



LIXIL Corporation

Q3 Financial Results Briefing for the Fiscal Year Ending March 2023 for Investors and Analysts

January 31, 2023

Event Summary

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	Sachio Matsumoto	Director, Representative Executive Officer, Executive Vice President, and CFO
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Presentation

MC: Now that the time has come, I would like to begin the LIXIL Corporation Q3 Financial Results Briefing for the Fiscal Year Ending March 2023 for Investors and Analysts.

This briefing is taking place via live internet streaming. Thank you for your attendance today.

Firstly, I would like to introduce today's attendees. Mr. Kinya Seto, Director, Representative Executive Officer, President, and CEO.

Seto: Good day.

MC: Mr. Sachio Matsumoto, Director, Representative Executive Officer, Executive Vice President, and CFO.

Matsumoto: Good day.

MC: Ms. Kayo Hirano, Senior Vice President, Leader, Investor Relations Office, and Leader, Finance & Treasury Corporate Accounting & Treasury/Tax.

Hirano: Thank you very much.

MC: Lastly, my name is Fukushima from the Investor Relations Office, and I will be the moderator for today's briefing.

Please refer to the presentation materials posted on the Company's website under the investor relations section.

I would now like to explain today's proceedings. To begin, CEO Seto will explain the financial results for Q3 of the fiscal year ending March 31, 2023. Followed by a question and answer session. This briefing is scheduled to end at 18:00. We appreciate your kind cooperation until the end.

Now, CEO Seto will explain the financial results for Q3 of the fiscal year ending March 31, 2023. CEO Seto, if you would please.

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› KEY HIGHLIGHTS

- **Revenue increased while profits declined year-on-year for the nine-month period of FYE2023**
- **Profitability improved in line with the plan for Q3, despite the impact of JPY depreciation and component price increases, helped by the implementation of price optimization**
 - Impact of supply chain issues in Europe remains, but expected to be resolved by the end of FYE2023
 - Asia Pacific is generally solid, while the situation in the Americas and China needs to be monitored

Summary of results for the nine-month period of FYE2023 and outlook

- Steady progress has been made on price optimization⁽¹⁾ in Japan in Oct and Nov 2022. Continued improvement in profitability is expected through Q4 onwards. Another round of price optimization⁽²⁾ is scheduled for April 2023
- Due to shipment delays in international businesses, particularly in Europe, the full-fledged positive impact from lower commodity prices are expected to appear from mid-March

LIXIL (1) Press release announced on June 23, 2022 "Partial Revision of Manufacturer's Suggested Retail Prices for Building Materials and Equipment"
(2) Press release announced on December 6, 2022 "Partial Revision of Manufacturer's Suggested Retail Prices for Building Materials and Equipment" ((1), (2) Japanese only)

Seto: Hello, everyone. I would now like to present our financial results for Q3 of the fiscal year ending March 31, 2023. Appreciate your kind attention.

We believe that this fiscal year, we have progressed as we had planned, which we revised downward. I have been President for about 26 years, but this year was the first time that so many events occurred each month.

Although the impact of various factors, such as the depreciation of the JPY, materials, and the sharp rise in parts prices, which the price optimization was made in October, have been absorbed, and profitability for the three months has been improving gradually.

There are, of course, still some concerns. For example, there are still some supply chain issues related to Europe, but these are now almost resolved. Asia Pacific are progressing quite firmly. As for the Americas and China, the Americas have finally gotten out of the bottom, if referring from the current standpoint. We feel that China will also soon be doing the same.

As for Europe, we expect demand to be sluggish, but we think we will be able to cope with this by changing the supply mix.

On the other hand, the situation in Japan is a bit worrisome. As for Japan, demand for new construction has clearly deteriorated since November. The demands, including for renovation, have been weak.

As for the cumulative results, price optimization in Japan is progressing smoothly, and I think Q4 will improve, this time in the form of cost improvement.

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However, shipments from international operations have fallen back somewhat, and in Europe particularly, although we have succeeded in price optimization, we have not been able to produce as much volume as we would have liked. We expect that the actual contribution to profit from the decline in cost of sales will be around mid-March.

› Q3 FYE2023 RESULTS

Profitability for both LWT and LHT improved in Q3

JPY billion		Q3 (9 months) FYE2022	FYE2023 Results			
			Q1	Q2	Q3	Q3 (9 months)
LIXIL	Revenue	1,074.4	360.3	372.4	391.2	1,123.8
	CE	61.8	7.0	-0.8	14.8	21.0
	(%)	5.7%	1.9%	-	3.8%	1.9%
LWT	Revenue	647.2	221.0	225.1	237.1	683.2
	CE	64.5	13.2	7.4	15.3	36.0
	(%)	10.0%	6.0%	3.3%	6.5%	5.3%
LHT	Revenue	441.4	143.0	150.2	161.0	454.3
	CE	30.5	3.1	2.9	9.5	15.5
	(%)	6.9%	2.2%	1.9%	5.9%	3.4%
Consolidation, adj. & other	Revenue	-14.2	-3.7	-3.0	-7.0	-13.7
	CE	-33.3	-9.4	-11.1	-10.0	-30.5

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Looking at the Q3 results, the core earnings margin is finally improving little by little, and although it is only 3.8% for the three months, the contents are getting much better. In addition to the October price optimization for LWT, we expect that the cost of sales, especially for the international business, will gradually improve in February and March.

