



LIXIL Corporation

Q2 Financial Results Briefing for the Fiscal Year Ending March 2024 for Investors and Analysts

October 31, 2023

Event Summary

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[Participants]		
[Number of Speakers]	3	
	Kinya Seto	Director, Representative Executive Officer, President, and CEO
	Sachio Matsumoto	Director, Representative Executive Officer, Executive Vice President, and CFO
	Kayo Hirano	Senior Vice President, Leader, Investor Relations Office
[Analyst Names]*	Sachiko Okada	Goldman Sachs
	Yoshihiro Nakagawa	Mizuho Securities
	Masashi Miki	Citigroup Global Markets
	Hiroki Kawashima	SMBC Nikko Securities
	Daisuke Fukushima	Nomura Securities
	Hiroki Watanabe	Morgan Stanley MUFG Securities

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North America 1.800.674.8375
Email Support support@scriptasia.com



Hideaki Teraoka
Masahiro Mochizuki
Ryo Yagi

Daiwa Securities
CLSA Securities
Mitsubishi UFJ Morgan Stanley Securities

*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A or whose questions were read by moderator/company representatives.

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Presentation

MC: Now it's time to begin the financial results briefing of LIXIL Corporation for Q2 of the fiscal year ending March 31, 2024. This briefing is being conducted via live internet streaming. Thank you very much for your cooperation.

Let me begin by introducing today's attendees. This is Kinya Seto, Director, Representative Executive Officer, President, and CEO. This is Sachio Matsumoto, Director, Representative Executive Officer, Executive Vice President, and CFO. This is Kayo Hirano, Senior Vice President, Leader, Investor Relations Office and Leader, Finance & Treasury Corporate Accounting & Treasury/Tax. I am Kawai from the Investor Relations Office and will be the moderator for today's meeting.

Please refer to the presentation materials posted in the investor relations section of the Company's website.

I will then explain today's proceedings. First of all, Mr. Seto, President and CEO, will explain the financial results for Q2 of the fiscal year ending March 2024. After that, there will be time for questions and answers. If you have any questions, please enter your company name, your name, and your question using the Q&A button displayed at the bottom of your screen. We would like to limit your questions to two per person. Questions are always welcome.

The event is scheduled to end at 6:00 PM. Please stay until the end.

Now, Mr. Seto will explain the financial results for Q2 of the fiscal year ending March 2024. Mr. Seto, please start.

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> KEY HIGHLIGHTS

Summary of results for H1 FYE2024

Revenue was flat while Core Earnings increased year-on-year for H1 (6 months) FYE2024

- Revenue was flat year-on-year. Core earnings increased by JPY2.7 billion to JPY8.8 billion
- For international businesses, the biggest challenge was weak demand in Europe
- Despite the headwind of higher procurement costs due to JPY depreciation for the Japan business, the gross margin gradually improved due to stabilization of variable costs such as raw material prices, component prices, and the transfer of cost increases to selling prices
- Higher fixed costs due to a decline in sales and production volume continues to be a challenge for profitability recovery. Structural reforms are underway to improve management resilience, particularly in international businesses
- Full-year dividend forecast remains unchanged. Resolved interim dividend of JPY45

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Seto: Hello, everyone. I will now explain the details of the financial results for Q2 of FYE2024.

As usual, I would like to start with today's key highlights.

The H1 results show a decrease in revenue and an increase in core earnings compared to the same period of the previous fiscal year. Revenue was almost unchanged YoY, but this is due to the impact of foreign exchange rates, so excluding the foreign exchange impact, the volume has dropped. Revenue was particularly decreased in Europe, but housing starts have been decreasing not only in Europe, but also in all of the US, China, and Japan. Core earnings increased by JPY2.7 billion YoY to JPY8.8 billion.

The major issue among them is the international business, especially in Europe, where demand has been weak, the worst in the past 40 years. Other countries were also in bad situations, but the US improved in Q2 YoY, and China's performance was not particularly bad compared to last year.

At the same time, the Japan business has been doing better in terms of gross profit, but not in terms of volume. In particular, the number of owner-occupied houses has decreased significantly. Although we are trying to shift more and more to renovation, the ratio of new construction is still high, and I believe that the increase in fixed costs is becoming a very large burden.

On the other hand, I don't think that Japanese market will grow very much in the future, but I believe that European and the US market will eventually make a major recovery, although it is still uncertain when that recovery will take place. And once they start to recover, they will grow. We would like to prepare for such an opportunity by first promoting structural reforms in order to reap a large harvest as a result of these structural reforms. That is part of the costs we saw in this fiscal year.

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There is no change in the dividend forecast for the full year.

› KEY HIGHLIGHTS

Summary of results for H1 FYE2024 (continued) and business outlook

H1 (6 months) FYE2024 results (overview by region)

- **Japan**
Although demand for new construction remained sluggish, the penetration of price optimizations and increased profits due to higher renovation demand for home insulation products contributed significantly to profitability improvement
- **International**
Earnings mainly affected by continued sluggish demand in Europe

H2 (6 months) FYE2024 outlook

- **Japan**
Although the recovery of demand for new construction needs to be monitored closely, renovation demand for insulation products continues to be strong, and continuing solid demand is expected from next year onward. We are implementing additional sales measures to raise our market share with the normalization of the competitive environment
- **International**
Despite the continued difficult business environment, mainly in Europe, positive effects of structural reforms underway are expected to be realized from Q4

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As for today's highlights, the H1 results show that demand for new construction was still sluggish, especially for owner-occupied houses, and the drop in demand for owner-occupied houses is now particularly severe. For companies such as ours that have relied heavily on new construction, the situation has become more difficult, but at the same time, we have finished our price optimizations early. Then, increased profits from the growing renovation demand for heat-insulation products are contributing to improved profitability.

