

[This is an English translation of the original text written in Japanese]

The LIXIL logo is displayed in a bold, orange, sans-serif font. The letters are spaced out, with the 'X' being a double-width character.

Nikkei CNBC “Dialogue with the Top”

LIXIL’s President and CEO, Kinya Seto appeared on
September 2, 2022 program

LIXIL Corporation
September 7, 2022

Nikkei CNBC “Dialogue with the Top”

Anchor: Masaki Morita, Editor Board Member, The Nikkei Newspaper

Guest: Kinya Seto, Representative Executive Officer and President, and Chief Executive Officer, LIXIL Corporation



Morita: Now we present Dialogue with the Top. Today’s guest is Kinya Seto, President and CEO of LIXIL Corporation. Mr. Seto, thank you for coming today.

Seto: Thank you for having me here today.

Morita: Now, LIXIL will be familiar to most people, but please remind us what kind of company it is.

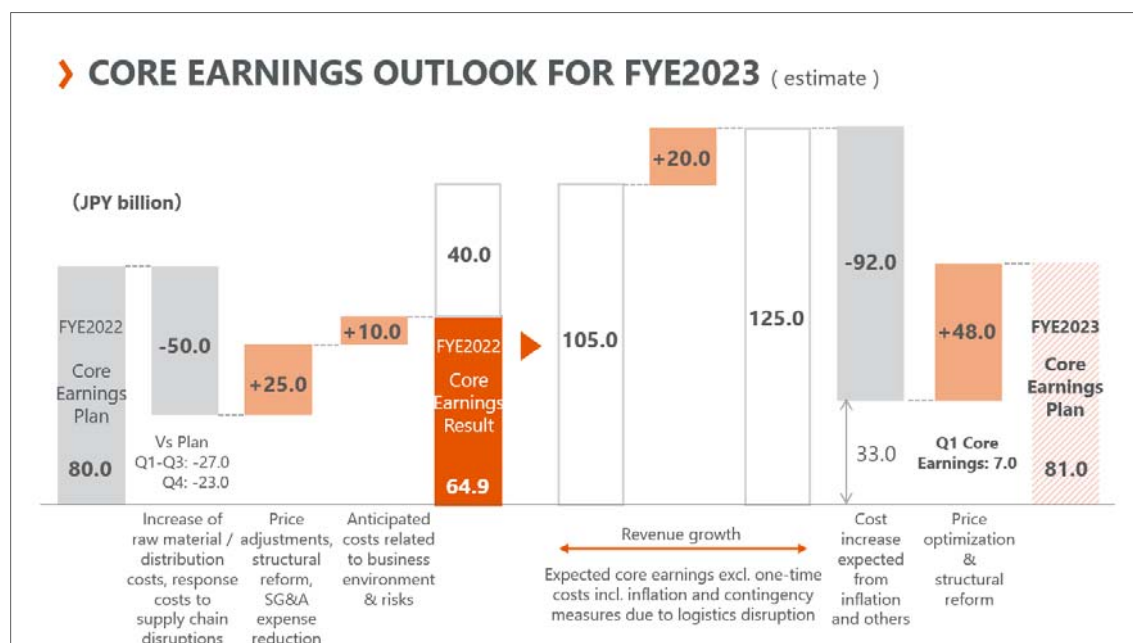
Seto: Yes, that’s right. It is a relatively new company, formed in 2011 through the merger of TOSTEM, INAX, TOEX, SUNWAVE, and Shin Nikkei, all leading Japanese housing equipment and building materials manufacturers. At that point it was a company operating only in Japan, but it has since grown to include international companies such as GROHE and America Standard. To be honest, we knew that Japan’s population was decreasing and expected the housing market to also decrease, so we quite actively, and in part by force, grew the company. The company was rather

inefficient in some ways, so we have been reorganizing those aspects. I think the company has become grounded by concentrating on its core businesses, which are water related and building materials businesses for residential homes.