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› Q3 FYE2023 RESULTS (FROM JANUARY TO DECEMBER 2022)

**Profitability improved in Q3 due to price optimization.
For international business, cost of sales improvement is expected from Q4 onwards, although accompanied by a decline in demand**



Let me summarize a few things that happened. First of all, there was the invasion of Ukraine in February. After that, energy costs have increased, and not just operational fuel costs but sea freight have increased significantly.

Of course, this was due in part to the clogging of vessels due to COVID-19, which caused sea freight to rise, but if we look at LIXIL as a company alone, another major impact was that the distribution center in Russia, which was scheduled to ship to the east of Europe, could no longer be used. This meant that we had to quickly switch our transportation system and distribution center structure, which was a major factor.

Commodity prices, which had been rising from the last fiscal year, generally reached their peak in March. Copper and aluminum, in particular, remained within the range of all-time highs.

In April, we optimized prices mainly in Japan and the Americas, and business gradually improved from around April, but at this point, in Europe and the Americas, where the economy was very strong, containers with products and parts were difficult to reach from Asia. Even when they arrived, we faced issues such as the port going on strike, no people due to COVID-19, and could not be transported by truck. Unfortunately, we were not able to take advantage of the very strong demand in our business, which in retrospect, was very disappointing.

In addition, requests for price revisions, especially by LWT's suppliers in Japan, began belatedly around May. The reason for this delayed start is that the prices of ordinary commodities such as copper, zinc, and aluminum had already risen in the last fiscal year, FYE2022, and our suppliers took the price increase and raised their prices to us sometime after that.

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As a result, the fact that we were forced to take care of this part of the project later negatively impacted the LWT's profitability.

Then in June, commodity prices began to fall, and I think this will take effect around March of this year, as mentioned earlier. This is about copper. Aluminum is taking effect a little faster and has become much more effective in Q3 of this year.

It was also during this period that the real estate situation in China began to deteriorate rapidly.

The JPY depreciation began in May, but it rapidly progressed in July and August, and the profitability of LHT Japan, the Japanese sash business, and the exterior business, in particular, deteriorated sharply during this period. We also import products from Thailand and Vietnam, and the depreciation of the JPY has had a negative impact on LHT's products from these countries.

The product mix in Europe and the Middle East began to change around this time, and although there was no major impact at that time, the impact gradually grew.

In the past, our European business was focused on non-flushing systems (product other than flush water tank installed behind the wall). However, the business of flushing systems (flush water tank installed behind the wall) has increased greatly, especially in the Middle East and India, and the mix of production plants and production distribution centers has also changed significantly around this time.

And the most painful part at that time for us was that the Americas distributors started inventory adjustments. Home Depot, Lowe's, and Ferguson in trade rapidly started not requiring orders as early as the end of July and as late as August.

The initial story was that this was for about a month, but it continued until November, when various distributors were not buying in the Americas. As I mentioned earlier, the situation in the Americas became very unprofitable because of the surplus of goods in front of the warehouses, which were brought in by containers that arrived late.

On the other hand, profits have been recovering steadily since this period, partly because of the price optimization in October.

Although the European economy slowed down, what made up for the volume to some extent, was the change in the product mix as I mentioned earlier such as flushing systems and the business in the Middle East, which surprisingly improved.

Also, as the inventory adjustment in the Americas and the inventory adjustment on the user side have been completed, the inventory situation in the Americas has been improving since November.

In December, the product mix of the plant and the distribution centers were almost normalized, and although I thought it would take until March for this to be fully normalized, I think the three months have been an orderly improvement.

Also, I didn't mention it here, but in December, the Japanese government decided to provide a large subsidy in a supplemental budget. This may have a limited impact this fiscal year, but I believe it will significantly impact the next fiscal year and beyond.

At JPY100 billion, an unprecedentedly large subsidy for a subsidy that will be applied only to window renovation. Until now, there have been various subsidies, but most have been at the level of JPY100 billion or JPY150 billion for all products combined, whereas this JPY100 billion is solely for windows alone.

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I believe that this was a very big step forward for us, as the government officials agreed that window renovation is a significant factor for CO₂ countermeasures in Japan.