With regard to the international business, as I mentioned earlier, the worst situation for the first time in 40 years in Europe has a major impact, and since Europe is our main source of earnings, it is the main factor that is putting pressure on our earnings.

On the other hand, in H2, we do not have high expectations for the recovery trend in demand for new construction in Japan. However, we believe that renovation demand for heat-insulation products will be strong as we are entering a seasonally demanding period.

In addition, as I mentioned earlier, we raised our prices earlier, and I think we lost more market share than the decrease in new construction, especially in H1. This is gradually showing a recovery trend. We are now recovering our market share because other companies have caught up with us by raising their price. Therefore, we have been performing well in the area of insulation renovation as well as recovering market share, so in this sense, we believe that in H2 we will be better for Japan.

As for international business, as I have been repeating for some time now, we thought that we could see some positive signs a little earlier in Europe, but we have not been able to see them yet. So, we have no choice but to promote structural reforms.

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Structural reforms have been carried out mainly in the US and Europe, and the effects in the US will start to emerge in around Q4, and we actually spent some money in Q2.

> H1 FYE2024 PERFORMANCE HIGHLIGHTS

Core Earnings increased year-on-year

- **Revenue: JPY732.2 billion, down JPY0.4 billion year-on-year**
 - Q2 (3 months) YoY: +1% in Japan and -2% in international markets (-9% excluding foreign exchange impact)
 - H1 (6 months) YoY: +1% in Japan and -4% in international markets (-11% excluding foreign exchange impact)
- **Core earnings: JPY8.8 billion, up JPY2.7 billion year-on-year**
 - Q2 (3 months) breakdown: JPY2.8 billion in LWT Japan, JPY0.7 billion in LWT International, JPY10.3 billion in LHT, and -JPY8.7 billion for consolidation adjustment/other factors
 - H1 (6 months) breakdown: JPY8.2 billion in LWT Japan, -JPY0.8 billion in LWT International, JPY18.6 billion in LHT, and -JPY17.1 billion for consolidation adjustment/other factors
- **Profit for the quarter⁽¹⁾: JPY0.5 billion, down JPY3.2 billion year-on-year**
 - Profit before tax decreased JPY7.4 billion primarily due to the absence of last year's gain on the transfer of land and other assets, and an increase in finance costs

LIXIL (1) Profit for the quarter = Profit for the quarter attributable to owners of the parent

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As I mentioned earlier, revenue was almost the same compared to H1 FYE2023, but revenue for the Japan business increased slightly due to the effect of price hikes. International business, excluding the foreign exchange impact, has actually gone down. The situation has been very difficult, especially in Europe.

Core earnings were almost in line with the forecast of JPY8 billion. This is slightly better than the previous fiscal year. This is getting better and better, but I still think it will be difficult to make a significant increase in earnings without the recovery of Europe. This is the current situation. It is not getting worse, but rather is getting a little bit better, which is probably the situation in international markets today. In the Japanese market, I think that the recovery of market share has been relatively steady, and the situation is improving.

Regarding profit for the quarter, last year we recorded a gain on the transfer of land, but this year, on the contrary, there was a loss on some of the assets we sold, and the difference caused a slight decline.

When we look at IFRS, we always tell you to look at core earnings, because there have been cases over the several years, or perhaps two or three years, where our company has had to sell various assets, or in some cases, dispose of them. We may sometimes have a loss, and at other times, we may have a gain.

Of course, we no longer have such large assets as Permasteelisa and VIVA, but there may be some fluctuations in the process of selling other small items. This year, unlike the previous year, profit before tax decreased in such areas.

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› H1 FYE2024 CONSOLIDATED BUSINESS RESULTS

JPY billion	H1 (6 months)				Q2 (3 months)		
	FYE2023	FYE2024	Increase/ decrease (YoY)	%	FYE2024	Increase/ decrease (YoY)	%
Revenue	732.7	732.2	-0.4	-0.1%	373.1	+0.7	+0.2%
Gross Profit	229.3	234.1	+4.9	+2.1%	118.5	+5.6	+5.0%
(%)	31.3%	32.0%	+0.7pp	-	31.8%	+1.5pp	-
SG&A	223.1	225.3	+2.2	+1.0%	113.4	-0.3	-0.2%
Core Earnings (CE) ⁽¹⁾	6.2	8.8	+2.7	+43.6%	5.1	+5.9	-
(%)	0.8%	1.2%	+0.4pp	-	1.4%	+1.6pp	-
Profit for the quarter including Discontinued Operations ⁽²⁾	3.7	0.5	-3.2	-86.8%	0.1	+2.1	-
EPS (JPY)	12.85	1.70	-11.15	-86.8%	0.39	+7.43	-
EBITDA ⁽³⁾	46.4	48.6	+2.2	+4.6%	25.1	+5.6	+28.9%
(%)	6.3%	6.6%	+0.3pp	-	6.7%	+1.5pp	-

- **Gross profit margin:** Increased by 0.7pp YoY
- **SG&A expenses:** Despite a decrease in logistics cost due to lower sales volume, increased by JPY2.2 billion YoY (Japan JPY4.7 billion decrease, International JPY1.3 billion increase, forex effect JPY5.6 billion increase) mainly due to personnel expenses for the international business, including forex impact. SG&A ratio increased by 0.3pp
- **CE margin:** Increased by 0.4pp YoY



- (1) Equivalent to "Operating profit" of JGAAP
 (2) Profit for the quarter attributable to owners of the parent
 (3) EBITDA=Core earnings + Depreciation + Amortization

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As for the consolidated business performance, therefore, core earnings improved somewhat, but it may be difficult for us to fully recover core earnings unless revenue in Europe improves. By reducing costs where we can and then increasing revenue where we can, we are now gradually recovering profits.