Morita: I understand that around 2016 there was a period when you had large sales of about 1.9 trillion yen, but since then you have made progress with efficiency improvements via selection and concentration?

Seto: Yes, that's right. At the end of December 2021, sales were 380 billion yen (third quarter three months), which was down about 25% from the same quarter of the fiscal year that ended March 31, 2016. But on the other hand, profits were up, which indicated that efficiency improvements were effective. Also, we have been selling off some of our businesses, which may seem to have slowed down our growth. But the core parts of the company are growing steadily and organically.

Morita: I see. Now I'd like to ask about business environment and revenue. I know that there have been difficult times recently with various factors such as COVID-19 and the situation in Ukraine, or supply chain disruption and cost inflation increasing around the world. Looking back at that, can you tell us about the revenue situation now, please?



Seto: Yes, that's right. As you said, we were moving forward with our strategy relatively smoothly and according to plan while thinking we could generate about 80 billion yen in core earnings in the previous fiscal year. But, just as you said right now, three major things happened.

First up, one was cost inflation. In our case for example, the materials we buy most often are

aluminum for sashes and exteriors, and copper for faucets. To take those as examples, aluminum went up from \$1,500 per tonne in March 2020 to \$4,000 per tonne in March of this year. That has now come down to \$2,500. Over the same period, meanwhile, copper went up from \$5,000 to \$10,000 per tonne and later dropped to around \$7,500. There was a particularly sharp price increase from January to March this year.

Secondly, at one point the cost of fuel had risen, increasing the cost of container freight rates (shipping costs) ten to twenty times. There was also a considerable period of time when freight wasn't moving at all. During the COVID-19 pandemic and other times, there was a situation where cargo was returned because port operators and transport companies weren't able to unload it anymore.

In the end, it wasn't just COVID-19; there were also often problems such as the sudden shutdown of factories due to power shortages, or the shutdown of entire towns. In our case, cost inflation amounted to around 50 billion last fiscal year, in particular a large increase in costs at the beginning of this year from January to March.

There was around 10 billion yen that we had anticipated to some extent, and about 25 billion yen of recovery measures we took after that. But in the end, we did not reach our target and ended up at 65 billion yen.

That was extremely disappointing. But to put it another way, if it wasn't for such exceptional circumstances, we would have been able to reach around 105 billion yen, not to mention 80 billion yen (our forecast at the beginning of the fiscal year).

Morita: So in other words, the figure of 105 billion shown in the bar chart is the figure you might have been able to achieve the previous fiscal year.

Seto: Regarding the current fiscal year, looking at the 105 billion, we should be in a position to get to around 20 billion.

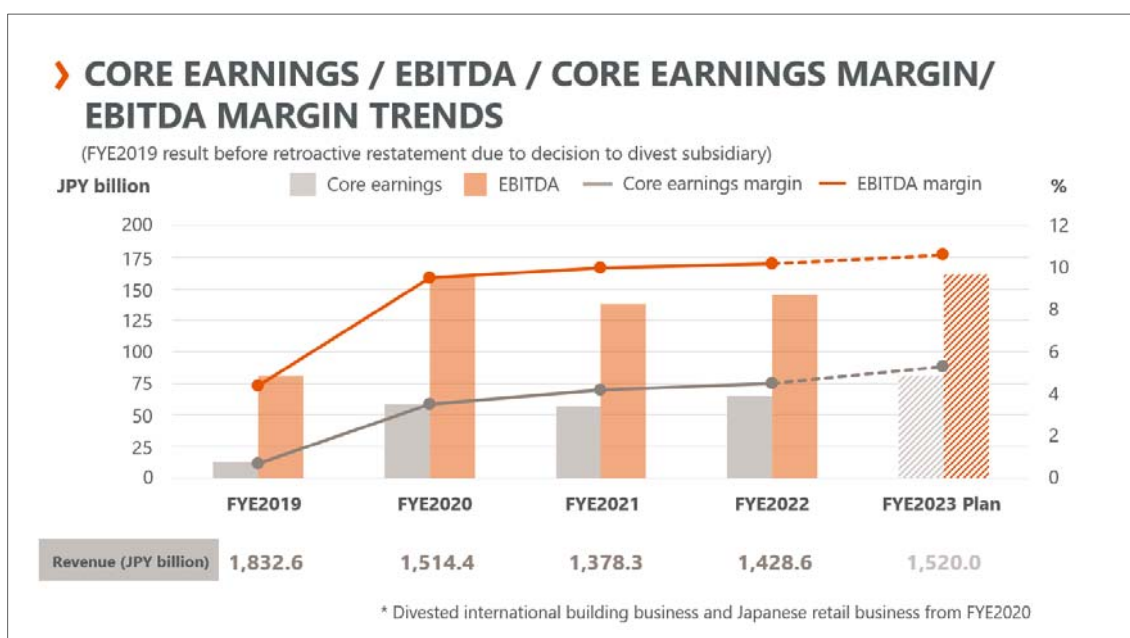
Morita: 20 billion more?

