



LIXIL Corporation

Q3 Financial Results Briefing for the Fiscal Year Ending March 2022 for Investors and Analysts

January 31, 2022

Event Summary

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[Participants]		
[Number of Speakers]	3	
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	Sachio Matsumoto	Director, Representative Executive Officer, Executive Vice President, and CFO
	Kayo Hirano	Senior Vice President, Leader, Investor Relations Office
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	Daisuke Fukushima	Nomura Securities Co., Ltd.
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Presentation

MC: It is now time to start the financial results briefing for Q3 of the fiscal year ending March 2022 of LIXIL Corporation. This briefing will be held via live webcast and conference call. Thank you.

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

Seto: Thank you.

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

Matsumoto: Thank you.

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

Hirano: Thank you.

MC: I am Fukushima from Investor Relations Office, and I am the moderator for today's session.

Next, as for the presentation materials for this meeting, please refer to the web screen if you are viewing the webcast, or to 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 Q3 of the fiscal year ending March 2022. After that, we will have a question-and-answer session. The session is scheduled to end at 5:45 PM. Thank you for your cooperation in advance.

President Seto will now explain the financial results for Q3 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)
	Continuing operations
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
	Discontinued operations
	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"



Seto: Hello everyone. I will now explain the details of the financial results for Q3 of the fiscal year ending March 2022.

We use the term "revenue" in IFRS, our standard, to refer to net sales under Japanese GAAP. As for the profit part, which is the center of this explanation, we use the term "core earnings" to describe operating profit under Japanese GAAP.

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› KEY HIGHLIGHTS

Summary of results for Q3 FYE2022

- **Revenue increased year-on-year**
Despite the impact of procurement difficulties and logistic disruptions in parts of the Japan businesses, revenue increased on continued strong sales growth in the Americas and Europe, as well as an economic recovery in the Asia-Pacific region
- **Gross profit margin and core earnings margin maintained improvement year-on-year**
Core earnings (CE) decreased in the three months of Q3 due to increased raw material and other costs. CE for the nine-month period continued its overall improvement in both the total amount and margin due to the implementation of continued structural reform measures, SG&A expense reduction measures from the beginning of the fiscal year, and handling of challenging operational environment
- Progress against the full-year forecast is 77% for core earnings and 88% for net profit⁽¹⁾
- Demand especially for renovation remains firm globally despite need to carry-forward demand in parts of Japan businesses due to procurement challenges

LIXIL (1) Net profit = Profit attributable to owners of the parent

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We believe that we did our best this time, considering the various difficult circumstances.

In particular, as I'm sure you are aware, there have been COVID-19 and other problems in various regions, especially in Asia, and some businesses have had difficulty procuring parts. This was not only for our products, but also for the parts of the products that are delivered together with our products.

Then, the logistics became very tight. In this context, first of all, the Americas and Europe, especially Europe, performed well.

Finally, compared to the COVID-19 pandemic, parts of Asia are getting better. Indonesia and India have been improving considerably, and Vietnam and Thailand are also starting to improve, although they were struggling in Q3. There were many problems, but we were able to overcome them and increase our revenue.

In terms of profit, in particular, raw materials and other costs caused a slight decrease in profit in the three months of Q3. However, we have been improving our business structure, lowering SG&A expenses since the beginning of the fiscal year, and addressing various operational issues. In the cumulative period, profits increased and the profit margin improved. The progress against the full-year forecasts of core earnings is 77%, and that of net profit is 88%.

As for the future, there is a slight tendency in some businesses in Japan to buy or make products after confirming the delivery of the parts mentioned above. In this sense, we are seeing some postponement of demand, but we believe that the demand for renovation is very strong to begin with.

Globally, the Americas and Europe are very strong, as I mentioned earlier, and Asia is also recovering.

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Although there are some concerns about China, it is safe to say that the market is strong in other regions.