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› H1 FYE2024 BUSINESS RESULTS BY SEGMENT

LWT revenue and profits decreased due to sluggish demand in Europe and the Americas. Profitability for LHT improved due to price optimization and higher sales of renovation products for insulation

JPY billion		H1 (6 months)			Q2 (3 months)	
		FYE2023	FYE2024	Increase/ decrease (YoY)	FYE2024	Increase/ decrease (YoY)
LWT	Revenue	446.1	436.1	-10.0	222.0	-3.1
	CE	20.7	7.3	-13.3	3.6	-3.9
LHT	Revenue	293.2	300.9	+7.6	153.5	+3.2
	CE	6.0	18.6	+12.6	10.3	+7.4
Consolidation, Adj. & Other	Revenue	-6.7	-4.7	+2.0	-2.4	+0.6
	CE	-20.5	-17.1	+3.4	-8.7	+2.4
LIXIL	Revenue	732.7	732.2	-0.4	373.1	+0.7
	CE	6.2	8.8	+2.7	5.1	+5.9

H1 impact from segment reclassification⁽¹⁾
 LWT: Revenue JPY0.0 billion, CE -JPY1.6 billion
 LHT: Revenue -JPY3.6 billion, CE +JPY1.4 billion
 Consolidation adj.: Revenue +JPY3.6 billion
 CE +JPY0.2 billion

Forex impact⁽²⁾
 H1 6 months: Revenue +JPY18.9 billion, CE +JPY1.1 billion
 Q2 3 months: Revenue +JPY10.1 billion, CE +JPY0.6 billion

LIXIL (1) Reflects reclassification of a subsidiary from Q1 FYE2024 to encompass both LWT and LHT (originally classified only to LHT), reflecting its P&L impact. The reporting segments changed to LWT and LHT
 (2) Forex translation effect gain(loss) from international subsidiaries

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In this sense, in Q2, revenue of LHT has been strong, and as sales of renovation products for insulation, for which demand has been very strong since April, has been steady so far. In addition to this, the market share of sashes and exteriors, for which we had raised prices for new construction ahead of competitors, has finally returned since September, which I think is a good sign.

As for LWT, we have raised the prices of almost all of our products ahead of competitors, and now all competitors have caught up with us. Consequently, our market share is recovering, which is also a good sign.

However, we would like to keep an eye on the recovery of Europe, which is the biggest earner, as the most important factor for the future.

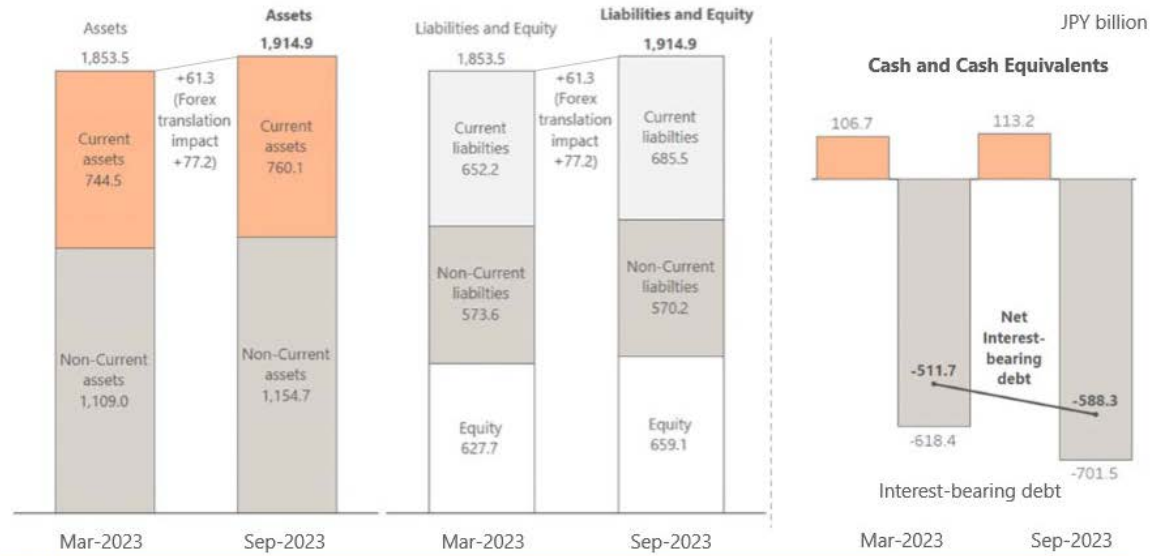
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› CONSOLIDATED FINANCIAL POSITION

The total assets increased slightly, due mainly to foreign currency translations. Interest-bearing debt increased due to an increase in working capital and fund-raising for bond redemptions. Equity ratio is 34.3%



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The equity ratio has improved slightly, but there is a foreign exchange impact.

In the meantime, as part of our Declaration for Building Partnerships initiative, we have decided to hold accounts payable with suppliers for a shorter period of time, as requested by the government, and this has required us to increase working capital by about JPY60 billion. Interest-bearing debt has increased due to such factors.

