



LIXIL Corporation

Q2 Financial Results Briefing for the Fiscal Year Ending March 2022 for Investors and Analysts

October 29, 2021

Event Summary

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[Participants]		
[Number of Speakers]	3	
	Kinya Seto	Director, Representative Executive Officer, President, and Chief Executive Officer
	Sachio Matsumoto	Director, Representative Executive Officer, Executive Vice President, and Chief Financial Officer
	Kayo Hirano	Senior Vice President, Leader, Investor Relations Office
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*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A.

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Presentation

MC: It is now time to commence the financial results briefing for Q2 of the fiscal year ending March 2022 of LIXIL Corporation. In consideration of preventing the spread of the coronavirus, the meeting will be held again via live Internet streaming and teleconference. Thank you.

First, I would like to introduce today's attendees. From the left, Kinya Seto, Director, Representative Executive Officer, President, and CEO.

Seto: Thank you.

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

Matsumoto: Thank you.

MC: Kayo Hirano, Senior Vice President, Leader, Investor Relations Office.

Hirano: Thank you.

MC: By the way I am Fukushima from Investor Relations Office who will be the moderator for today's session.

Next, as for the presentation material for this meeting, please refer to the web screen if you are viewing the webcast, or the presentation materials posted on our website, Investor Relations, if you are participating in the teleconference.

Next, I would like to explain how we will proceed today. First, President Seto will explain the financial results for Q2 of the fiscal year ending March 2022. After that, we will have a question and answer session. The session is scheduled to end at 4:30 PM. Thank you for your cooperation in advance.

Seto will now explain the financial results for Q2 of the fiscal year ending March 2022. President Seto, please.

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› LIXIL TRANSITIONED TO IFRS FROM FYE2016 CHANGE IN PROFIT LEVEL STRUCTURE IS AS SHOWN

JGAAP	IFRS (LIXIL Financial Reporting)
	<u>Continuing operations</u>
Net sales	Revenue
Cost of sales	Cost of sales
Gross profit	Gross profit
SG&A	SG&A
Operating profit	Core earnings (CE)
Non-operating income/expenses	Other income/expenses
Ordinary income	Operating profit
Extraordinary income/loss	Finance income/costs
	Share of profit (loss) of investments accounted for using equity method
Profit before income taxes	Profit before tax
	Profit from continuing operations
	<u>Discontinued operations</u>
	Profit for discontinued operations
Net profit attributable to	Profit attributable to
Non-controlling interests	Owners of the parent
Owners of the parent	Non-controlling interests

"Core earnings" in IFRS is equivalent to JGAAP's "Operating profit"

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Seto: Hello, everyone. This is Seto from LIXIL. Now, I will explain the results for Q2 of the fiscal year ending March 2022.

As always, I would just like to emphasize that since we have adopted IFRS, the so-called operating income under Japanese GAAP is the core earnings of our company.

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› KEY HIGHLIGHTS

Summary of results for H1 FYE2022

- **Revenue and profit increased year-on-year** due to continuing strong demand, mainly in Americas and Europe, and the progress of structural reform in Japan. This was despite earnings softening during September due to the unexpected expansion and impact of lockdowns in APAC region, difficulties in procuring parts, increased costs due to container shortage, and delays in production and shipments. **Profit for the first half period⁽¹⁾ reached a record high**
- Continued implementation of structural reform measures have resulted in **a higher gross margin and core earnings margin despite increased raw material prices**
- Gross profit margin improved by 2.1pp year-on-year. The core earnings margin increased to 5.4%
- No change in annual dividend forecast of 80 yen. Interim dividend of 40 yen was approved

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

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In Q2 of the fiscal year ending March 2022, a great many things happened, especially in the last two weeks of September; the impact of the lockdown in the Asia-Pacific region went beyond expectations. This is because the lockdown in Vietnam has affected our parts manufacturers and our own factory operations in various ways.

Then there is the difficulty in procuring parts due to the electricity shortage in China, and, of course, the lockdown in Vietnam. Costs increased due to unprecedented container shortages. As a result, production and shipments were delayed until the end of September, especially in Japan, Europe, and the Americas, where demand was very strong, but the products could not be delivered eventually.

It was regrettable that the portion was carried over beyond October. However, thanks to strong demand and progress in structural reforms, we were able to increase both sales and profits YoY. Profit for the first half period reached a record high.

As you can see here, the various measures we have been taking to improve our business structure have taken root, and although many things have happened, we have managed to improve our gross profit margin and core earnings.

First, I would like to say that I honestly believe that we are in the midst of a paradigm shift, not only in our business, but in many other businesses around the world, especially in the manufacturing industry.

In the past, as the prices of various products, materials, and commodities have fallen to some extent, there has been a demand for just-in-time delivery at the lowest possible cost to customers. On the other hand, after the coronavirus pandemic broke out, as the price of commodities has been rising due to a variety of factors such as political conflict, deflation is turning into inflation or stagflation mainly due to a lack of supply. We have to deal with that.

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In our case, all our competitors are basically under the same conditions, so we can adjust our selling prices. As for the business itself, especially in Japan, it is common practice to revise prices once a year, which inevitably leads to the problem of how to manage the cost within the time lag.

Another thing is that given the unexpected shortages of parts and semiconductors that have occurred in various areas, the assumption that we could purchase goods from anywhere in the world at the lowest possible price has changed. In other words, I think we need to make the procurement supply chain redundant.

We have been doing and responding to both of these things, and not just for this reason. In fact, by differentiating our products, we can escape commoditization and adjust prices. And our efforts to create products at prices that customers can appreciate will make it easier for us to respond to prices as we transition from deflation to inflation or stagflation.

In Japan, we can mostly adjust the price just once a year but in Europe and the Americas, there are some areas that we have adjusted the prices for two or three times this time. In addition, we have been making the procurement redundant many times in the past when there were incidents such as disasters and problems at suppliers, not only in the face of the coronavirus pandemic this time. Therefore, I think we have been able to provide a stable supply of products by succeeding in making our purchasing redundant compared to other competitors.