› CHALLENGES AND RESPONSES

■ Challenges

1. Softening demand in Europe, Americas, China and Japan
2. Price increases by small- to mid-sized suppliers, potential business closures that would affect supply
3. Prolongation of Russia/Ukraine crisis
4. Possible surge in global commodity prices as China economy recovers

■ Responses

1. Differentiated products

- Strengthening of environmental-friendly products such as *Revia*⁽¹⁾ (launch in Q4 FYE2023)
- Strengthening of shower-related products (Acquisition of Basco⁽²⁾ / *KINUAMI U*)

2. Differentiated raw materials

- Shift of yellow brass to zinc
- Introduction of recycle aluminum products such as R70/R100⁽³⁾

3. Streamlining of supply chain

- Restructuring of inter-regional purchasing
- Knockdown production / Localization of downstream process
- Strengthening of businesses in Middle East and China

4. Further transformation of business model in Americas and China



(1) News Release <https://newsroom.lixil.com/2022101802>

(2) Business and ESG related topics p.26 "Promote Growth of International Water Technology Business"

(3) Business and ESG related topics p.26 "Contribute to Decarbonized Society and Circular Economy"

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Many things have happened, and many things will happen in the future, but we are worried about the decline in demand.

As for Europe, the decline in demand last year was slower than other companies because, as mentioned earlier, the flushing systems sold well, and we are strong in the Middle East, but the demand for non-flushing systems, has been slow, in particular, it has been declining in Europe.

However, although sales are mostly maintained, the volume is declining because this is due to the price optimization.

In the Americas, as mentioned earlier, things started to get worse from August last year, but eventually, from November, the inventory adjustments ended, and retail companies started to buy, so in that sense, things got better. In January, we achieved our highest sales in the Americas to date, not including the sales increasing from the company acquisition, and the organic sales alone were the largest, so I think the Americas are doing somewhat better.

China is not moving at all at this point after the Chinese New Year, but projects are actually reviving with government funding coming in, so I think things will be much better by spring.

On the other hand, things have been slowly getting worse in Japan since November, and now we are seeing a major decline in demand, especially for new housing. This is where the renovation of windows that I talked about a little bit earlier, may have positive effect. Up until now, inevitably, when it came to renovation, the

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trend in Japan has been to only focus on the water-related area, but if it comes to the exterior wall area, I think this will drastically change, and I have high expectations for this area from April onward.

The second is the increase in procurement prices from small- and medium-sized suppliers. As mentioned earlier, small- and medium-sized suppliers do not raise prices immediately regarding commodity price increases. Also, labor costs have gradually been rising, but not immediately. Thus, the government is now actively allowing small- and medium-sized enterprises to raise their prices in order to raise the national level as a whole. I believe this is an area where we must accept the government's policy to a certain extent.

There has been price rise in these areas, and some small- and medium-sized enterprises are closing their businesses because they are already struggling so much. In that sense, I am sure there will be needs to address for the cost increase in that area.

As for the Russia-Ukraine issue, we have to expect a prolonged period of time. I am concerned that this will lead to long-term issues related to fuel costs and also that the economic recovery in both eastern and western Europe will be somewhat less robust.

On the other hand, the resumption of economic activity in China is a plus for business itself, but how to deal with the sudden rise in commodity prices as the economy eventually recovers again is a cause for concern.

We have gained some experience in this area, and I think we have become more sophisticated than before in terms of how we raise prices and how we deal with such matters, but I think there will be price hikes in commodities after April and, in fact, aluminum and copper prices have risen considerably recently.

The first and foremost response to these is to differentiate products and create profitable products. In terms of this differentiation, one direction is that we believe it is important to first make environmentally friendly products.

Among these ideas is *revia*. This product, which will go on sale this quarter, will utilize waste plastic, almost all plastic waste, which we think will be a product that will help the environment and can be sold as recycled wood.

We have also made it our policy to focus on shower-related products as the products of choice for end users. One manifestation of this is that the shower door is the first choice in the Americas when selecting an entire shower. To strengthen its shower doors, we acquired Basco, a leading shower door manufacturer.

In addition, we will focus on shower products such as *KINUAMI U*, *Body Hug Shower*, and *ECO AQUA SHOWER SPA*, which are unique products that only we have. One thing we will focus on is such showers, and as a product, we will compete with products that are hard to compare with others.

We are trying to differentiate ourselves not only in terms of products but also in terms of materials. First of all, as I have mentioned before, the zincification of yellow brass is progressing. Of course, this is good for the environment, but there is, of course, a big difference in cost.

In fact, yellow brass is 65% copper and 35% zinc, but the price of yellow brass itself is now approaching the price of copper. This is partly due to the fact that the price of yellow brass itself is now very high, as users are increasingly demanding scrap yellow brass to be melted down for use.

In this context, the price difference with zinc has become so great that we believe we can raise the ratio of zincification to about 30% in the next fiscal year. This is mainly in the area of faucets.

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On the other hand, the use of resin in showers is rapidly advancing. By using resin for a significant portion of the product, the reliance on yellow brass has also changed here to the point that there is not much reliance on yellow brass.

What was also very good news for us this time was the introduction of recycled aluminum products such as R70 and R100. When made from virgin ingots, aluminum emits 10 kg of CO₂ to produce 1 kg of aluminum. In contrast, when aluminum is made from aluminum scrap, only 0.3 kg of CO₂ is emitted to produce 1 kg of aluminum. In other words, a 97% improvement is expected. I think this part is huge.