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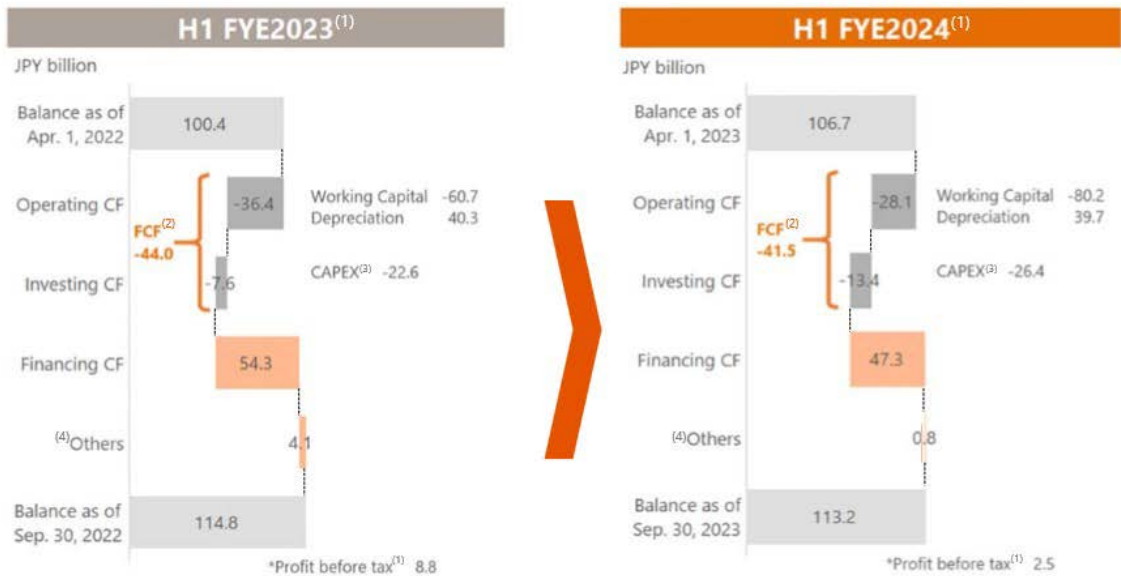
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➤ CASH FLOW STATUS AND CASH BALANCE

Free Cash Flow (FCF) increased by JPY2.5 billion due to inventory reduction, partially offsetting a decrease primarily in trade payables in response to the “Declaration for Building Partnerships” initiative



(1) Includes discontinued operations
 (2) “FCF” = Operating CF + Investing CF
 (3) CAPEX = Purchase of property, plant and equipment +

Purchase of intangible assets (Excluding Right of use assets in IFRS16)
 (4) “Others” = Effects of exchange rate changes + Net increase (decrease) in cash and cash equivalents included in assets held for sale

As for cash flow, there was a negative impact from a decrease in trade payables as I just said, but this was offset by a large reduction in inventories, resulting in a JPY2.5 billion improvement YoY.

We believe that there is room to reduce inventories further in the future, and we believe that we can improve our operating cash flow in this area.

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Question & Answer

MC [M]: Then, we will now have time for questions and answers. If you have any questions, please click the Q&A button at the bottom of the screen. On the input screen, please enter your company name, your name, and your question, and then submit it.

Now let me introduce the first question. We have received two questions from Ms. Okada of Goldman Sachs.

Okada [Q]: First question. Housing sales have been strong from Q1, but will this continue in Q3 and beyond? The government is likely to continue subsidies in some form, but will the positive impact continue in the next fiscal year and beyond?

Seto [A]: We believe it will certainly continue. Basically, although subsidies were a trigger, the cost of energy has been rising remarkably. In Germany and other countries, word of mouth has been spreading that the house has become warmer and the air conditioner has worked better as a result of the renovation of the housing sashes, and now we hear such review in Japan as well. I believe that this positive impact will continue.

Okada [Q]: Second question. The negative trend continues in both the US and Europe. What is your company's outlook for the impact on the valuation of goodwill and intangible assets?

Matsumoto [A]: Thank you for your question. I understand that you are concerned about signs of impairment of goodwill and intangible assets.

As mentioned earlier, the performance of the US in particular is showing signs of recovery. And inventories are also decreasing, so both of these factors have a positive effect on the calculation of future cash flows.

On the other hand, there was an increase in interest rates between Q1 and Q2, which would have a negative impact on the calculation of future cash flows. From the results of the calculation based on the positive factors and the negative factors I just mentioned, it is decided that there would be no need for impairment, and this has been judged appropriate by the auditing firm. So, we announced the current financial results.

Europe is a highly profitable market to begin with, and we see no signs for impairment, in spite of the recent increase in interest rates. We have received such opinions from our auditing firm.

MC [M]: Next, we have two questions from Mr. Nakagawa of Mizuho Securities.

Nakagawa [Q]: First question. What is your outlook for H2 and beyond, given the ongoing difficult business environment in Europe? Other companies' financial results stated that the negative impact of heat pump subsidies continues in Germany, and the economy itself continues to soften. Is there a possibility of bottoming out in the next term?

Seto [A]: Yes. I believe that the difficult business environment will continue for some time. However, I believe that the negative impact from heat pump subsidies is subsiding. This is because we have received information that there is a continuing overstock of heat pumps themselves.

More than that, the key is Europe. After all, interest rates have been rising and the discounted cash flow has caused the assets to drop. In this sense, while asset prices are falling and other prices are rising due to inflation, I think people have been choosing to buy or invest in other products whose prices may change tomorrow, rather than investing in housing-related items. Therefore, we believe that the factors that may change the most are interest rates and inflation.

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However, as announced last week, in Europe, interest rates will not be raised this year, and there is no indication of a stance to aggressively raise rates next year and beyond.

The other factor is inflation, which is also clearly slowing down. One factor that is not clear is whether or not interest rates will be raised to cope with inflation when oil prices rise, which may be caused by the Israeli issue. However, in Europe, the growth rate of Germany has been negative, so I think it would be difficult to take such a step. If so, I think there is a possibility that overall interest rates will not be raised next year, and if inflation is reduced, then things may improve.

As far as we know, there is no more destocking by our customers and the inventory level of our dealers or distributors is almost stable. I think, therefore, the key is to have confidence in demand for end users.