Seto: But I've explained how the period from January to March of this year was very difficult. Those elements remain, so the highest costs will be reflected in the current fiscal year. In that sense, we will probably spend about 92 billion yen this fiscal year on such inflation and the special countermeasures I mentioned earlier.

Morita: Just now you mentioned that the prices of various materials are starting to drop slightly. Are you starting to see the effects of that?

Seto: We won't see that this year. First up, we hedge our copper and aluminum. Of course, we keep a stock of goods we have manufactured; and, as I mentioned earlier, supply chains were disrupted by COVID-19, so naturally we have a substantial inventory. In that sense, higher costs will be reflected until the end of the year. But we expect to be gradually released from that from around January next year. On the other hand, since price increases to reflect higher costs will not begin in earnest until October, the first half of the fiscal year will inevitably be difficult. We plan to push earnings up 48 billion yen through the various measures I mentioned earlier so the final figure will be 81 billion yen. We'll do our best this fiscal year but mostly it will be the first half that is hard. That's why the first quarter only produced seven billion, but we can do our best from October onward.

Morita: You have just talked about core earnings, but please explain about EBITDA indicators too.



Seto: We use IFRS, so operating profit according to JGAAP is equivalent to our core earnings. On the other hand, EBITDA is profit before amortization, and in fact, as you can see here, a characteristic of our company is an enormous difference between EBITDA and core earnings. One reason for this is the substantial amortization of intellectual property and brands following the purchase of GROHE and American Standard that I mentioned earlier, as well as the large number of factories and assets which we have compared to our industry competitors, which makes the amortization component larger. On the other hand, however, our cash earnings are top class for our industry, and I think that is surprisingly poorly understood. When it comes to core earnings, perhaps they aren't particularly good compared to our competitors, especially when compared to size of sales.

However, when we consider EBITDA, I'd like people to understand that it is top class. Also, I talked about sales earlier. Even though sales have been falling due to selling off businesses, these numbers here (core earnings margin and EBITDA margin) have been going up. I hope people can take this opportunity to understand that, had it not been for inflation and other factors, not only would we have been able to increase our business a little more naturally and grow our profits organically in the fiscal year ended March 31, 2022, but also that the absolute amount of EBITDA is quite large.

Morita: I understand. Here's another question. One term that has been attracting a lot of attention in the market recently is "Purpose Management". In your company's case, LIXIL operates in 150 countries and has a diversity of employees, so I think it must be difficult to unite them and move in one direction. But you have the LIXIL Playbook, don't you?



Seto: It is just as you say. As I explained earlier, this company is a "gathering together" of other companies, so the company's identity ends up being based on the companies that individuals worked for in the past. That aspect is where we all need to come together as one.