Therefore, I believe that the pressure on profitability to some extent due to rising price costs is temporary. Also, there may be some delays in improving profitability due to delays in parts procurement, et cetera, but I don't think this is a fundamental problem. The fundamental problem is how to respond to this in an agile manner, and to hedge risks by making procurement redundant so that we can continue to provide products more stably than our competitors. This is where we need to make efforts in the long run.

No change has been made to the dividend forecast at this time.

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› KEY HIGHLIGHTS

Business environment, countermeasures, and business outlook

External factors outside of our projections softened business performance during September, although most of the challenges are expected to be largely solved by the end of October

Anticipated/Addressed	Exceeding expectation
<ul style="list-style-type: none"> • Lumber shortage Led to partial delay in partly delayed in housing construction. However, the impact was within the original expectation and limited • Increased raw material prices <ul style="list-style-type: none"> ✓ Lumber: Limited impact on profitability of H&S business. However, it is limited ✓ Copper, Steel: The impact of the higher costs was largely offset by a combination of hedging, cost reduction efforts and price optimization from an early stage • Business in China <ul style="list-style-type: none"> ✓ Housing market slumps Direct impact was limited due to advance measures we took. Although we expect demand for developers to soften, we expect growth in the next fiscal year and beyond by continuing to diversify our business into retail and accelerated investment in renovation ✓ Electricity shortages Currently no impact on the business as we have prepared for the situation, such as securing in-house power generation facilities and diversifying supply sources 	<ul style="list-style-type: none"> • Lockdowns <ul style="list-style-type: none"> ✓ Asia-Pacific region Despite a large drop in demand in major countries⁽¹⁾, economic activities are recovering ✓ Product supply from Vietnam to Japan market <ul style="list-style-type: none"> - Fixtures(toilet): Parts shortages caused a delay in production and a supply gap in Sep. and Oct., resulting in achievement of 90% of the original plan. The situation is now improving and will be normalized in Nov - Exteriors: Alternative production in Japan during Aug.-Oct. caused a temporary increase in costs. However, this prevented product shortages, and the situation is expected to be normalized in mid-Nov • Increased raw material prices <ul style="list-style-type: none"> ✓ Aluminum: Advance measures were taken for a certain level. However, the historically high price level has exceeded forecast and we expect to see some pressure on profitability until the next price revision • Transportation: shipping container shortage COVID-related lockdowns delayed cargo transfers, leading to unexpected increase in overall transportation costs and in transit inventory. Elevated cost expected to continue through Q1 of next fiscal year

LIXIL (1) India, Thailand, Indonesia, Philippines, Vietnam

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As I mentioned briefly, many things have happened this time, especially in the latter half of September. We were able to cope with them because we had anticipated them for a long time, but there were also things that were beyond our expectations. I have divided them into two parts.

The first thing I think we dealt with well by preparing some measures in advance was lumber shortage. I think we were able to deal with this, or rather, Japan as a whole was able to deal with this. To be honest, although there were some delays in housing starts for some of the smaller construction companies and local construction companies and some problems such as price increases, the volume of new construction starts did not drop significantly.

On the other hand, the increase in material prices had an impact on the profits and losses of some of our businesses. However, it was limited. As for copper, since it is mostly for the international businesses, we have been hedging the risk, and as a result, we were able to reduce the cost or adjust the prices.

Copper and aluminum have experienced historic price increases, but one thing that can be said about copper is that zinc die casting is being promoted in international businesses. In other words, we have been changing materials from copper to zinc, and for that part, zinc was better for the environment in the first place and also had a stronger hedge against the price. It's also cheap to begin with. Because of this, I think we were able to cope with the issue in that area better than other companies.

As for the China business, we have been expecting something to happen in China for several years now. I think direct damage is limited in that sense. Originally, we were selling directly to developers, but we changed it to go through dealers. We also increased the number of retail and renovation projects. Therefore, I think the direct damage is limited.

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However, considering that the market for developers will become increasingly severe, I think we should be conservative about growth in China in the next fiscal year and beyond, including a change in our business model.

Then, this time, as reported, the problem of insufficient electricity supply happened in China. As the weather is about to get colder, there is a possibility that there will be less electricity coming to the factory, perhaps in the form of power outages or another forced reduction in electricity usage.

For our own factories and vendors, we are securing our own power generation in various ways and diversifying our procurement as I mentioned earlier. In some cases, we can even create some of the core parts of the product ourselves. We are prepared for that to a certain extent, but in any case, since there are a wide variety of parts, many things can happen in the future. However, so far, we have been able to handle all of these issues.

The other thing that we didn't expect to such extent was the lockdown especially in Vietnam. One was a shortage of a specific part for sanitary ware, which caused some delays in production and supply. The production dropped to around 90% to 95%. However, the situation is almost under control.

In this case, there was a period from September to October when our competitor manufacturers were almost unable to produce the product, so there was some confusion due to the large number of orders transferred to us from our competitors, and to be honest, we were not able to respond to that. As for us, we are doing our best to supply our own customers.

In addition to that, we have a factory in Ho Chi Minh City for exteriors. We became unable to produce in the factory at all. Therefore, we produced all of them in Japan as an alternative. Therefore, although we did not cause any inconvenience to our customers, we were not able to generate the expected profit due to the increased costs.

Then there is the price of materials. For aluminum, in particular, the JPY3,000 level per ton is a historic price, and it was something we have never expected. I think we will be squeezed in terms of profitability to a certain extent until the next price adjustment, but we have been converting costs by platform standardization. And then when we launched the new hybrid window product this time, we factored in the price to a certain extent. Therefore, the impact was not on all of it, although the situation was difficult.

It was also unexpected that the cost of shipping containers was 5x or 10x higher than before the coronavirus pandemic. In fact, since logistics has a tendency to affect all the others when one of them gets jammed up, and if it starts to get tight, it can be very bad. As you know, in Europe, due to the decrease in the number of immigrants, there have been situations where containers have been left unloaded and unloading has not been possible.