The situation is becoming a little strange, as is the case in the US, but in Europe as well, demand itself is very strong, but I think they may feel that if they invest money now, it will probably drop again. So, I think there may be a pent-up demand.

In addition, although heat pumps have not gone all the way, I believe that customers who have installed heat pumps will naturally have to replace plumbing next, so I believe that at some point it will be on the upswing.

If by next term you mean the period beginning next April, I believe there is a natural possibility of bottoming out during the term. When we made this forecast, we thought we would see some signs of improvement by the end of the year, but I think it will be tough. I think there is a good chance that this will be the case somewhere in the next term.

Nakagawa [Q]: Second question. What measures do you see the need to take in the future to stimulate demand for water-related renovations in Japan and link this to business performance?

Seto [A]: First of all, considering that our company has seen an enormous increase in heat-insulation renovations this time, I think it is important to promote additional renovations to customers who have undergone such heat-insulation renovations. Of course, as a broader goal, we need to expand the scope of insulation to include not only windows but also walls, but this is a bit of a medium-term discussion. If we are trying to do this in the short term as much as possible, it is important for us to expand from windows.

Conversely, I believe that the reason why our competitor has traditionally been stronger than us when it comes to water-related renovations is that they are strong for plumbing contractors. I believe that plumbing contractors choose our competitor, so we have to think about a different playing field. In that sense, I think one thing that could be done is to remodel from windows.

MC [M]: Next, we have two questions from Mr. Miki of Citigroup Global Markets.

Miki [Q]: Regarding core earnings, what was the reason for the improvement in the H1 results YoY, which was JPY17 billion in consolidated adjustments? You are planning a negative JPY46 billion for the full year, but do you plan to see an increase in the negative consolidated adjustment in H2?

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RESULTS AND FORECASTS BY SEGMENT

	JPY billion	H1 FYE2023 Results			H1 FYE2024 Results ⁽¹⁾				FYE2024 Full Year Forecast			
		Japan	Intl.	Total	Japan	Intl.	Total	Total YoY%	Japan	Intl.	Total	Total YoY%
LWT	Revenue	201.6	244.5	446.1	200.3	235.8	436.1	-2.2%	429.5	515.5	945.0	+3.2%
	CE	10.8	9.8	20.7	8.2	-0.8	7.3	-64.5%	25.5	27.5	53.0	+12.2%
	CE margin	5.4%	4.0%	4.6%	4.1%	-	1.7%	-3.0pp	5.9%	5.3%	5.6%	+0.4pp
LHT	Revenue	280.0	13.3	293.2	288.4	12.5	300.9	+2.6%	583.0	23.5	606.5	+1.4%
	CE	5.6	0.4	6.0	18.0	0.7	18.6	+211.1%	32.5	0.5	33.0	+70.4%
	CE margin	2.0%	2.8%	2.0%	6.2%	5.2%	6.2%	+4.1pp	5.6%	2.1%	5.4%	+2.2pp
Cons. Adj. & Others ⁽²⁾	Revenue			-6.7			-4.7	-			-21.5	-
	CE			-20.5			-17.1	-			-46.0	-
LIXIL ⁽²⁾	Revenue	481.6	257.7	732.7	488.6	248.3	732.2	-0.1%	1,012.5	539.0	1,530.0	+2.3%
	CE	16.5	10.2	6.2	26.2	-0.2	8.8	+43.6%	58.0	28.0	40.0	+55.4%
	CE margin	3.4%	4.0%	0.8%	5.4%	-	1.2%	+0.4pp	5.7%	5.2%	2.6%	+0.9pp



⁽¹⁾ Reflects reclassification of a subsidiary from Q1 FYE2024 to encompass both LWT and LHT (originally classified only to LHT), reflecting its P&L impact. The reporting segments changed to LWT and LHT. Please refer to p.6 for details

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⁽²⁾ Difference between sum total of Japan and International in Revenue and Core earnings and "Total" is the amount of consolidation, adj. & others

Matsumoto [A]: I assume that you are asking about what is described on page 20 of the presentation material.

Under the title of results and forecasts by segment, the consolidated adjustment for H1 of last fiscal year was a negative JPY20.5 billion, and negative JPY17.1 billion for H1 of this fiscal year, which is a decrease of about JPY3 billion. In other words, you mean that there is an effect of boosting profits.

As I mentioned earlier, the inventory is decreasing. This is a bit accounting story, but the portion of inventory that would have originally been profitable if sold outside the Company must be reduced from an accounting perspective. The inventory is lower this year than last year, so the adjustment for the reduction is lower. This is one of the big reasons.

In addition, the full-year figure is negative JPY46 billion, which is a large amount, but I would like to answer that there are two main reasons for this. One is that we are looking at risks from a company-wide perspective here, as some of the full-year forecasts for each organization are difficult to predict. The other is costs for structural reforms. These are the two main reasons. Therefore, risk assessment and restructuring costs are included in this JPY46 billion.

MC [M]: Next, we have a second question from Mr. Miki.

Miki [Q]: Geopolitical risks are increasing in the Middle East. Is there any change in business environment in the Middle East? Is there a possibility of a decline in consumer confidence or stagnation in the supply chain?

Seto [A]: Frankly speaking, I believe that the Middle East is going to get rather better. It will depend on how the geopolitics change, but the biggest demand in the Middle East is still Saudi Arabia and then the UAE. We believe that the likelihood of political, social, or military tensions escalating in this area is very low at this point.

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On the other hand, the actual outcome from higher geopolitical risk in the Middle East is the increase in price of oil. Saudi Arabia is in the midst of a construction boom at this point, and I think that fund will increase further there. As for the Middle East, especially with regard to Saudi Arabia, it is not simply a matter of more money for the country, but also of spending that money on young people, who are a very large portion of the population.

