products in particular is not declining. While our year-on-year growth rate for instant noodles as a whole is higher than that of the market, current consumption trends show rising demand for cheaper products. Demand for premium products may seem to be slowing due to such trends, but the Company recognized strong sales of premium products and upward trends in July despite this environment. Rather, premium products remained flat year on year in Q1 due to an increase in distribution inventories resulting from aggressive promotions and sales promotion activities in Q4 of the previous year, aiming for growth in the 10% range of the initial plan for the full year.

Q. Although you mentioned that premium products are performing well in the U.S., the actual figures feel underwhelming. Are sales of premium products actually growing?

A. We reported a positive Q1 sales volume growth rate that surpasses mid-single digit growth, surpassing the positive low-single digit rate in overall U.S. market. The *+low-single digit %* indicated under volume on page 10 of the financial results presentation depicts sell-in figures. Note that it is necessary to use sell-out figures when analyzing market comparisons. There is a discrepancy between the figures in question with the figures on this page, as you sell-in figures do not always match sell-out figures. The ratio of premium products amounted to slightly below the mid-40% range, down slightly year on year.

Q. Will premium products really be accepted in the U.S.?

A. One reason behind the recent sharp decline in U.S. stock prices, is the growing sense of uncertainty in the U.S. economy. Such uncertainty is forcing McDonald's to continue its cheaper $5 menu, amongst other situations. We believe this environment offers growth potential for affordable products as an alternative to eating out. Given these circumstances, we believe that consumers who typically have eaten more expensive products outside of instant noodles are likely to consume our premium products as a meal at a higher rate than low-income consumers who mainly consumer our base products.

Q. How is competition in the U.S.? Are you concerned about overcapacity given the enhanced facilities of other companies attained through launching new plants?

A. The market data we use does not include information on certain competitors, but we believe that the overall instant noodle market is also growing in the U.S. Data indicates that our sales are growing in terms of volume and our market share has remained flat. We are not aware of any competition overtaking the shelfs at the retail storefronts of major supermarkets, nor are we aware of any threatening competitors. We will dispel any concerns about overcapacity by constructing new plants to increase the supply of premium products and differentiate us from competitors whose strength is in base products.

Q. You mention that volume growth and sales growth in overseas business is in the high-single digit percentages and the single-digit percentages, respectively. Does this indicate that unit prices are declining? Are unit prices falling in the U.S. and Hong Kong while rising in Brazil?

A. Unit prices appear to be declining in overseas operations in part due to our use of selling expenses, particularly in the U.S. and Brazil. While unit prices may appear to be falling in the U.S., this is mainly the effect of the significant impacts from changes in our product mix. Unit prices appear to be falling due to the growth of base products, which have relatively low unit prices. Unit prices for base and premium products either declined slightly from the previous year or remained almost the same. In Mexico, profits declined due to a temporary buildup of distribution inventories and stagnant sell-in growth. However, current sell-out growth is strong are currently strong and we expect no future problems as long as inventories are cleared.

Q. Unit prices appear to be weak overall. Is it correct to understand that if the product mix improves from Q2 with the growth of premium products in the U.S., that there is a possibility that unit prices will improve overseas as a whole?

A. As mentioned earlier, we are using selling expenses in the U.S. and Brazil. We are not aware of unit prices falling in any another particular region.

Q. Why have overseas logistics costs increased significantly year on year? And will these costs continue to increase from Q2?

A. We are making strategic enhancements to production and building up inventories in the U.S. for the sales promotion beginning in Q2. As a result, we reported a temporary increase in external warehouse expenses, which led to an increase in distribution costs. These costs are a one-time expense that we expect will decrease as sales grow and inventories decline.

Q. How is the situation regarding the use of selling expenses in Brazil and the U.S.?

A. Brazil implemented a price revision in July that will have positive effects on profit levels. We are maintaining a high profit level compared to the previous high-single digit profit margin. In the U.S., we achieved a high rate of volume growth in the compared to the market while using fewer selling expenses than planned for the current quarter. We plan to monitor sales and adjust future use as need, but we could see an upside in profits if sales are favorable.

Q. Why does the profit margin in Brazil appear low given the growth in volume and the remaining effects the price increase from the previous year?

A. We are making strategic use of selling and marketing expenses due to production troubles leading to the loss of a portion of our market shares. But our profit margins are higher than previous levels, with both revenue and core operating profit improving steadily.

Q. Please comment on the sustainability of the production system in Brazil. I assume the current plant will stay in full operation until the launch of the new plant, but are there any issues with the facilities? Will production be possible even future volumes continue to grow?

A. The issues in the previous year were caused by the increased speed and production line efficiency, but these issues have since been resolved. We also increased supply capacity, so we are unlikely to face production issues before the launch of the new plant. As for the production system, we already established a system to dispatch personnel with experience in Japan to respond immediately to any problems that may arise. We do not have any particular concerns regarding system sustainability.

Q. A major competitor in Mexico revised its prices in April; did you also implement a price revision? Also, to what extent is volume growing in Mexico?

A. We have not implemented a price revision at this time. Sell-out volumes are steadily growing at double-digit rates year on year, outpacing the growth of our competitors. Our market share is also expanding accordingly. We will monitor market reactions and decide on price revisions going forward.

Q. Does the increase in profit in Asia from Thai President Foods include temporary factors? Also, what is the future outlook of the region given that profits declined in other regions of Asia? Finally, it appears that the lower profit reported by Mareven Food Holdings is impacting EMEA results. Please indicate if the Company has made any forecasts regarding the elimination of this decline in profit.

A. We forecast a year-on-year increase in Thai President Foods and NURC. There are no particular temporary factors contributing to the upward swing in Q1 and declining raw material prices are having positive effects on performance. Current performance in Asia is not weak. Rather, there was a slight one-time increase in costs due to a change in cup measurements in Thailand. In Indonesia, sales faced negative effects from the dates of Ramadan and Lebaran, the dates of which differ based on the lunar calendar. The outlook for Mareven Food Holdings in EMEA is unclear due to higher domestic wheat prices in Q1 in Russia. Wheat is subject to government price controls, making it difficult to forecast. Premier Foods is likely to perform in line with the plan, remaining nearly flat compared to the previous year. NISSIN FOODS EUROPE continues to perform well, reporting double-digit growth in both revenue and profit. The supply capacity of bag-type instant noodles increased in line with the operation of our new lines, with supply likely to continue to increase.

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