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› KEY HIGHLIGHTS

Update on business environment issues and countermeasures

Responding to challenges in operational environment such as procurement difficulties and logistic disruption



Increase of raw material and other costs



Supply chain disruption



Increase of natural disasters and spread of infection

- **Price optimization that can flexibly respond to changes in the external environment and structural changes**
 - ✓ Shortening of time lag
 - ✓ Digitalization
 - ✓ Request for business partners' cooperation
- **Shift to mid-to-high-end price range products**
- **Strengthening of supply chain and stable supply of products**
 - ✓ Narrowing down of production items
 - ✓ Promotion of parts standardization
 - ✓ Redundancy of supply chain (multiple suppliers and sites)
- **Strengthening of resilience to changes in the external environment**
 - ✓ Continuous reduction of fixed costs (HQ relocation to smaller space, reorganization of production system, and optimization of personnel distribution)
 - ✓ Strengthening of platform production

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I am sure that you are all interested in the recent business environment and how we have responded to it. As a business owner, it would be insufficient if I only explained our countermeasures, so I would like to also explain how we have been able to link these events and various happenings to our long-term growth.

First, regarding our response to what has happened, the price of raw materials has increased, as you already know. As I mentioned last time, we are basically thinking of raising the price.

However, it's not like we can raise it right away, like in the Americas and Europe. In the case of Japan, there is always a time lag due to the revision of the retail price, the multiplier, and the catalog problem. We made a lot of efforts to shorten the time lag this time.

One of these is to go digital. We started indicating prices digitally so that they can be easily changed. We are no longer relying solely on paper printing.

Also, by asking for the understanding and cooperation of our partners, we were able to get them to accept our request to raise prices more than twice a year, which had never been done before.

Another thing is, regarding the price range. It is difficult to raise prices of commodity products. Therefore, we have been making efforts to lower our price sensitivity by shifting to high value-added products.

Second, the supply chain is tight. This has already happened in many places. However, the first thing we did when the COVID-19 pandemic occurred was to narrow down our production items. This is a very important point, and the bottom line is that when something like COVID-19 happens, people stop going out. In this way,

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rather than searching for various products, they will try to buy products that they know, or secure products that they know and feel safe with.

Therefore, by focusing on the high demand products first, we are able to reduce the risk itself.

We have also continued to standardize parts.

Also, we have made the supply chain redundant. As a result of our continued effort, including in-house production, we have been able to continue production in the face of the supply chain disruption, which is quite a feat in this industry.

Of course, costs have gone up by producing things in Japan that used to be produced in Vietnam or China. However, I think it was a good thing that we were able to get by without causing any trouble to our customers.

Then, there are natural disasters and the spread of infectious diseases. There is no way around it. Something like this happened this time, but we don't think this is something special. We are sure there will be more to come.

One thing we can do in this context is to strengthen platform production first. When we make the production of a factory into a platform, the redundancy of production increases greatly.

We also need to reduce fixed costs and improve marginal profits as much as possible. The purpose of the relocation of our head office to smaller space is not necessarily a cost reduction, but rather the transformation of workstyles. However, we have been able to lower our fixed costs by increasing work from home.

Then, regarding the production system, we are closing the factories on a certain schedule, and we are optimizing personnel distribution.

By doing these, we have been able to respond flexibly to changes in the external environment to some extent.

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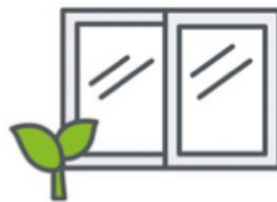
KEY HIGHLIGHTS

Promoting measures for growth and capturing new opportunities in the new normal, while continuing to deal with ongoing operational issues



Responding to rising commodity prices

- Expansion of renovation products
Shift from the conventional renovation focusing on the water related areas to renovation that improves the performance of the entire house



Responding to growing awareness of environmental issues

- Approx. 90% of existing homes in Japan do not meet current energy conservation standards
- By replacing the glass of a single pane glass window, which is used in about 70% of existing homes in Japan, with triple pane glass, the estimated CO2 emissions reduction would be approx. 15.09 M tons/year⁽¹⁾
- In Japan, where fossil fuels are the main source of energy, energy conservation measures in existing homes will contribute greatly to decarbonization



Responding to demand in the new normal

- Develop differentiated products that meet growing needs from society in the new normal
 - ✓ Expand use of water systems such as GROHE BLUE
 - ✓ Launch of QuickFix⁽²⁾, a product portfolio tailored to DIY requirements
- Promotion of recycling of aluminum and resin sash
- Utilization of recycled plastic wood

LIXIL ⁽¹⁾ Priority for measures against global warming is "high performance houses". LIXIL published a report on "High performance houses for the realization of a decarbonized society". ⁽²⁾ Business and ESG related topics page25 "Launched GROHE QuickFix Series" <https://newsroom.lixil.com/ja/2022011701> (Japanese only as of January 31. English report will be available in early February. 4

However, this is not all. This is the next point.