In one of the worst cases in our business, we imported goods from China to Africa, and although they actually arrived in Africa, there was no one to unload them so they had to go back to China. So, we had to have them come again, which was a very unusual situation.

We did not anticipate such situation, and it was one of the reasons why we could not ship even though we had enough orders, especially for our European and American business.

However, it is very unlikely that this will continue forever. As for the tightness of containers, I think it will be normalized to some extent in about six months to a year. Therefore, I think the issues are basically temporary in all areas.

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The phenomenon of inflation or stagflation is a major change, and the increasing risk of suppliers is a fixed one. However, in terms of the business itself, I think it is possible to pass on the increased costs. And by constantly making our suppliers redundant, we have strengthened our risk management system to some extent.

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› PERFORMANCE HIGHLIGHTS

- **Revenue: JPY 696.2 billion, up 5% year-on-year**
 - Decreased 2% year-on-year in Japan (+2% growth excluding impact from divestments) while rising 25% in international markets
 - Strong in Q1, but production and shipment delays in September impacted Q2 (mainly in Japan, the Americas, and EMEA); expected to gradually normalize from November
- **Core earnings: JPY 37.3 billion, up JPY 21.9 billion year-on-year**
 - Driven by LWT sales growth in the Americas and Europe and the progress of structural reform in Japan
 - Slowdown in Q2 due to delays in production and shipments, especially in September, despite strong demand
- **Profit for the quarter⁽¹⁾: JPY 25.7 billion, up JPY 14.8 billion year-on-year** **Record high for H1**
 - Increased due to business recovery from restrictions on economic activities from previous year and progress of structural reform

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

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Originally, revenue could have been higher. However, due to such situations unfortunately, we were unable to deliver what we wanted to deliver in the last month of September. Since October, we have been able to get it out quite a bit, and I think it will mostly normalize after November, so I think we can catch up here.

Also, slight decline in revenue for Japan is due to the sale of our subsidiaries from previous year.

Core earnings showed strong growth in Q1, since Q1 of last year was very weak. On the other hand, in Q2 of last year, there was growth in the pent-up demand especially in Europe and Americas and pent-up demand due to the coronavirus. In that sense, that part of the businesses did not grow that much, but in total, both the core earnings and profit for the quarter grew about 140%.

Profit for the quarter is the highest ever for H1.

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› H1 FYE2022 CONSOLIDATED BUSINESS RESULTS

JPY billion	H1 6 months				Q2 3 months		
	FYE2021	FYE2022	Increase /decrease	%	FYE2022	Increase /decrease	%
Revenue	660.5	696.2	+35.7	+5.4%	350.5	+0.4	+0.1%
Gross Profit	217.7	244.2	+26.5	+12.2%	119.2	-1.8	-1.5%
(%)	33.0%	35.1%	+2.1pp	-	34.0%	-0.6pp	-
SG&A	202.3	206.9	+4.6	+2.3%	105.0	+2.0	+2.0%
Core Earnings ⁽¹⁾	15.4	37.3	+21.9	+142.5%	14.2	-3.8	-21.2%
(%)	2.3%	5.4%	+3.0pp	-	4.1%	-1.1pp	-
Profit for the quarter including Discontinued Operations ⁽²⁾	10.9	25.7	+14.8	+136.5%	8.9	-5.7	-39.1%
EPS (Yen)	37.47	88.46	+50.99	-	30.55	-19.74	-
EBITDA ⁽³⁾	55.9	77.4	+21.5	+38.5%	34.3	-3.9	-10.2%
(%)	8.5%	11.1%	+2.7pp	-	9.8%	-1.1pp	-

- **CE margin:** Improved by 3.0pp (gross profit margin improved by 2.1pp and SG&A ratio improved by 0.9pp)
- **Gross profit margin and core earnings margin:** Increase in the sales distribution ratio of the international business with higher profit margin and an increase in factory utilization rates as well as benefits from various transformation initiatives in previous years drove the improvement
- **SG&A expenses:** Increased by JPY4.6 billion in six months year-on-year due to increase of revenue (Japan JPY 4.9 billion decrease, International JPY 9.5 billion increase)

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(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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Looking at the consolidated results for the fiscal year ending March 2022, gross profit increased by 2.1pp to 35.1%, but for the last three months it was 34%. This is because we started to see the impact of that, as I mentioned earlier, for example, the exterior products had to be produced in Japan and the cost of containers has risen.

However, despite this, we were able to maintain stable profits. In the past, when various events like this have occurred, the range of variable costs has been very large, especially in the housing business, but we were able to endure this situation, which is a good thing.

In addition, EBITDA is 11.1% through six months. We are now at a level where we can return enough to our investors.

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› H1 FYE2022 CONSOLIDATED BUSINESS RESULTS

JPY billion	H1 6 months				Q2 3 months		
	FYE2021	FYE2022	Increase /decrease	%	FYE2022	Increase /decrease	%
Revenue	660.5	696.2	+35.7	+5.4%	350.5	+0.4	+0.1%
Gross Profit	217.7	244.2	+26.5	+12.2%	119.2	-1.8	-1.5%
(%)	33.0%	35.1%	+2.1pp	-	34.0%	-0.6pp	-
SG&A	202.3	206.9	+4.6	+2.3%	105.0	+2.0	+2.0%
Core Earnings ⁽¹⁾	15.4	37.3	+21.9	+142.5%	14.2	-3.8	-21.2%
(%)	2.3%	5.4%	+3.0pp	-	4.1%	-1.1pp	-
Profit for the quarter including Discontinued Operations ⁽²⁾	10.9	25.7	+14.8	+136.5%	8.9	-5.7	-39.1%
EPS (Yen)	37.47	88.46	+50.99	-	30.55	-19.74	-
EBITDA ⁽³⁾	55.9	77.4	+21.5	+38.5%	34.3	-3.9	-10.2%
(%)	8.5%	11.1%	+2.7pp	-	9.8%	-1.1pp	-

- **CE margin:** Improved by 3.0pp (gross profit margin improved by 2.1pp and SG&A ratio improved by 0.9pp)
- **Gross profit margin and core earnings margin:** Increase in the sales distribution ratio of the international business with higher profit margin and an increase in factory utilization rates as well as benefits from various transformation initiatives in previous years drove the improvement
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LIXIL (1) Equivalent to "Operating profit" of JGAAP
 (2) Profit for the quarter attributable to owners of the parent
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By segment, LWT business, in particular, has been growing supported by the growth of international businesses. In the LHT business, we have struggled a bit in terms of revenue due to the environmental issues I mentioned earlier and the lack of new construction, but we have been able to generate profits by improving the business structure.