Probably the biggest housing rush in the entire world right now is in the Middle East. Each project will create hundreds of thousands of homes, and the rush is on to even exceed a million or so projects in terms of planning alone. Therefore, with regard to Saudi Arabia, I believe that we will see quite high growth in the future.

In terms of potential supply chain stagnation, we make very few things in the Middle East, so for now, the focus will ultimately be on delivery to the Middle East. However, in Saudi Arabia, we are being asked to buy Saudi Arabia, and there is a possibility that localization may be required in the future, so there may be such ups and downs. In the meantime, to answer your question again, geopolitical risk itself in the Middle East is not likely to be an issue. In fact, it has been a phenomenon from the past to increase demand in the Middle East, and especially in places like Saudi Arabia and the UAE, where geopolitical risks are low, I think the problem is not so great.

We do very little business in Israel and have only about 10 employees there, so we do not expect any major damage.

MC [M]: Next, we have two questions from Mr. Kawashima of SMBC Nikko Securities.

Kawashima [Q]: First question. Please give me an update on the progress of your structural reform initiatives, to the extent you are comfortable with. Is there a delay in planning and organizational decisions because the financial impact (other expenses) is not so large?

Seto [A]: That is not true. However, with respect to structural reforms, depending on the scale of the reforms and the way they are carried out, they are sometimes viewed as business expenses and sometimes as non-business expenses. This time, the scale was not so large, and the cost was largely viewed as business expenses. Therefore, there was some expenses incurred this time.

However, we would like you to understand that we believe there are three ways of thinking about structural reforms. One is to sell non-core assets we now have in turn. We have been working on this for a long time now, and although the big ones are over, there are still some smaller ones left. As a result, this has caused the smaller amount of final profit this time because the assets sold last year were rather profitable, but as for the assets sold in H1 of this year, there was not much profit or there was a loss.

The second, in terms of the cost of structural reforms, is the people. As for the people, the focus this time was on the US and Europe, and as for the US, it can be done relatively quickly. As you all already know, there are fixed rules and you can do it once you make an announcement. However, as far as the cost is concerned, we will spend in Q3, and the benefit will be actually realized in Q4. On the other hand, it is not so easy in Europe, where labor unions are very strong, so it will take some time there.

In conclusion, regarding the cost and actions, not all of them will be taken in the current term, and some of them will be taken in the next term. However, even in the part of Q2 that we are explaining, we are already in a situation where actual actions have been taken at a cost.

As for what to do with the assets themselves, not the company, please understand that this will take some time.

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MC [M]: Next, we have a second question from Mr. Kawashima.

Kawashima [Q]: Looking at slides 10 and 11, it appears that LWT will need to recover in H2, but what is your outlook? Can the contribution of LHT and other factors compensate for the suffering of LWT?

Seto [A]: Regarding LWT, in Japan, as I mentioned earlier, we were the first to raise our prices, and now that our competitors have finally raised their prices in H1 this fiscal year, we are actually making progress in regaining market share. This is one thing we can say. And as for Europe and the US, the costs are going down from Q4, because of the structural reforms I mentioned earlier. Also, the profits we saw on the revenue side are also rising, albeit very slowly. In some places, especially in the US, there is a recovery.

In the meantime, on a larger scale, I think it is possible that we will continue to see, or rather, have better numbers than before in terms of heat-insulation renovation in LHT.

MC [M]: Next, we have a question from Mr. Fukushima of Nomura Securities regarding structural reforms in Europe and the US, but since we have already answered it in the previous question, I will skip it.

Then, we have received two questions from Mr. Watanabe of Morgan Stanley MUFG Securities. The first question is related to structural reforms, so I will skip this one as well.

Watanabe [Q]: Second question. Could you please share the situation by country/region in Europe? I often see media reports about Germany, but I would like to know the situation of your faucets business also in other regions.

Seto [A]: The biggest thing that is happening right now is that the value of the assets has gone down while interest rates are going up, and the value in the market is going down, while experiencing inflation. Consequently, we face a difficult situation in countries where it is better to buy something else as an investment effect, considering how the interest rate rises and how the value of housing-related assets that you have lowers, and their relationship with inflation. I think another important factor is how much the mortgage balance as a percentage of GDP is and then the ratio of variable interest rate among the mortgages.

In that sense, perhaps the worst case is Sweden, where almost all mortgages are variable-rate, so the 4% increase in interest rates has had an immediate impact on the value of the home. On the other hand, since it is a cold country, inflation caused by the rise in oil prices will have a huge impact, and the situation is very severe.

Then, another country where we face a difficult situation is the Netherlands. The Netherlands is in a situation where the mortgage balance as a percentage of GDP is about 100%, so it is not surprising that the situation here is such that money cannot be spent elsewhere. Then, in the UK, where the inflation situation is very severe, we have a tough situation because it is better to invest in other things than to buy a house. Germany is equally tough.

Then in France, which has a high mortgage balance as a percentage of GDP, we have larger retail sales ratio than in Germany. In Germany, we have a two-step selling process, and the distributors who holds the inventory have a large inventory and then sell from there, so it takes time for the final inventory reduction to occur in the industry as a whole. However, in France we use retailers, which means destocking by the customers take place relatively quickly, and I think the signs of recovery are easier to see.

In Southern Europe, the situation is not worse than Scandinavia or Central Europe. Eastern Europe has a fragile economic system to begin with and is economically dependent on sales to Germany, so the economy is not doing so well.

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MC [M]: Next, we have two questions from Mr. Grew of Alma Capital.

Grew [Q]: Could you elaborate a bit more on what structural reforms you are implementing in the US and Europe and why the US will start to recover in Q4?