While thinking about this, we also consider that the business changes that are actually occurring are becoming quite permanent changes, and that these permanent changes are an important trigger for growth.

I often use the term "Blessing in disguise" to refer to the fact that when there are many problems, conversely, opportunities are also created.

As commodity prices continue to rise, it will become more and more difficult to implement the business model of rebuilding low-cost houses in a short period of time, which has been the premise of Japanese housing until now.

If this happens, we will be able to fix the exterior walls, windows, doors, roofs, shutters, and many other things to improve existing houses. In other words, until now, when we talk about renovation, people only think about the water related areas. However, products other than toilets, kitchens, and baths will also be subject to renovation. Accordingly, I believe that the market for renovation will become very large.

Traditionally, the common sense in Japan has been that the ratio of the new construction market to the renovation market is two to one. However, in so-called developed countries, such as the Americas and Europe, the demand for renovation is three or four and new construction is one. It's the opposite of Japan.

If the market changes in this way, we can naturally grow the renovation market. That's why we are changing our business model from one that focuses on water-related products to one that sells a variety of products. This is a great opportunity for growth.

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The second is environmental issues. In particular, social pressure on CO₂ emissions has been increasing.

As you know, in Japan, the largest sector of primary energy consumption is buildings. It is said to account for about 40%.

On the other hand, the percentage for mobility, such as automobiles and trains, is in the 20% range.

In other words, we use the most energy in our homes. Of these, 58% are openings where energy is going out (loss and dissipation of heat). It is mainly windows and doors. In the case of Japan, heat insulation is very poor compared to the Americas and Europe.

For this reason, the Japanese government has been campaigning for better insulation, such as ZEH (net zero energy houses), but this is only for new houses.

In the case of automobiles, if we took measures on new cars, all cars can be replaced within five to 10 years, but this is not the case with houses. There are only about 840,000 new houses being built this year, compared to about 62 million existing houses.

Therefore, it is necessary to improve the energy efficiency of the existing stock of houses. And of these 62 million existing stock houses, about 90% of them do not meet Japan's energy-saving standards for 2016. If we do not do something about this, we cannot reduce CO₂ emissions.

The fastest way to do that is with windows. For example, just by remodeling the single pane glass used in about 70% of existing houses in Japan to triple pane glass, about 15 million tons of CO₂ can be reduced annually. The Ministry of Economy, Trade and Industry is currently considering making all automobiles eco-friendly, and the target value for energy conservation is about 25 million tons, so this much can be achieved with windows alone. Moreover, it only takes about three hours to change a window.

Furthermore, in the case of automobiles, even if we say that we are saving energy, we cannot necessarily reduce CO₂ emissions as long as the electricity itself is made from fossil fuels when we switch to electric vehicles. In the case of windows, however, there is a direct effect because replacing the windows will actually reduce energy consumption itself.

Not only that, but by changing the windows, we can reduce heat shock. More people die from heat shock than from traffic accidents. Therefore, the health of the people can be improved, and just changing the windows can make a big difference. This market is very large.

If we were to replace all the windows in one house with the triple pane window called *Replus*, which is a new product we launched this time, these would cost about JPY2 million. If we could change the windows of, say, 10 million houses with this product, it would be a JPY20 trillion market.

The annual sales of our conventional sashes are over 100 billion Japanese yen, so there is a huge market, and selling these sashes is useful for the world.

This time, we have launched *TW*, high-performance triple pane hybrid windows, and *Replus*, which enables replacement to high-performance triple pane hybrid windows. We are planning to sell more and more of these products from this February. This is a huge growth opportunity.

Also, there are many different types of businesses that can respond to the new normal. In Europe, products that are tailored to the new normal are selling very well and contributing to our profits.

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One is the water system. I have already told you about a product called *GROHE Blue*, which allows people to drink carbonated water from the tap after purifying the water. This is a very growing trend.

Then I would like to introduce you to a new brand of GROHE, *QuickFix*. The number of so-called plumbers is insufficient, which is a problem not only in Europe, but also all over the world. When we don't have enough of those people, we created this product so that they could easily change it by themselves, for example, by using a QR code and watching a YouTube video.

This can be done by amateurs, of course, or by professional plumbers. I believe that this product will be popularized in the future because it is very fast and easy. This is a brand and a product line that we have very high expectations for.