Our strength is that we are global. Because there is no other company in our industry that does business in 150 countries. Among our competitors, we are the only one that has a presence in Europe, Asia, and the Americas, so in that sense, we must unite so that the company can show its true strength. We must become "One LIXIL".

Because of that, first we decided to create a goal that we could all be proud of.

We decided to state LIXIL's "Purpose" in that sense as "make(ing) better homes a reality for everyone, everywhere."

And, as we considered how we could make that happen, we decided to create a Playbook.

But what specifically should we do to achieve that purpose?

Firstly, as I mentioned earlier, we will concentrate on our core business through things such as selling off businesses that do not contribute to our core business. That's one, and that is almost finished.

Another thing is that our industry is fundamentally related to housing, which along with food and clothing is one of the necessities of life. So, the market expands not only with the growth of the world's population but also as those people become affluent. Yet, Japan's own population is shrinking. On the other hand, given that two-thirds of our revenue comes from our business in Japan, we can say that the Japan business is very mature and has a high market share. Because that's so, we really have to make cash in Japan. We need to make solid cash here, and since the international market is clearly a growth market, we need to put money into profitable areas in the international regions as well.

But, as I mentioned earlier, we have a lot of assets, and conversely, we have a lot to use for innovation. Regarding the need to make that innovation a strength... an "in this kind of scenario, let's all work together" type of unity is crucial. And alongside that of course we must also thoroughly implement the Corporate Responsibility Strategy that makes people feel what we are doing is useful to the world.

Morita: Please explain that in brief.



Seto: We do it by making sure everyone understands these three things and by setting targets for each of them: “Global Sanitation & Hygiene”, “Water Conservation & Environmental Sustainability”, and “Diversity & Inclusion”.

Morita: In that context, you mentioned that you place huge importance on “Global Sanitation & Hygiene,” and you are developing a brand called SATO.

Seto: Yes, we are. SATO is not a person’s name. It is short for “Safe Toilet”.

Seto: In fact, globally around 1.7 billion people do not have adequate and safe toilets. So, what do they do? In the end they do it outside. And when they do it outside, usually they do it near water. It could be a pond or a river.

And what happens then? The people who live there end up using that water, so the sanitary conditions become much worse.

Children in particular have no immunity and can easily get diarrhea if they wash their hands with that water or use it to prepare food.

Morita: I see.

Seto: More than 800 children die every day from that kind of diarrhea.

This is a truly heartbreaking situation, and since we are in the water business, we need to ensure that toilets are used more widely.

In short, by making proper toilets we will enrich the lives of all. Our goal is to provide toilets to 100 million people by 2025, and so far we have reached 35 million people.



Morita: Let's talk about how, at the same time as focusing on these social businesses, there's your international water business going forward. Living conditions vary from country to country. You're also focusing on that, aren't you?

Seto: Yes, that's right. *GROHE Blue* is a revolutionary new product that carbonates water and dispenses it from faucets, but it has another specific function: to clean water. As water around the world gradually becomes unsafe it is important to make water clean. Another important thing is to reduce the number of plastic bottles by dispensing carbonated water from faucets.

Plastic waste is a globally occurring problem, so by releasing this kind of product, we can contribute to the earth and our employees can be proud. We would like to focus on this kind of product.



Morita: We are gradually running out of time, but please talk about the improved profitability of the Japan business.

Seto: Regarding the Japan business, as I mentioned earlier, in a market that is mature and where growth is somewhat declining or actually declining, the important thing is that we, as a company, try not to have too many assets. And that we ensure we can make a profit. By focusing on design, like that kind of water-related product, for example.



Morita: And renovation too?

Seto: As new construction in Japan continues to decline, the renovation market is important for taking good care of homes. It is also important to make money in the digital area.

Morita: Let's take a quick look at the next image. (Pointing at the *InPlus for Renovation* image). You're talking about this?

Seto: Yes, that's right.