As for LHT, I believe that the business of renovation will rapidly increase in the future due to the need to respond to environmental issues. Furthermore, I believe that unlike in the past, there will be a business opportunity to reverse the situation and increase revenue as well.

As for LBT, since we are using the percentage-of-completion method for accounting process, the profit improvement activities that we started last year will take two years or three years to complete. We are a little behind schedule, but as you can see from core earnings, profitability has been recovering.

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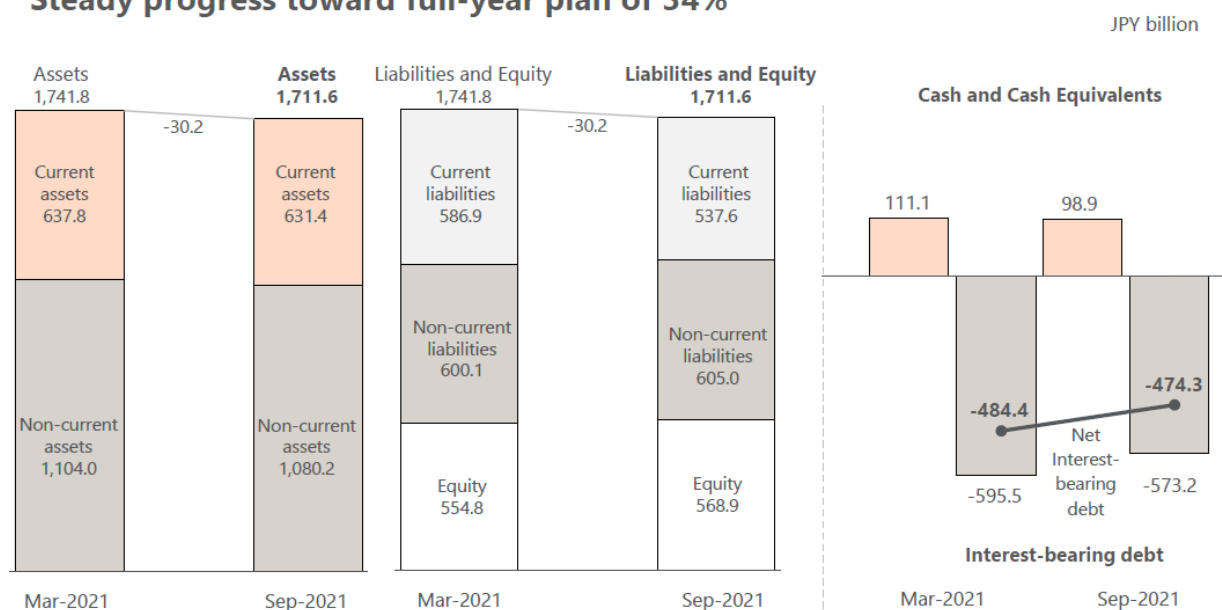
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› CONSOLIDATED FINANCIAL POSITION

Equity ratio improved by 1.4pp to 33.1% from March 2021.
Steady progress toward full-year plan of 34%



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When we look at it as a balance sheet, it is improving because we have more money to make from the business itself and we have been on the asset-light management in terms of the investment we made. The equity ratio is currently 33.1%, and I believe that we will be able to achieve the full-year plan of 34% without any problems.

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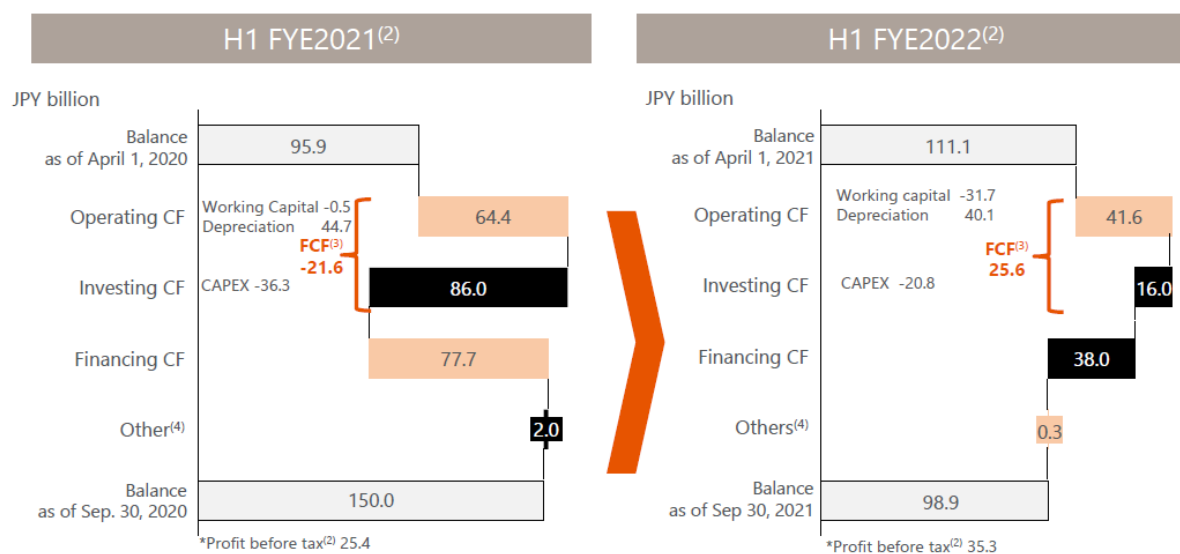
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› CASH FLOW STATUS AND CASH BALANCE