We are also promoting the recycling of aluminum and resin sashes. As for aluminum and resin sashes, recycling has not been strengthened much so far. Resin sashes, in particular, have hardly been recycled in Japan, but we are now selling resin sashes that are designed to be recycled, and aluminum sashes that have the highest recycling rate in the industry.

And as I explained in my previous presentation, recycled plastic wood will not only reduce CO₂ emissions, but will also be one of the great alternatives under the concrete shortage.

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› PERFORMANCE HIGHLIGHTS

■ Revenue: JPY 1,074.4 billion, up 4% year-on-year, Q3 (3 mon.) up 1%

- Q3 (9 months) : -2% in Japan (+1% excl. impact from divestments) and +20% in international markets
- Q3 (3 months): -4% in Japan (-0% excl. impact from divestments) and +13% in international markets. Stable supply of high demand products and a strong international businesses compensated for impact from supply shortages and parts procurement difficulties in Japan

■ Core earnings: JPY 61.8 billion, up JPY 16.5 billion year-on-year, Q3 (3 mon.) down JPY 5.4 billion

- Q3 (9 months): Driven by sales growth in the Americas and Europe, the progress of structural reform in Japan, and SG&A expense reduction from the beginning of the fiscal year
- Q3 (3 months): Declined due to the increased raw material price that exceeded the price adjustment at the beginning of the fiscal year and an increase in costs for stable supply of products, but this was addressed by SG&A expense reduction measures such as promoting digitalization

■ Profit for the quarter⁽¹⁾: JPY 41.5 billion, up JPY 2.8 billion year-on-year

- Steady progress in profit for the quarter as a result of reduced volatility in business performance due to focus on core businesses

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

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This is the financial highlights for Q3. As I mentioned earlier, in terms of the nine-month period, revenue and profits increased, but in terms of the three-month period, profits decreased slightly. We had no choice as the prices of raw materials increased beyond the product price optimization at the beginning of the fiscal year, and costs to ensure a stable supply increased.

However, we were looking for ways to reduce SG&A expenses, so we promoted digitalization as aggressively as possible, and as I mentioned earlier, products in our European market with high profit margins sold well, so I think we managed to get through this time at a good level.

As for the profit for the quarter, reducing volatilities in business performance that we have seen in the past by concentrating on our core businesses, we have been able to generate stable profit, and increase the profit as well. As I mentioned earlier, the progress against the full-year forecast of the net profit is 88% at present.

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› Q3 FYE2022 CONSOLIDATED BUSINESS RESULTS

JPY billion	Q3 9 months				Q3 3 months		
	FYE2021	FYE2022	Increase /decrease	%	FYE2022	Increase /decrease	%
Revenue	1,035.5	1,074.4	+38.9	+3.8%	378.2	+3.2	+0.8%
Gross Profit	349.9	373.4	+23.5	+6.7%	129.2	-3.1	-2.3%
(%)	33.8%	34.8%	+1.0pp	-	34.2%	-1.1pp	-
SG&A	304.7	311.6	+6.9	+2.3%	104.7	+2.3	+2.3%
Core Earnings ⁽¹⁾	45.2	61.8	+16.5	+36.6%	24.5	-5.4	-18.0%
(%)	4.4%	5.7%	+1.4pp	-	6.5%	-1.5pp	-
Profit for the quarter including Discontinued Operations ⁽²⁾	38.7	41.5	+2.8	+7.3%	15.8	-12.0	-43.2%
EPS (Yen)	133.35	142.79	+9.44	-	54.33	-41.55	-
EBITDA ⁽³⁾	105.9	122.2	+16.3	+15.4%	44.8	-5.2	-10.5%
(%)	10.2%	11.4%	+1.1pp	-	11.8%	-1.5pp	-

- **CE margin:** Improved by 1.4pp (Gross profit margin improved by 1.0pp, SG&A ratio improved by 0.4pp)
- **Gross profit margin and core earnings margin:** Improvement driven by an increase in the sales distribution ratio of the international business with higher profit margin and benefits from structural reform in previous years as well as price optimization and SG&A expenses reduction measures
- **SG&A expenses:** SG&A expense ratio improved by 0.4pp despite the increase of JPY6.9 billion in nine months year-on-year (Japan JPY 7.3 billion decrease, International JPY 14.2 billion increase) due to increase of revenue

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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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In terms of consolidated results, gross profit margin also increased from 33.8% to 34.8% year-on-year, and core earnings margin increased from 4.4% to 5.7%.