Morita: With the declining birthrate and aging population, many things will happen. You are offering new value through things like *KINUAMI U*, aren't you?

Seto: Yes, that's right. As I said before, innovation is extremely important. We have created a product called *KINUAMI U*. Our *KINUAMI U* product directly makes bubbles when you shower.

Normally, you would turn on the hot water, pick up the soap and wash, but bubbles come out from the start. Because scrubbing the skin is unnecessary, this could be something used to hugely improve the lives of people who, for example, are elderly, have limited use of their hands, or have eczema.

Morita: For example, it could also be used in nursing homes.

Triple-paned windows significantly improve the thermal insulation performance of windows, which contributes to drastic improvement of CO₂ emissions reduction effect of the houses

› CO₂ reduction effect by improving thermal performance of windows at homes



If all the existing houses in Japan were refitted with triple-paned windows

CO₂ reduction

Approx. **15.09 M tonnes/annual**

[Equivalent to approx. 60% of the CO₂ reduction effect from improved fuel efficiency of cars]



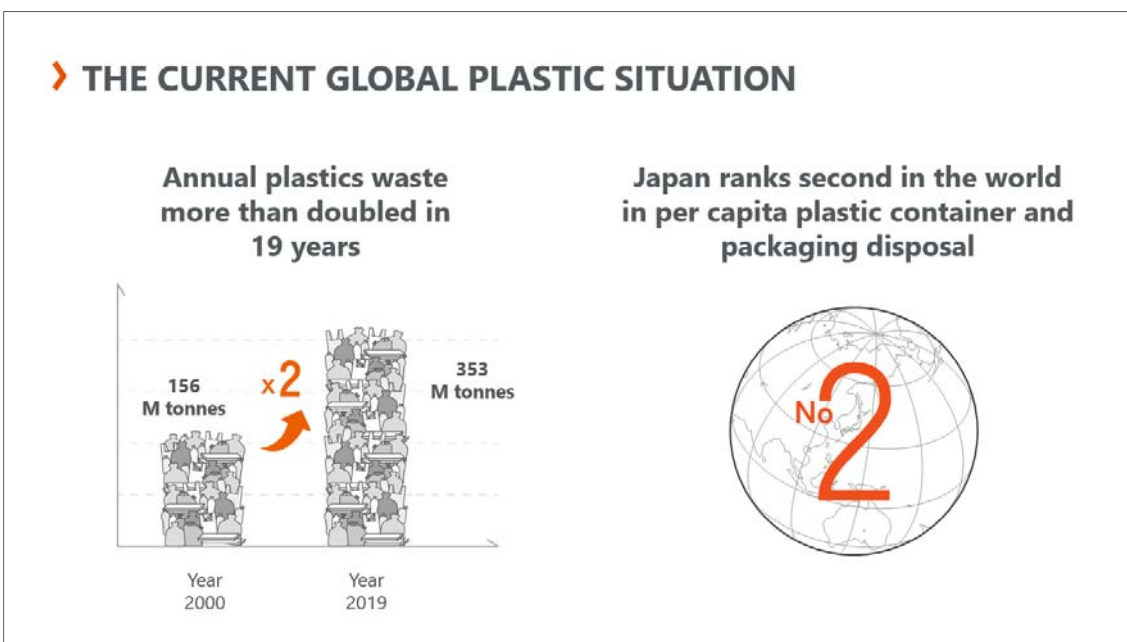
Single-paned window

Triple-paned window

Morita: Next up... decarbonization and energy conservation will be very important topics going forward. Please tell us about your efforts in those areas.