For example, general contractors are said to be trying to reduce CO₂ emissions by 40% for the entire building, but the materials used by general contractors and those used for embedding are concrete, steel, and aluminum, and it is still difficult to find a way to reduce CO₂ emissions to that level for both concrete and steel.

Basis this fact, it is a very big innovation to be able to reduce 97% of the aluminum alone here. In fact, Hydro ASA in Norway and our company are the only companies that can do this and produce 100% recycled products, and I believe we are the only large-scale manufacturer that will use it for all building materials on a large scale.

In this sense, this product is now attracting a great deal of attention, and I believe it will be one of the keys to our differentiation.

We are currently guaranteeing a product called R70, which we launched last month, and the Company as a whole has been promoting recycling for a long time, and on average, we have already reached the 70% standard in Vietnam, Thailand, and Japan combined. The 100% standard product is due out at the end of this year, and I believe that the Company as a whole will be able to achieve its goal of making everything from aluminum scrap by 2030. I think this is a very big step forward.

Then there is the streamlining of the supply chain, which is also important. This time, the supply chain issue was a big part of what we discussed in the Americas and Europe.

Considering the current fragmented supply chain issue, it is important to supply within a region, and considering transporting goods over long distances using expensive energy is not good for the environment, it is important to do more between regions. We were able to sort out a lot, this time that it is necessary to change the global supply chain to a regional one.

For example, with regards to the Americas which had been relying heavily on Asian products, we have changed to purchasing 80% of our products from within the Americas, mainly from Mexico. We are also gradually shifting products from Europe to Asia and the Americas, with production in Europe, in the Americas, and then in Asia. When this part of the supply chain is completed, we expect it to be very robust. As for China now, the basic idea is to sell products made in China in China.

For example, when we sell our products to countries in the Middle East or India, we used to export finished products, but we are now bringing only the core parts that cannot be made in the country, and the rest is manufactured locally as a knockdown process.

We believe that this part of the supply chain and cost will also be strengthened. In particular, we think that the rising cost of energy is now leading to a strengthening in the Middle East, which is growing very rapidly as a market, and then in India.

In the Americas and China, as we have mentioned many times, we are trying to change the business focus on sanitary ware to retail business, which has been the mainstay of the Americas market. As for products, we are diversifying our product line by focusing on showers, which I mentioned earlier, and then faucets.

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We have been increasing the number of customers in the trade, but we are also increasing the number of builders and remodelers in addition to that.

In China, we will reduce our project-related business at large private companies but on sales mainly to government agencies who have no concerns about credit, dealers, renovation companies, and individual customers. We will also try to increase our profitability by selling high-end faucets, which is one of our strengths.

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› PERFORMANCE HIGHLIGHTS

Revenue increased but profits decreased year-on-year

■ Revenue: JPY1,123.8 billion, up 5% year-on-year

- Q3 (3 months) YoY: +1% in Japan and +9% in international markets (-2.9% excluding foreign exchange impact)
- Q3 (9 months) YoY: +1% in Japan and +11% in international markets (-0.7% excluding foreign exchange impact)

■ Core earnings: JPY21.0 billion, down JPY40.8 billion year-on-year

- Q3 (3 months) YoY: -JPY3.2 billion in Japan, -JPY7.6 billion in international markets and +JPY1.2 billion for consolidation adjustment/other factors
- Q3 (9 months) YoY: -JPY20.1 billion in Japan, -JPY23.5 billion in international markets and +JPY2.8 billion for consolidation adjustment/other factors

■ Profit for the quarter⁽¹⁾: JPY11.0 billion, down JPY30.5 billion year-on-year

- Decreased primarily due to decrease in core earnings

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

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As for the highlights of the financial results, in terms of revenue, 1% growth was generated in Japan business and 9% growth was from international business during the past three months, but in reality, the impact of foreign exchange rates was significant. Excluding foreign exchange impact, the figure would be negative 2.9% in international business. At this stage, China, Europe, and the Americas are all a bit of a weak factor.

However, I feel things will improve in the Americas and China this quarter or the next quarter, and in Europe, we have been able to reorganize the supply chain. Hence, we think we can increase sales by relying on flushing systems, which is our specialty in the Middle East, India, and the future. That said, I think we are just in a transitional period at this moment.

As for core earnings, we managed to recover in Q3 and brought it to JPY21 billion. We are going to keep improving and try to make this a good trend for the next term.