Free Cash Flow (FCF) increased by JPY47.2 billion due to progress of structural reform⁽¹⁾ totaling JPY28.4 billion, increase in profit before tax, and a decreased need for investment as a result of the asset-light investment strategy



(1) Voluntary retirement program and divestments
 (2) Includes discontinued operations
 (3) "FCF" = Operating CF + Investing CF

(4) "Others" = Effects of exchange rate changes + Net increase/decrease in cash and cash equivalents included in assets classified as held for sale ⁸

As for cash flow, free cash flow increased by JPY47.2 billion YoY, which is quite a large increase when including investments for the promotion of asset-light management, although we also had structural reforms such as New Life last year.

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› BUSINESS OUTLOOK FOR FYE2022 H2

- Despite strong demand, the external environment, including increased material prices and logistics costs, continue to make the outlook uncertain
- We will address business risk factors by diversifying production bases, focusing on in-demand products to ensure a stable supply of products, and making constant efforts to reduce costs through digitization and asset-light measures

Outlook for demand

- Japan**
- ✓ **New housing:** Lumber shortage has been causing a slight delay in the start of construction, but no major impact expected
 - ✓ **Renovation:** Strong demand continues
- International**
- ✓ **EMEA, Americas:** Strong demand continues. Product supply is the bottleneck
 - ✓ **China:** Expect growth from FYE2023 due to rapid slowdown in housing market
 - ✓ **APAC:** Recovery trend continues, however, temporary set-backs possible

Business risk factors

- ✓ Soaring material prices
- ✓ Electricity shortages in China
- ✓ Transportation: shipping container shortage and elevated cost
- ✓ Unpredictable occurrence of lockdowns
- ✓ (Due to unpredictable factors including the above results) Shortage of supply of various parts

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For the next six months, demand is basically as strong as ever in Japan, and especially in Europe and the Americas. Southeast Asia is also on the road to recovery with the coronavirus pandemic finally subsided. I am sure something will happen again, but with the exception of China, I think we are very strong.

China is experiencing a sharp slowdown. So, if we try to achieve too much growth in China, we may be hurt later. Therefore, we will continue to do what we have been doing cautiously, more cautiously. I think we need to make efforts to sell our products to the dealers and retailers rather than the big developers.

In the case of China, there are cases where major developers sell housing with furniture, meaning toilets, sanitary ware, and bathrooms, and cases where they don't sell together and keep that part separate. I think it's important to target these small things.

Also, in Japan, there is some delay in new construction due to the lumber shortage, but renovation is as brisk as ever. The most important thing for us as an individual company in the field of renovation is that renovation used to be only for water-related facilities, but now companies are paying much more attention to the environment. In this situation, it would be our strengths to be able to increase the renovation of exterior walls and windows.

On the other hand, there are many business risks. If we look at this demand alone, I think we can actually achieve high growth in H2 of the year. However, considering the current business risks, I don't think we should change that easily. Under normal circumstances, I think it would be possible to revise forecasts upward but considering the business risks that I have just mentioned, I think we should think carefully about that.

The first is the historically high price of materials. The price of copper and aluminum are rising higher and higher. Things have calmed down a bit here, but I don't know what will happen now. Also, as I mentioned

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earlier, if there are power supply restrictions in China during the winter it will be difficult to produce parts, which will make delivery of products difficult.

Then there's the container crunch. It's hard to imagine it getting any worse, but as I mentioned earlier, it's a bit of a ball-and-chain situation. So, it may take some time for everything to start moving smoothly.

Also, although we have experienced lockdowns in Southeast Asia, I honestly believe that we do not know what will happen.

As a result of the combination of these several factors, I believe that unpredictable shortages of parts due to unpredictable causes can occur. But again, we have been working on redundancy in the supply chain for a long time in various fields, so I think our structure is strong to some extent. In that sense, the degree to which we inconvenience our customers is small, and I think it has definitely been small in the past. However, this time, for example, the supply of hot water heaters was delayed at a stroke. As a result of this situation, it was difficult to sell bathrooms and kitchens without hot water heaters.

Therefore, not only us, but also the products that are delivered together with ours may have problems that we have no control over. Considering the combination of several factors, such as the coronavirus, the shortage of electricity supply in China, and the container, I think it would be irresponsible to be too optimistic. So I have decided to maintain our outlook.

I would like to provide further explanation by answering questions. Thank you very much.

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Question & Answer

MC: We will now move onto a question-and-answer session. If you have any questions, please feel free to send them to us via chat or email.

Here are the questions we received via chat.

From Mr. Kawashima, SMBC Nikko Securities Inc. In relation to the fact that the gross profit margin declined, and core earnings decreased in three months of Q2, first, please explain the factors for the increase in revenue and decrease in profit in LWT international businesses. Second, any factors other than the substitution of production of exteriors to Japan that contributed to the increase in revenue and decrease in profit in LHT Japan compared to Q1.

Seto: The first part is mostly because we had orders in Europe, the Americas, and Japan in September, but we couldn't ship them out for different reasons.

In the case of Japan, as I mentioned earlier, when other manufacturers were unable to release their products, we as a housing equipment manufacturer were not able to ship them in the last one week because it was no longer necessary (since it cannot be installed without other manufacturer's product). One more thing is that in Europe and the Americas, the containers did not reach us sufficiently. As a result, although we received orders in September due to the demand season, we were not able to deliver them.

In terms of profit decline, in Q2 of last year, international businesses of LWT, especially in the Americas and Europe, had a kind of shakeout against pent-up demand. I think there were quite a few orders delivered.