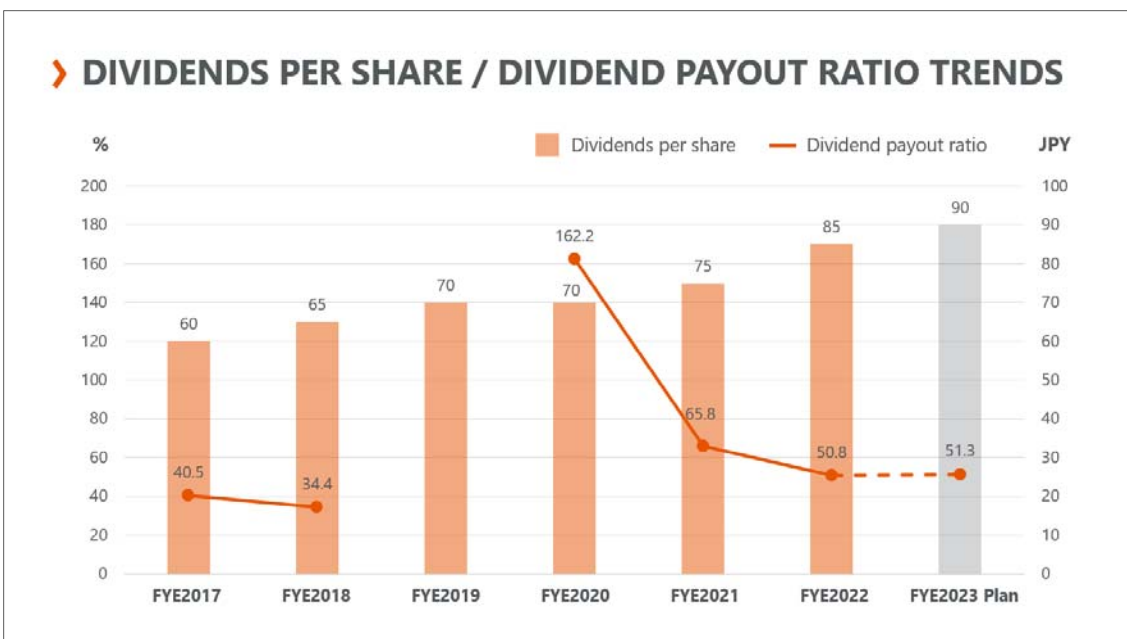
Seto: As a window manufacturer, we know that roughly 40% of primary energy consumption is through the building, and 58% of the energy goes out through windows. Meanwhile, about 90% of Japanese houses don't meet 2016 energy conservation standards. There are many single-paned windows. Just by making those windows triple glazed, we can reduce CO₂ by about 15 million tonnes per year for Japan as a whole.

This is what we need to focus on, and looking at a single industry, this is probably the largest CO₂ reduction.



Morita: It's said that plastics will also be important going forwards.

Seto: Yes, that's right. Plastic is also a major problem, and we need to reduce the number of plastic bottles. But we are also using waste plastic as a resource to make new products. We are planning to make an announcement this fall, so please watch out for that.



Morita: In 30 seconds or so, please tell us about shareholder returns.

Seto: We have said that the dividend payout ratio will be 30% or more, and have announced plans to increase it from 85 yen to 90 yen for the current fiscal year. EBITDA is at a very high level, so I

believe we will be able to create sufficient resources to provide returns to all our shareholders.

Morita: I see. The stock price is what it is, but there's no need to comment now. Finally, please could you provide a 30-second or so message for our viewers?

Seto: I would like to make LIXIL a good company... a company that is good for the world and that its employees can be proud of... a company like that. For example, we need your support for SATO and our window initiatives.

Therefore, we would like to create a situation where investing in this company is a good thing for Japan and the world. Please support us in that.

Morita: Today we spoke with the president of LIXIL, Kinya Seto. Thank you very much, Mr. Seto.

Seto: Thank you very much.

[ENDS]

Cautionary Statements with Respect to Forward-Looking Statements

Statements made in this material with respect to plans, strategies and future performance that are not historical facts are forward-looking statements. LIXIL Corporation cautions that a number of factors could cause actual results to differ materially from those discussed in the forward-looking statements.