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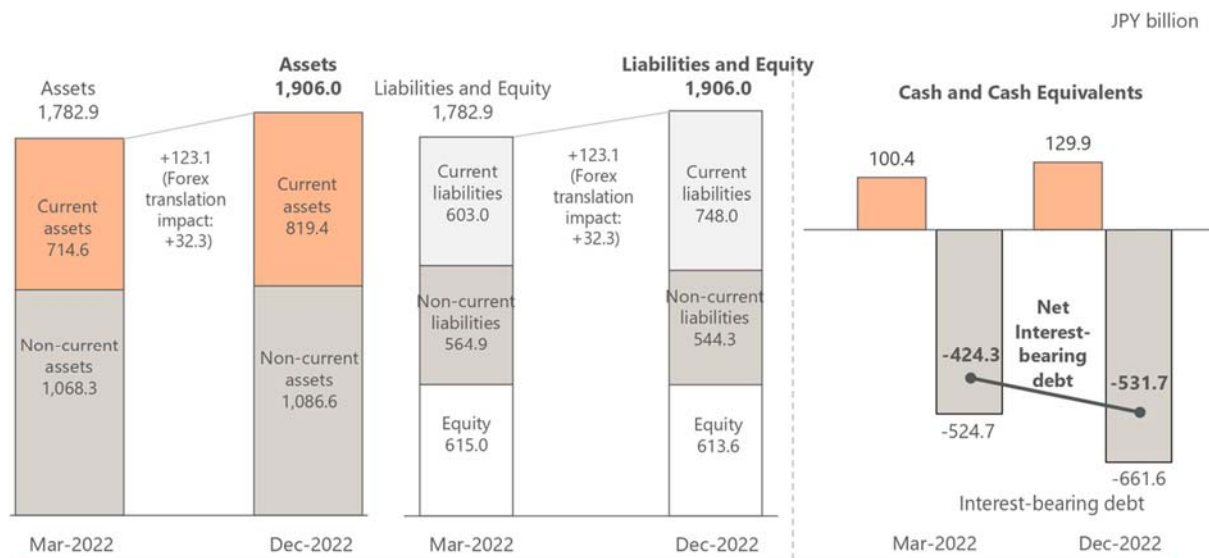
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› CONSOLIDATED FINANCIAL POSITION

Interest-bearing debt increased mainly due to fund-raising in Q2 for promoting efforts to accelerate payments based on the “Declaration for Building Partnerships”⁽¹⁾. Equity ratio is 32.1%



LIXIL (1) Please refer to H1 Results for the Fiscal Year Ending March 31, 2023 (IFRS) p.33 Business and ESG related topics “Responsible procurement with a reliable supply of products across the supply chain”

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Next is the balance sheet.

This time, especially in the last fiscal year, we suffered from supply chain issues, especially in the Americas, where we were not able to bring products from China, and we also suffered from inventory adjustment by our customers.

As for Europe, there are preparations for a change in the product mix, and overall inventory levels have increased, which has swelled the balance sheet.

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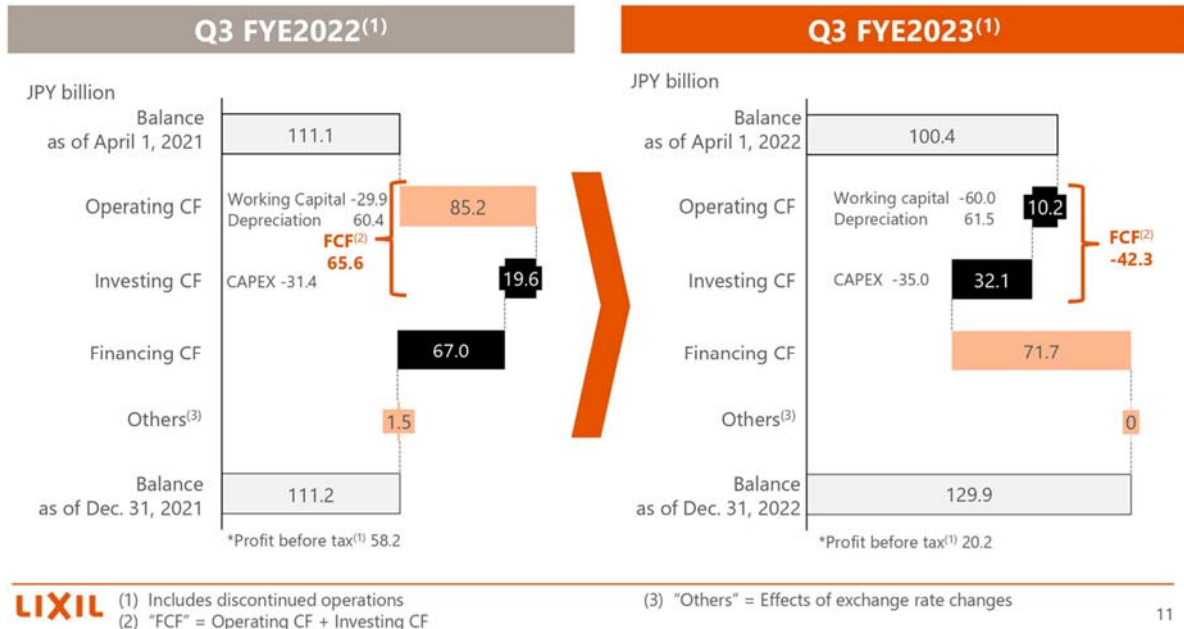
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› CASH FLOW STATUS AND CASH BALANCE

Free Cash Flow (FCF) declined by JPY107.9 billion due to factors including higher inventory levels for supply chain disruptions and a lower profit before tax



On the other hand, for cash flow, as this is already a requirement for Japan as a whole, we have committed to shortening the payment site to suppliers as a "Declaration for Building Partnerships." Thus, we had to borrow some funds to cover these expenses, so we believe we did not do very well in terms of cash flow this fiscal year. That said, this is gradually becoming a good factor now, and I think our goal for the next fiscal year will be to get back on track.