Since the profit margin in Europe and the Americas is very high, it was a bit of blow that we were not able to produce much in the last two weeks of September this year, while the results were strong last year in Europe and the Americas.

However, with regard to LWT, we were able to hedge the price of commodities by adjusting the price at relatively early stage, but the large increase in the cost of containers was quite unexpected. Especially the last one month or so. I think the cost of containers was a very big factor in the 5x to 10x increase (vs. pre COVID-19) in cost.

As for LHT, one of the reasons is increased aluminum price. In April, the price of aluminum was around USD2,100 per ton, but by September it had reached over USD3,000 at its worst.

So, of course, we have to pass on these costs, but there are some parts that we cannot pass on in time. This happens not only with aluminum, not only with sashes, but also with doors and exteriors. So, there was an increase in the price of those commodities. And, of course, the increased container costs had an impact to the part that was imported.

MC: Next, we received two questions from Mr. Fukushima of Nomura Securities Co., Ltd., so we will answer them separately. Here is the first question.

Fukushima: Is it correct to assume that you use about 160,000 tons of aluminum and 20,000 tons of copper per year?

Hirano: I'm Hirano from IR Office. I would like to respond on behalf of Seto. The results at the end of last fiscal year have been finalized, and the result for aluminum were about 130,800 tons. This is not the plan for this fiscal year. On a global basis, the result of copper usage was about 22,300 tons.

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Seto: I think in terms of per sales ratio, the amount has been decreasing. As for copper, one of the reasons is that the use of zinc is advancing. As for aluminum, the ratio of scrap is increasing, so it is true that the amount of aluminum purchased in international markets is decreasing.

In addition, we have also launched resin window sashes this time, and I think that the ratio of resin sashes will increase considerably over the years.

MC: Here is another question from Mr. Fukushima of Nomura Securities.

In Japan, I believe you have raised the prices of baths, kitchens, toilets, et cetera. How much of the cost increase will be covered by the price increase?

Seto: We have already done so, but the reason I can't answer is because each situation is a little different. First, in the case of the bathroom, the major reason for the substantial cost increase in the latter half of the year is that cost was increased after our price increase. To address this issue, although this is a bit of an exception, we are thinking of raising the price for the second time within this year, and we are not in a position to give an immediate answer about the situation.

As for kitchens and toilets, we believe that we were almost able to cover the cost by the price increase. However, we didn't raise the prices for that purpose, but rather for the purpose of rectifying the distribution system as a whole and switching to the successor products. So we didn't raise the prices this spring for the purpose of covering the cost increase that I mentioned earlier.

MC: We are moving onto the next question we received via chat as well. This is from Ms. Katsuyama, Morgan Stanley MUFG Securities Co., Ltd.

Katsuyama: The price of aluminum continues to rise, but how much time lag should we expect before the price is adjusted?

Seto: As common sense, the basic price revision is once a year. In this situation, as what we can do, we have raised the prices of so-called low-priced products, and for customers who buy in large quantities during the process. Therefore, it is difficult to say in general, but the time lag between the aluminum price hike and the price increase will be one year at the maximum.

MC: Now I would like to introduce some questions that we received via e-mail. This is a question from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management Co., Ltd.

Takegawa: Will there be any change in demand in Japan, the Americas, or Europe? Also, what kinds of commercial products are in demand in each country? And what is the status of the order backlog?

Seto: In terms of demand, we believe that Japan is strong in all areas. With regard to new housing, the figures are not as high as initially expected due to the lumber shortage as I mentioned earlier, but there has been no major change. And the demand for renovation is very strong.

In addition, when looking at the demand for commercial products, the demand itself for some products depends on the reason of competition. For instance, it is true that the demand for toilets is very high, especially for shower toilets, but we are currently in the situation where our competitors are unable to deliver toilets and we also do not have the production capacity to fully cover their demand.

Other than that, in general, the demand is not so strong for bathrooms, which are common in new construction, but strong for toilets and kitchens that are common in renovation.

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In terms of the order backlog, we are taking orders in the same way as before. So as far as judging from the current order backlog, I don't think the situation will change significantly within this year at least.

The demand in Americas is also very strong. In the case of the Americas, it is bit difficult to foresee the situation. While the demand is very strong, the supply of products is lagging not only by LIXIL, but also by other companies. Since customers order through various channels other than the ones that they originally had, the demand looks quite large.

However, I don't think there are any major changes. In our case, rather than looking at the demand by country, we have been focusing on products that we want to increase such as high-end sanitary ware, bathroom showers, and bathroom faucets. These are the areas that are in high demand, but we have not yet been able to deliver in full.

For showers in particular, demand from the Americas and Europe is very strong, so we are trying to respond by increasing production volume by narrowing down the range of products, because we cannot cover the demand even if we are at the full production capacity.

The demand in Europe is also very strong. However, there are differences between countries here. The demand from Germany to Northern Europe has weakened somewhat over the past two months to three months, but on the other hand, demand from Eastern Europe to Russia has become stronger. Overall, the demand in Europe has been very strong as well, and we do not see any trend in which this situation changes dramatically.

For us, the question is what to sell in this area. We are receiving huge demand for flushing systems and water systems. Especially in the area of water systems, *Grohe Blue*, a product that allows you to make carbonated water directly for drinking instead of buying carbonated water in plastic bottles, is showing great growth, especially in Southern Europe.

As for the flushing system, we see the strong demand in Eastern Europe and Russia, the countries I mentioned earlier. The demand in England is also strong. To sum up, we believe that the area with weaker demand is Central and Northern Europe, and the rest of the area is quite strong.

We also have a quite large order backlog accumulated there. What we can do to deal with this order backlog is basically to increase the number of SKUs for hot-selling products and further increase the production volume at our factories.

Also, due to the delay in some production in Asia caused by the coronavirus pandemic, sanitary ware-related products have been delayed in general. Therefore, the key is how much we can catch up in this area going forward.

MC: Now, moving onto the next question which we received in chat again. This is the question from Ms. Okada of Goldman Sachs Japan Co., Ltd.