This is due to the fact that we have been able to reduce costs and sell high value-added products.

If we hadn't had to deal with the rising cost of raw materials, which have never been seen before, and increased costs, such as bringing in products by air that we didn't have enough of, or making products in Japan that used to be made in international factories, including lockdowns, we would have been able to achieve even better results. I am very disappointed.

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› Q3 FYE2022 BUSINESS RESULTS BY SEGMENT

Strong LWT business drove revenue increase and core businesses drove core earnings growth

Segment	JPY billion	Q3 9 months			Q3 3 months	
		FYE2021 Results	FYE2022 Results	Increase/ decrease	FYE2022 Results	Increase/ decrease
LWT	Revenue	577.4	647.2	+69.8	226.7	+15.0
	CE	46.4	64.5	+18.1	23.7	-2.8
LHT	Revenue	366.1	354.4	-11.7	124.7	-5.9
	CE	26.0	29.1	+3.1	10.8	-1.6
LBT	Revenue	70.8	65.7	-5.1	25.1	+0.6
	CE	0.8	2.0	+1.2	0.9	+0.6
H&S	Revenue	36.9	22.7	-14.2	7.7	-6.2
	CE	1.9	-0.5	-2.5	0.2	-0.8
Consolidation, adj. & other	Revenue	-15.7	-15.6	+0.1	-6.0	-0.2
	CE	-29.8	-33.2	-3.4	-11.1	-0.8
LIXIL	Revenue	1,035.5	1,074.4	+38.9	378.2	+3.2
	CE	45.2	61.8	+16.5	24.5	-5.4

Forex impact :

Q3 nine months: Revenue +19.2 billion, Core earnings +1.9 billion

Q3 three months: Revenue +7.7 billion, Core earnings +1.1 billion

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Looking at the results by segment, it looks like the housing business is suffering a bit, but revenues are up here as well.

However, it is true that it was difficult because the housing business used aluminum the most, and it was also a business where production in Vietnam was shifted alternatively to production in Japan, so we had some difficulties there.

On the other hand, we were able to increase profits and revenues in the water-related business, mainly in international businesses.

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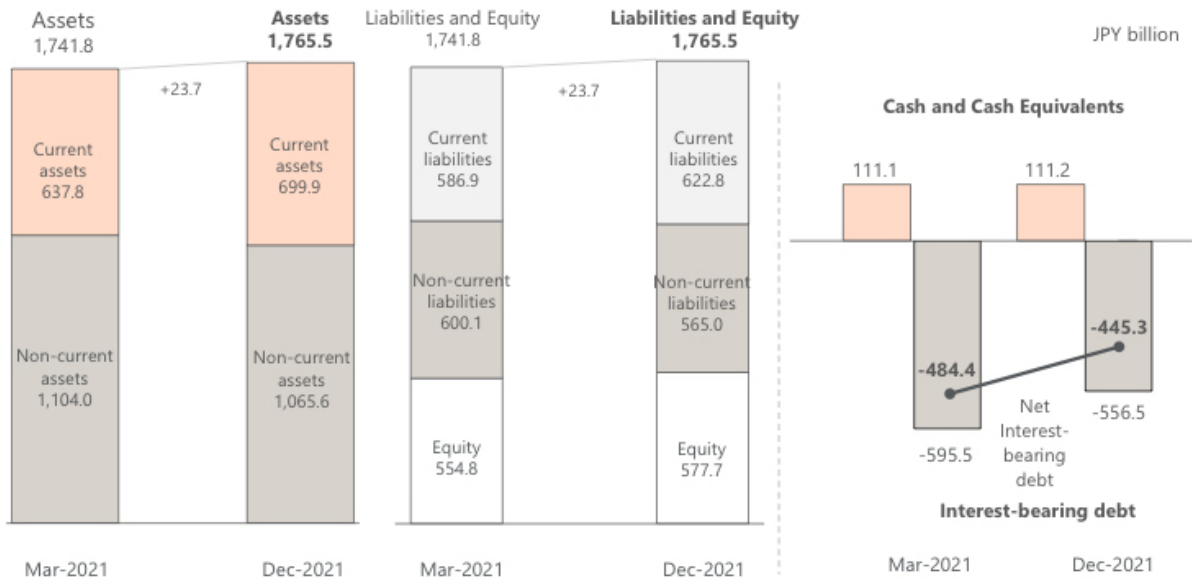
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> CONSOLIDATED FINANCIAL POSITION

Equity ratio improved by 0.9pp to 32.6% from March 2021.
Steady progress toward full-year plan of 34%



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Our equity ratio is currently 32.6%. We are making good progress against the full-year plan of 34%, and the increased profits are helping to lower interest-bearing debts.