This concludes my explanation. Now, I would like to shift to the question and answer session.

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Question & Answer

MC [Q]: Now it is time for the Q&A session.

Let me read out the first question. Ms. Okada of Goldman Sachs has asked us two questions, so we will start with each question.

To achieve the full-year plan, the LWT and LHT businesses need to achieve a core earnings margin of 7.8% and 10.5%, respectively, in Q4 alone. Please explain the degree of certainty of achieving this goal, including the effect of the price optimization and current demand trends.

Seto [A]: As for LHT, it is definitely getting better, and although the price has gone up a bit at the moment, the price of raw materials has come down, and the effect of the price optimization since October is being fully harvested.

Also, the competitors are lagging behind, but they have raised their prices in Q3, which is a good trend. Especially in the next fiscal year, the window renovation business, which will receive the JPY100 billion subsidy I mentioned earlier, will be a business that can maintain a high-profit margin, and in this sense, I think LHT is steadily improving.

Regarding LWT, I think the trend is a little different in Japan and international businesses. As for the improvement in core earnings in Japan, considering the increase in purchase prices for small- and medium-sized companies that I mentioned earlier, there is a part where we are increasing renovation sales with price optimization, but it may be somewhat difficult to say whether there will be a significant improvement in Q4.

However, as mentioned earlier, with respect to LIXIL International (LWT International), I believe that LWT as a whole will be able to improve sufficiently, given the improvement in the cost of sales and the recovery in the Americas.

MC [Q]: Now, the second question. Regarding demand in Japan for renovation, there are concerns about the impact on demand for renovation due to the convergence of the impact of COVID-19, which will reduce the amount of time spent at home. What is your view on this? Also, what are the trends in orders received for the replacement of window sashes with higher environmental performance?

Seto [A]: Earlier, I mentioned that new construction has been slowing down since November. As for renovation in Japan, as you said, we think there is a temporary decrease in the number of visitors to showrooms and that there is some impact.

On the other hand, the last part of your question, the replacement of window sashes, is attracting a great deal of interest because of the maximum 50% subsidy of up to JPY2 million. Although extreme, I think that 50% would be a high subsidy, almost as if either the construction or the windows were free.

We have changed our production system to be able to produce up to three times as many windows for renovation, including inner windows. Hence, if we make sure not to miss this opportunity, I think we will be able to change the situation in which the water related area has been the focus of renovation.

MC [Q]: Next, we have two questions from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management. Which I will read each out loud.

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Progress of core earnings is 50% in Q3 against the full-year plan for the current fiscal year. How much can you recover in Q4? Please give us an idea of the range of under-achievement by sector: LWT Japan, LWT international, and LHT Japan.

Seto [A]: We really struggled this year, and in H1 alone, the progress ratio to the core earnings plan was 15%. In that sense, we believe that we have improved that area steadily, with the rate rising 35% just in Q3.

As I mentioned earlier, I do not see many factors that would change the relatively steady trend with respect to LHT. LWT, on the other hand, as to whether or not there will be any further improvement regarding Q4, as said earlier, there is the issue of purchasing price of suppliers in Japan, so I think that is somewhat okay.

For international businesses, there is a lot of uncertainties. Demand is clearly recovering in the Americas, with the largest sales to date in January, and in China, January and February were bad, but the situation is expected to improve in March. In some respects, we could say that the past has been a little too bad. Although sales in Europe are slowing down, we are maintaining sales as a result, and the core earnings margin will improve from March. We believe that we can do well in each of these areas.

MC [Q]: The second question. Please explain the situation in each country. In Japan, the decline in demand for new construction is understandable with the loss of the special demand due to COVID-19, but why is the remodeling business slowing down? Is it a decrease in demand due to price optimizations, or is the window remodel not going as well as it should? What are your plans for future measures? And how will you grow volume and secure profits amid fears of a recession in both the Americas and Europe?

Seto [A]: Regarding the remodeling business, this kind of overlaps with your earlier question, but it is true that the water related business is getting worse. This is not as much of a drop as in new construction, but I think there is the same part of the special demand for nesting due to COVID-19 described here regarding the water related business.

I think that there are fewer demand than in the past, such as for improving bad toilets or bad bathtubs during the stay-at-home period, and touchless products, due to the impact of COVID-19.

On the other hand, window remodeling is going to be very strong. I think Q4 may have been a bit of a wait because of the subsidies, but even so, the number of windows remodels increased to roughly 1.5 times in December of Q3, so we expect that it will further grow in the future.

The annual sales for the window remodeling business is about JPY20 billion of the sash and door division business. We think that the total of JPY100 billion subsidy of 33% to 50% range, with a maximum of JPY2 million per case, in those areas, is a very big expectation.