Okada: I understand that you have accumulated a backlog due to supply constraints in Europe, the Americas, and Japan. If the supply bottlenecks are resolved, can we expect to see some impact on your business performance in the next fiscal year?

Seto: It is difficult to answer this question because we would like to do resolve the situation by the end of this fiscal year if possible, but I am sure that there is an increase in the amount that is clearly behind schedule. In Japan, I don't think we have demand so large as to cause a bottleneck, but especially in the Americas and Europe, it is true that backlogs to demand have been delayed further.

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MC: Here are some questions that we received via e-mail. From Mr. Omuro, BofA Securities Japan Co., Ltd.

Omuro: The earnings presentation says that most of the problems will be solved by the end of October, but since it is already the last week of October, please tell us what you see that will be solved or not at this stage.

Seto: In Japan, almost everything has been resolved. Some part of the seat-type shower toilets is a little bit behind. However, this will probably normalize completely in the second week of November. Also, although there are some very detailed products, such as public products, that will be delayed to January, almost everything is expected to be resolved by around the second week of November.

Regarding Europe, the Americas, and Africa, this is a container issue, so it's something that will be resolved in order. From the report we received that the issues will be resolved gradually by the end of November and the fact that the products have arrived at the port, we believe that we should be able to deliver.

The fundamental problem is not so clear, but I believe that the situation in Europe and the Americas, where containers are not being unloaded, will gradually be resolved. However, there are some things for which the demand exceeds the production volume in the first place. For instance, something like the shower I mentioned earlier.

In this regard, there are internal rather than external reasons, as the production capacity itself must be increased. We would like to aim for further growth, so in that sense, I think we will continue to take our time to deal with it. However, I expect that impact continuing through December will be minimal

MC: We have received one more question from Mr. Omuro of BofA Securities.

Omuro: Earlier, you mentioned that China may need to change its business model, but what exactly can be done? Can we think of something like increasing the number of direct sales to consumers, rather than to developers?

Seto: I worded it a little wrong. Business model shift was necessary, so we are already doing it.

In terms of what we are doing, the area that we need to reduce the most is selling directly to major developers. As I mentioned earlier, in some projects, we make products for empty housing, and when we sell our products to empty housing, consumers often buy facilities on their own. So, we will increase sales to such dealers and retailers. We also offer a 24-hour renovation service called LIXIL24.

Also, when it comes to GROHE's products, there are many products that are retrofitted in their projects, so we will focus on such products. We are also increasing direct sales through ecommerce.

The ratio of such sales is increasing substantially. On the other hand, it is true that the percentage of sales to major developers is decreasing. Considering that until four years or five years ago most of our business was for developers, I think we are making a major shift in our business model over the past five years.

However, it is a fact that the major developers have been rather leading the growth of China, so if those portion of sales decrease, we will inevitably have to think about growth with some caution. On the other hand, if you want to grow in China, we have to make a decision on whether or not to incorporate them, but we have made the decision not to incorporate them too much.

MC: Now I will move onto a question that we received via e-mail. Here is the question from Mr. Yagi of Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.

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Yagi: For the items you listed in the business risk factors for H2 of the fiscal year, how much of the impact of each item could be seen in core earnings? In particular, please tell us about the cost impact of rising material prices and tighter containers.

Seto: For example, the price of aluminum was up to USD3,000 per ton, but now it is down to about USD2,700 per ton. If we were to say that it would reach USD5,000 per ton, there would be no way to think about it anymore. So the way we think about it is that we are already at a very high level, so we have included this level in our current business forecast.

So, as you may be able to see if you calculate backwards, if the price hadn't skyrocketed to that level, I think we could have made a much better upward revision. In that sense, the current figures are based on all factors that can be predicted at the moment.

MC: We have received one more question from Mr. Yagi, so I will continue.

Yagi: As for the impact on profit decline compared to the previous year, will the impact of material price hikes and container tightness be greater or lesser in H2 than in H1? Please let me know if you have any images.

Seto: It will be greater, however, as it was questioned earlier, orders are being carried over to H2, which means that demand is actually very high. Also, in Europe and the Americas, prices can be revised a little more frequently than in Japan, so we are catching up in some area. Also, if our supply capacity is limited amid the large demand eventually, we may naturally prioritize high-margin businesses.

Basically, from this perspective, although the impact of costs will naturally be higher in H2 of the year than in H1, we believe that H2 of the year will be more profitable because we will be able to earn profits that exceed the impact of costs.

MC: Next, let me introduce a question we received in the chat room. This question is from Mr. Teraoka, Daiwa Securities Co. Ltd.

Teraoka: If demand shifts from staying home to travel and eating out in the future, how do you think this will affect the current strong demand for medium- to high-end products?

Seto: We do not think that is a negative story. Because we have lost something, and that is the project business. In the case of hotels, and especially in Southeast Asia, this project business is a large part of our business.

If the demand is to shift there, especially in the area of faucets, GROHE would always be the first choice, and since GROHE products have a high profit margin in our business portfolio, I don't think this is a bad story.

When it comes to what will happen to Japan, I think it is hard to imagine a situation will change quickly from the one in which people stay at home to the one they start travelling more and more.

In addition, in Japan, what we are most looking forward to are not water-related products, but so-called insulated exterior walls and, in particular, window renovations. We are expecting very large growth in this area.

I don't think the potential in this area will not change as long as we have environmental issues, even after people start eating out. In fact, more interest in ESG increases, more demand for renovation of windows, doors, and other openings will increase. Also, when working or doing something outside of the house, there is demand for exterior, as we see the actual demand in our project. Therefore, we do not expect the demand in this area to deteriorate.

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MC: Next, we have a question from Ms. Katsuyama of Morgan Stanley MUFG Securities Co., Ltd.

Katsuyama: We recognize that the industry traditionally has the structure in which the price adjustment of raw material costs has been very difficult to negotiate. Please let us know if there are any changes in business practices or environment, such as easier acceptance now.