Seto [A]: There are several types of structural reforms, as I mentioned earlier, and if we talk about the people part of it, the US is relatively easy to deal with for its systemic reason. The other reason why in the US, we are doing better in Q2 than in Q1, and why we are doing better YoY, is that we are now gaining share in the faucets market.

As I have mentioned several times since last year, we have been trying to change the quality of our sales, and thanks to our efforts to focus on competitive faucets rather than commoditized sanitary ware, our market share in this area itself is increasing.

Grew [Q]: Second question. What's new in luxury brand window sashes, interiors, and renovations?

Seto [A]: I think you are referring to NODEA, a high-end brand of sashes, which we target the highly-affluent consumers. The business is finally becoming profitable, and also, we are receiving strong inquiries not only from Japan but also from Asia. In Asia, revenue was JPY1 to 2 billion when we started a few years ago, but it has grown to JPY10 billion in this fiscal term and are expected to reach around JPY15 billion in next term.

We sell larger windows in Asia than in Japan, and sales of these have been very good. This luxury brand provides larger products, and we have heard that customers want to buy those products. I think that this high-end brand of window sash is a very effective means for our Asian strategy as well.

On the other hand, in the area of wooden interior materials, last year there were accidents at other companies, so we compensated for their work. In H1 this fiscal year, I think the competitors have recovered due to such effect. As for H2, as with other products, competitors have finally caught up with us in some areas where we were ahead of them in raising prices, so we believe that we are making progress here.

Our solutions for interior renovations, in which we show simulations with images, are now very well received, and I think this is also promising for the future.

MC [M]: Next, we have two questions from Mr. Teraoka of Daiwa Securities.

Teraoka [Q]: First question. You have left the corporate plan unchanged, but is it possible to achieve the full-year core earnings of JPY40 billion?

Seto [A]: Our assumption when we made the plan was that the international economy, including Europe, would improve by the end of the year, but it is true that we have suffered there. On the other hand, we believe that we can achieve the target, given the steady progress in structural reforms and the fact that, as I mentioned earlier, things are getting better, including the recovery of market share, with regard to the Japan business.

Teraoka [Q]: Second question. What positive effects do you expect from the structural reforms in the international businesses?

Seto [A]: At this stage, I can't talk about the amount of money. Currently, revenue has been down roughly 20% compared to the good times, but once they return, I think the profit margin will naturally be higher than before. In particular, we are probably more asset-heavy than our competitors, and I think this will be an opportunity to change that.

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MC [M]: Next, we have two questions from Mr. Mochizuki of CLSA Securities.

Mochizuki [Q]: ASB returned to profitability in Q2, but the core earnings margin was 1.2%, which I think was low. What is needed to improve ASB profitability? It would be helpful if you could also tell me about the risk factors that would again result in a loss in core earnings.

Seto [A]: I think the most important key to improving ASB's profitability will be to increase revenue of faucets, and then to sell differentiated products. In that sense, I believe that this is progressing well. The major risk of a loss in core earnings up to now has been in the area of selling large quantities of highly commodity-oriented sanitary ware to retailers, but as you can see from the current decline in inventory, the portion of sales that relies on these products has decreased. In this sense, I expect that the share of high-margin products will increase in the future.

MC [M]: Next, Mr. Mochizuki has a second question.

Mochizuki [Q]: Will the cost of structural reforms only be recorded in H2? Is there a possibility that similar costs will be recorded in the next fiscal year? I believe that continued structural reforms will lower employee morale, but do you have any concerns about that?

Seto [A]: I don't think the cost will be the same, but we plan to include it in the next fiscal year as well. It is a bit difficult to give the specific amount because we have not yet decided on how much to do.

As for the question of employee morale if we continue with structural reforms, our employees are well aware of the recent recession in Europe and the economic downturn in the US. There are other companies which have already announced major restructuring, and some of our competitors have actually gone bankrupt or have been acquired because of their inability to survive. In this context, we believe we have gained sufficient understanding from our employees.

We bought both GROHE in Europe and American Standard from private equity firms, and I think our employees fully appreciate the fact that we have invested in areas that had not been invested in during the previous private equity period.

MC [M]: Next, we have additional questions from Mr. Fukushima of Nomura Securities.

Fukushima [Q]: First question. How about streamlining within Japan? With the exception of heat-insulation renovation, I believe the business environment will continue to be difficult.

Seto [A]: Naturally, we will have to reorganize the areas where demand has dropped, and since we all agree on the overall direction of making things on an asset-light basis, we will continue to rationalize in that sense.

Fukushima [Q]: Second question. To achieve the full-year plan for core earnings, you need to generate more than JPY31 billion in H2. If you divide the JPY31 billion into Japan, international, LWT, LHT, and others, what would the numbers be?

Matsumoto [A]: I'm sorry, but on page 20, there are the results for H1 and the forecast for the full year by Japan, international, LWT, and LHT. I am truly sorry, but I would like you to do this subtraction.

MC [M]: Next, we have two questions from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management.

Takegawa [Q]: At the briefing at the beginning of the fiscal year, you mentioned that a considerable amount of costs for structural reforms would be recorded in H1, but has this changed to a focus on Q4? If there has been a change, please indicate the factors involved.

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Seto [A]: We initially thought that the costs for structural reforms could not be included in business expenses that are subject to core earnings, but in the lower part of that. But in fact, it was recorded as a business expense, and it was actually reflected in the core earnings. Thus, in Q2, we actually cost a good deal of money. However, in Europe, there was a need to negotiate and coordinate with various unions, so this is delayed to Q4 or the next fiscal year.

MC [M]: Next, we have a second question from Mr. Takegawa.

Takegawa [Q]: Is the dividend for this fiscal year in line with your initial plan? You may revisit this issue for the next fiscal year, looking at business conditions and taking into account the dividend payout ratio.