On the other hand, it is somewhat debatable whether the Americas are in a recession. Certainly, things have gotten worse so far, but if we think about it for this fiscal year, especially in the short term, I think it may not be so bad, especially since the customer inventory adjustments is over and January was a very good month.

On the other hand, there are clear concerns about an economic recession in Europe, but so far we have been able to secure sales despite a decrease in volume, partly because of the effect of price optimizations, but also because we were able to gain new markets such as the Middle and Near East, which I think was quite significant. The Middle East is starting to enjoy good sales due to rise in energy costs.

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

Looking at page four of the Q3 financial results material, the monthly trend of core earnings for December is about JPY7 billion per month. If the spending is JPY7 billion from January to March achieving a total of JPY21

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billion in the three months, the full-year total will be the same as the full-year plan. That said, in Japan, demand is usually at its peak from October to December, with January to March being the low-demand season. Currently, demand for new houses in Japan and the Americas is sluggish. Can the December profit level be maintained for three months?

Seto [A]: Based on past patterns, January is a bad month. The past pattern has been for February and March to improve, so in that sense, we believe we must do more than JPY7 billion in February and March.

For us, our focus will be LHT Japan. For the international businesses, as it is mentioned in page 14, the demand for new construction in the Americas is softer, but on the other hand, as I mentioned earlier, there is also the backlash from the convergence of customer inventory adjustments, so in conclusion, I think it will depend on Europe in the end.

As for Europe, we still have a large order backlogs. I think the key to this plan is how much of that can be resolved in the next three months.

MC [Q]: The second question. Sales in Japan, Europe, and the US have not increased despite price optimizations. Perhaps the full effect of the price optimization has not yet been reflected, but in terms of sales volume, how much has it declined, and how much do you expect volume to grow in the future? Please advise for Japan, the US, and Europe, respectively.

Seto [A]: It's a little difficult to answer simply, but as you said, volume is clearly down, given the image that sales are maintained on the one hand while price optimizations are conducted.

But the product mixes are changing dramatically. Especially in Europe, as I mentioned earlier, flushing systems are growing more than non-flushing systems such as faucets or showers. In the Americas, we have seen a slight decrease in the sales distribution ratio of ceramic products, and in Japan, the overall sales mix is changing. It is not easy to say, but we estimate that the overall volume has decreased by at least 5% or more.

MC [Q]: We have received multiple questions from Mr. Grew of Alma Capital, so we will split this into two parts.

First, how do you expect Basco to contribute in Q4? And in your full-year plan, you have increased the consolidation adjustments of core earnings to minus JPY47.5 billion. Does this mean that more expenses will be incurred in Q4?

Matsumoto [A]: I, Matsumoto, would like to answer. Basco's contribution is roughly a quarter of the Company's annual sales of about JPY12 billion. We are in a very strong business with profit margins in the low 10% range, so if you multiply the numbers I just mentioned by those numbers, I think you will get roughly the same profit.

As for the JPY47.5 billion consolidation adjustments to core earnings, we do not expect to incur a particularly large amount of expenses in Q4, although there will be some seasonal consolidation adjustment expenses. We are not anticipating many expenses, i.e., restructuring or anything like that.

MC [Q]: Next question. To what extent are the demands softening? Please elaborate on the regions and products that were hit hardest.

Seto [A]: Result-wise, the inventory adjustments in the Americas was the biggest hit. And we have excess inventory. Basically, this is sanitary ware.

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As for Japan, we believe that this year is characterized by the fact that the situation is gradually becoming worse than planned.

As for Europe, the softening of demand has not had a huge impact on our business yet, but we are disappointed as we could have achieved a much better result in Europe and in the Americas if there had not been a delay in unloading due to COVID-19 from April to June. I think we could have achieved a very good result.

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

ASB was also in the red in Q3, but is my understanding correct that it will be profitable from Q4? Or should we assume that it will be profitable from the next fiscal year?

Seto [A]: As I mentioned earlier, January sales were the largest ever for American Standard, or the Americas business itself, so we believe that this is already profitable.

Also, Basco, which Mr. Matsumoto talked about, will also contribute, so my understanding is that is already profitable from Q4.

MC [Q]: The second question. I believe that global cost-push inflation is continuing and that there is an increasing risk that your company's procurement costs will increase not only for FYE2023, but also for FYE2024. Is it correct to assume that suppliers will also request price increases for the next fiscal year?

Seto [A]: I think you should think of it in three parts. LWT Japan, in short, has a small and medium sized suppliers that uses many wood and steel products. Requests for price increases from this point on have been increasing since about July and August. The request started in May and was gradually reflected from about July. In general, the prices of such transactions are fixed for one year, so in that sense, the large part of these occurred in the latter half of this fiscal year, so the price increase will have some impact on LWT Japan.

On the other hand, however, the cost of steel and wood itself has already begun to decline. In fact, prices have been falling overall since last June, but only in Japan have prices remained high due to special circumstances. One of the reasons for this is that there are issues regarding Japanese lumber, such as the JIS and JAS regulations, which prevent the free use of lumber. In the case of iron, there have been various investments in blast furnaces, and prices of commodities have been rising, which related to our products, so it is true that the prices of iron and wood have remained high compared to other countries, but these prices have recently begun to fall.