Seto: Well, we have had no problem in adjusting the cost of raw materials to the retail price for exteriors in the past.

As for sashes, manufacturers including us, and competitors have not done so sufficiently historically. In another words, it wasn't that the price didn't go up, but we did not raise. We have completely changed our policy in this area, and, conversely, it is something we are unlikely to pass in the current situation. Therefore, we do not expect our competitors to act differently.

However, even if our competitors did not do so, we have been able to create good products that are differentiated substantially when it comes to the window business, so in that sense, we do not think that we cannot pass through a price increase. I think we can raise the price enough to make it work.

To put it simply, windows are probably a product that is not inherently price-sensitive. I don't think there are many users who know the price of windows. In that sense, this is a problem with the structure of the industry that we brought on ourselves, and I think it is a problem that can be fixed on our own if we try.

MC: Next, let me move onto a question that we received in the chat room. From Mr. Kawashima, SMBC Nikko Securities Inc.

Kawashima: With regard to passing on the increase in aluminum prices to product prices, you mentioned the need for a longer interval between price adjustment. What are the factors that make this difficult to implement, even from the perspective of President Seto and his management team, who have challenged old industry practices? Is it not possible for other companies in the same industry to revise prices as needed, as is the case with international companies, who are also suffering from the high cost of materials?

Seto: Well. One of the strongest business practices in Japan is to do business based on the retail price and the multiplier. When the retail price actually goes up, it is easier to raise as we can present it to consumers saying this is the list price. However, if the price is increased by raising the multiplier, its difference with the retail price will be narrower, so the profit for the intermediate distributor will be reduced.

So, it is the Japanese system that inevitably requires that the retail price to be raised. In the case of Japan, this is bound to happen as long as the product is distributed. This is probably a common problem not only in our industry, but also in B2B through intermediary distribution.

So, changing that retail price would require changing the price system itself. All the catalogs may need to be changed as well. In such cases, we may be able to cope but there are often cases where intermediary distributors are not able to respond. In other words, it is quite important to promote the digitization of intermediary distributors.

Also, there was no sense of a surcharge in this industry until now. But I think the concept of surcharging is one possibility.

So, I think we need to do various things. In that sense, rather than giving up because we couldn't do it before, we are going to try to increase the frequency of such activities. Also, as I mentioned earlier, we need to convince our customers to get their understanding in reviewing contracts that have been made in the past simply by buying in large quantities. It is a steady effort, but I would like to make it this fiscal year.

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By doing this in this fiscal year, we will be able to greatly reduce the risk in the future, and it is a major factor. On the other hand, if we tolerate the current situation, next year's price hike will have to be based on the assumption of a possible price hike after that, which, in turn, is not necessarily a positive thing for the consumers.

Given that, I think it would probably be good for the ecosystem to create a situation where both sides can be flexible in that area, so I think that's what we'll be doing.

MC: Now, let me move onto the question we received via e-mail. This is from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management Co., Ltd.

Takegawa: The stock price fell sharply after the announcement of the financial results. We believe that there was disappointment toward the financial results. If there is anything that investors have overlooked, or anything that you would like to communicate for the next fiscal year, please let us know.

Seto: Well. Probably the main reason is that people were expecting a slightly better number and we could not realize it. As I have explained many times, we were not able to ship enough in Japan for the last two weeks of September. Another reason is that, especially in Europe and the Americas, containers of goods were no longer unloaded.

Therefore, we should be able to catch up once the shipment becomes possible over time. Also, this represents the fact that the demand is strong. It is like the water flowing in all at once into the pipe and the pipe got broken. It proves that more water can flow in by changing to a bigger pipe, so in that sense, I don't think it's a bad story in the long run.

We may have disappointed you as the results fell due to such issues happened in the short term and we are sorry for that. For us, the situation we are in now is something that we can't control.

However, even in the situation we can't control, we can address issues by adjusting the price, common prices, as I mentioned earlier, and time will solve the container issue and the impact of lockdowns. Therefore, I don't think there is much need to worry about that.

On the contrary, we were able to show the strength of demand and the strength of our fundamental business to some extent, which may have been overlooked.

In this sense, the profit margin has been squeezed a little by factors related to exterior that I mentioned earlier and the price hikes in commodities, but by passing on this pressure, I believe that the profit margin will improve at least to or more than the level in Q2. I hope you will consider that the fundamentals are very good.

Matsumoto: If I may add an explanation, the balance sheet has been steadily improving. We also believe that our ability to earn cash is steadily improving. Also, of course, structural reforms have made the company stronger, so I hope that you will analyze those things this weekend.

Seto: If I may add one more thing, to begin with, I think the company LIXIL itself is not trusted yet.

To be honest, I think we deserve a higher evaluation, considering the cash we are earning now, the resilience of our earnings to the problems that are occurring, the degree of growth of our international businesses as you can see, and the fact that we are developing businesses with high profit margins.

However, I believe that the fact that we have not been able to gain such a high reputation is due to the background in the past, we have repeatedly incurred large losses in areas that you did not expect, such as the [Permasteelisa S.p.A.] case and the [Jouyou] case.

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In this sense, I believe there is room for our stock to grow significantly if we are able to gain the trust of our supporters.

I am fully convinced that trust is extremely important. When I was running my previous company, MonotaRO Co., Ltd., the first three years after it went public were just as unpredictable as ever. This was partly because we were a venture company, but once we were able to analyze and predict customer behavior to some extent, and assume the correct results, our stock price rose rapidly.

Therefore, I would like to say that stocks are not just about the simple good results, but also about how much trust shareholders and investors have in the company. So, I think that because we haven't yet accumulated enough of that, the market reacts very badly to small differences.

MC: We have a few more minutes, so if you have any questions, please send them to us via chat or email.

As there are no further questions, we will end the question-and-answer session.

This concludes the financial results briefing for Q2 of the fiscal year ending March 2022 of LIXIL Corporation.

Thank you for your continued support of LIXIL. Thank you very much.

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