Seto [A]: In the last two years until FYE2023, there were problems such as the COVID-19 and the supply chain, and in the current period, we continue to have problems with the European situation, which is almost externally related. If this is cleared up, we will naturally be able to increase the dividend itself sufficiently.

When considering the overall dividend payout ratio, what needs to be considered is that we are divesting more and more non-core businesses, and we are also divesting assets related to non-core businesses. In that case, sometimes there is a profit and sometimes there is a loss. If you sell the ones that are easy to sell first, then you will have to incur losses to some degree.

In both cases, however, there is no decrease in cash, and as a practical matter, we believe it is acceptable to return such temporary cash to shareholders. Therefore, we believe that it is possible to continue the current dividend payment until the business returns to normal.

However, since the actual decisions on dividend payout ratio and dividends are made not only by management but also by directors, it is not for me to say what will happen in the future. My personal view is, as I said, that we can continue.

MC [M]: Next, we have two questions from Mr. Yagi of Mitsubishi UFJ Morgan Stanley Securities.

Yagi [Q]: Please explain the background behind ASB's turnaround to profitability in Q2 and the outlook for US demand in H2 and beyond.

Seto [A]: As I mentioned earlier, we have changed our focus to faucets, and we have increased our market share, and the other is that the excess sanitary ware inventory from the previous fiscal year has started to clear.

As for the demand forecast for the US in H2 and beyond, it is not necessarily very good compared to Europe, but we are currently receiving enough inquiries from customers for our faucets, so we do not expect the US demand to be bad. I do not believe we are in a great economic condition.

MC [M]: Second question is about the timing of the implementation of structural reforms, so I will skip it here. Mr. Takegawa of Sumitomo Mitsui Trust Asset Management then asked an additional question.

Takegawa [Q]: Please tell me about your view on the situation of the remodeling market in Japan after the special demand for interior windows.

Seto [A]: We believe that it is not a special demand. Basically, the situation in Japan where more than 80% of the windows are single glass ones must be changed. I think the potential demand related to the fact that energy costs could be lowered by changing the windows or that a comfortable lifestyle could be achieved by changing windows is significant.

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As a country, subsidies have been created from the current energy crisis, CO₂ measures, and other such environmental measures, so this is not something that can be finished in a year. Rather, in the case of Germany, for example, this has still continued since the late 1990s. As a result, 75% of the overall demand in housing has been remodeled, so we believe that this is a demand that will last for a long time, since the replacement is only done at the level of hundreds of thousands of units, among the tens of millions of existing houses that are currently available.

MC [M]: Mr. Mochizuki from CLSA Securities has one additional question.

Mochizuki [Q]: With the decline in revenue, it seems likely that the CE margin of GROHE will continue to decline, but is it natural to assume that the CE margin of GROHE will continue to decrease for the next six months or so? Or are there any factors that could improve the situation?

Seto [A]: If by worsening you mean it will get any worse, I see no reason why it should get any worse. Although it is doubtful whether demand will improve in the next six months, the level of inventory held by dealers is already at normal levels. We do not believe that the volume will decrease significantly anymore, considering that it depends on if the end-users themselves will change.

On the other hand, as I have said before, we will reduce costs through structural reforms as a factor for improvement. Simply put, I think that by thinking about the number of people, and then the disposition of assets, and some other things like that, we will be able to increase our CE margin.

MC [M]: Sumitomo Mitsui Trust Asset Management Mr. Takegawa has one question.

Takegawa [Q]: Please tell me about the consumption trends of remodeling customers including water-related businesses in Japan.

Seto [A]: In the case of so-called remodeling, there are two types of demand: replacement and renovation. The replacement business itself is robust, but since there are many orders from plumbing contractors, I think that many of the orders tend to go to our competitor.

On the other hand, in terms of renovation itself, we need to link the renovation of windows to the renovation of other things including water-related businesses. If we can link them, the situation will improve. On the other hand, to put it simply, we did not expect the demand for interior windows to increase so rapidly, and we did not have enough resource. Consequently, we have not been able to fully capture the remodeling demand for the water-related area, which is something we need to reflect on.

MC [M]: Next, we have an additional question from Mr. Miki of Citigroup Securities.

Miki [Q]: Could you comment on the outlook for the China business?

Seto [A]: Actually, it has not been so bad YoY. This is partly because only about 5% of our total revenue came from China, but also because our business as a whole is centered on renovation.

For example, we have focused not on toilet seats, but on shower integrated toilets, which are very popular nowadays, and we have also focused on relatively specialized showers, such as showers for seniors. As a result of these efforts, particularly in China, where they are paying a great deal of attention to products for the nursing care and elderly generations, we are seeing a sign of recovery, not a bad sign.

MC [M]: Next, we have an additional question from Ms. Okada of Goldman Sachs.

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Okada [Q]: Aluminum prices have remained flat compared to last year, which is lower than your company's expectation, but is there a possibility that the CE margin of the LHT business will exceed your company's plan?

Seto [A]: Since there is a portion that is reserved and hedged, I think that this will be a story for the next term and beyond, rather than this term. However, we believe that the CE margin itself is higher than planned due to the increase in the number of interior windows.

MC [M]: Since that seems to be all the questions we have; we will now conclude the question-and-answer session. Thank you for your many questions.

This concludes the financial results briefing of LIXIL Corporation for Q2 of the fiscal year ending March 31, 2024. We look forward to your continued support of LIXIL. Thank you very much.

Seto [M]: Thank you very much.

[END]

Document Notes

1. *Speaker speech is classified based on whether it [Q] asks a question to the Company, [A] provides an answer from the Company, or [M] neither asks nor answers a question.*
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