Therefore, we expect LWT Japan to go up to some extent, but we believe that the situation will move more or less within the expected range rather than becoming a major problem. We will raise the portion of the fee that goes up, and since we already know what to expect to a certain extent, we believe we can manage LWT Japan in this regard.

As for LHT, the aluminum price in last March was up to about USD4,000 per tonne, but it is now down to about USD2,000 per tonne, while the JPY has depreciated quickly, so I think there are factors for both the exchange rate and aluminum. However, we have been successful in basically transferring costs in the past here as well, and I think we will not fail greatly.

Lastly, LIXIL International (LWT International), the largest cost factor here is copper. However, as I mentioned earlier, resin and zincification are progressing sequentially. The cost of commodities will vary depending on how much it rises. However, in terms of cost-push inflation, as cost-push inflation is driven by demand, given the current overall situation of declining demand and the fact that the economy is not improving at a rapid pace, we do not expect the cost of commodities to rise significantly.

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Even if there were rise in costs, we would have an advantage over competitors because we are increasing the number of alternative materials.

MC [Q]: Next, we have a question from Mr. Omuro of BofA Securities.

The revised plan reflected a considerably weaker JPY, but what offset the buffer as a result? What are some of the major negative factors that were not reflected in the revised plan?

Seto [A]: I think one reason is that we could not increase sales in the first place. As for the Americas, we expected that the inventory adjustments would be roughly over by September or so, but it ended up taking until November. As for Europe, there was a lot of order backlogs, but in the end, we were not able to ship out the portion of the product mix that had changed, which I think was a problem for both the factory and the distribution center. The result was that sales in that area did not increase.

Another is that the factory had to stop operation at some point when the inventory became excessive. I think the fixed cost burden, especially for sanitary ware, has impacted the Americas.

Finally, regarding the decline in demand in Japan, I would say that sales were lower than planned by about 5%. The key factors behind this are the public expectations of demand for new housing starts and the fact that demand for renovation has not grown as much as expected.

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

The first question. The foreign exchange rate trend has changed from three months ago. How has this affected your business performance?

Seto [A]: At the moment, the biggest impact of the exchange rate is on the price of aluminum used for aluminum sashes. Naturally, the JPY's appreciation is a positive factor for us, but it is also true that the price of aluminum is gradually rising.

As I mentioned earlier, we will continue to differentiate ourselves by making sashes from scrap aluminum, but on the other hand, if we use scrap aluminum, we will not be able to hedge, and I think this will tend to increase volatility.

In that sense, I think we have to reflect to the price of our products the fact that we have changed the materials and made environmentally friendly products.

Again, the biggest impact of the foreign exchange rate will be mainly for LHT, with impacts on aluminum and products imported from Thailand and Vietnam.

That said, if the foreign exchange rate were to appreciate against the US dollar, the Americas business would have an advantage, but as asked earlier, there have been various problems that have resulted in losses, which have impacted the business. As profits start to come in from now on, although we may have areas where profit is not enough, at this point in time, we believe that a stronger JPY will positively impact our business performance.

MC [Q]: The second question. Regarding the impact of inflation on the ability to consume, do you feel the risk of mix deterioration in Japan and the Americas due to volume declines and preference for lower-priced goods?

Seto [A]: One thing I feel now is Europe. With respect to Europe, renovation is changing to a smaller scale, and as it changes to a smaller scale, it becomes more DIY to some extent.

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In this context, we actually launched our brand *QuickFix* two years ago. This *QuickFix* is a product that allows easy renovation by yourself, and other products are being replaced by this product. As mentioned earlier, the product mix has changed significantly, and as a result, although our products are lower-priced than conventional GROHE products, they are profitable enough. To some extent, fewer SKUs will be sold, so in that area, I think we are successfully hedging the impact of inflation on consumption capacity with respect to Europe.

On the other hand, the Americas will see a decrease in sales of commodity, open-price sanitary ware products, which have been a major source of sales. However, this part of the process has to stop to some extent anyway, or we will not be able to prevent long-term volatility. As mentioned earlier, we will be changing products to more showers and faucets. Hence we will be changing buyers, so in that sense, I think the risk of a worse mix will go down, obviously, in the Americas, where it is happening in the big boxes.

On the other hand, Japan has not seen any significant increase so far. However, going forward in Japan, the most successful new houses will be those that are built inexpensively in the detached houses for sale market, so there is a risk that our high-end products and price optimized products will lose market share as the demand for such products increases.

I think the basic strategy will be to promote product differentiation so that we can respond to this.

MC [M]: We have answered all the questions we have received so far. Well, since there seem to be no other questions, I would like to end the question and answer session.

This concludes the LIXIL Corporation Q3 Financial Results Briefing for the Fiscal Year Ending March 2023 for Investors and Analysts.

We look forward to your continued support of LIXIL Corporation. Thank you all 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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