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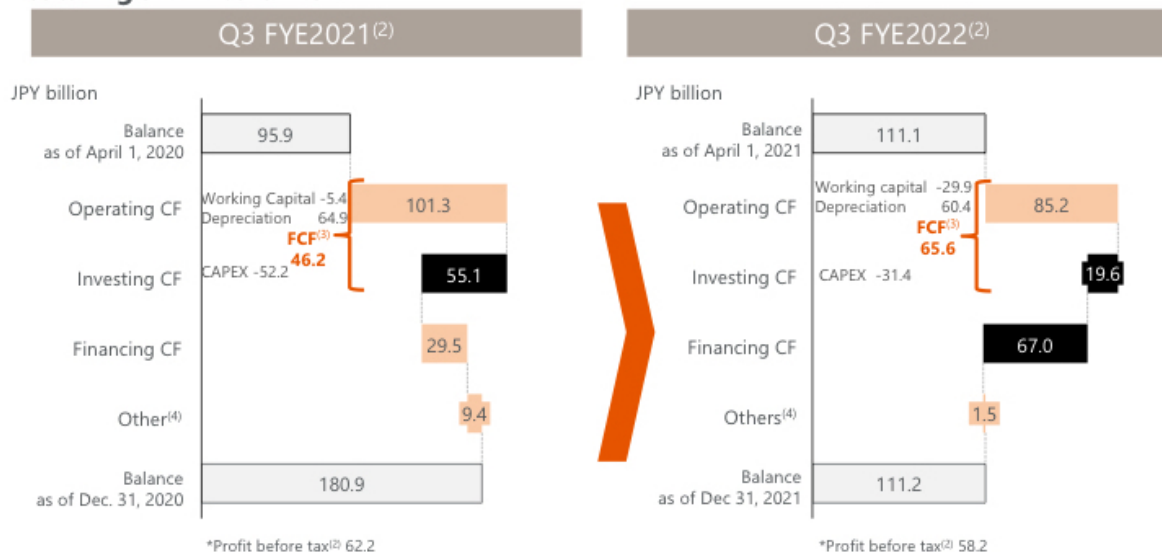
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› CASH FLOW STATUS AND CASH BALANCE

Free Cash Flow (FCF) increased by JPY19.5 billion due to lower need for investment as a result of the asset-light investment strategy, increase in working capital due to business reform, and various costs incurred with progress of structural reform⁽¹⁾ totaling JPY17.6 billion



- (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 9 classified as held for sale

In terms of cash flow, working capital increased due to the absence of structural reforms last year, but free cash flow increased due to a decrease in investment as a result of the asset-light investment strategy.

We have been able to pay back some of the money that we had to borrow urgently due to COVID-19 last year.

The above is a brief explanation of Q3 financial results.

I would like to cover the details on the remaining slides by answering your questions.

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Question & Answer

MC [Q]: We will now have a question-and-answer session.

Let me introduce the first question. This is a question from Mr. Daisuke Fukushima of Nomura Securities Co., Ltd.

You have announced that you will raise the prices of the products you receive orders in Japan from April. If you are able to raise the prices as you expect, will you be able to cover the increase in material prices? How can we see the effect of cost reduction in the fiscal year ending March 2023 for your company?

Seto [A]: We believe that the price increase can definitely be done as speculated. However, as for April onwards, there are some products that have not been able to cover some of the increase in material prices. This is because the announcement of the price hike was implemented in December last year, and in January, the price of commodities increased further.

Therefore, some items will be raised one more time, and we will also actively raise prices for items with relatively low unit prices in the overall average price. We will do this in various ways, but, of course, we will cover this in some way, although there could be some time lag.

On the other hand, as for the effect of cost reduction in the fiscal year ending March 2023, we will implement the career option this year as well.

Not only that, but we are also reducing the size of our headquarters, which is currently very costly to maintain, and reducing the number of sales offices by less than 1/2.

The factories are also systematically lowering their costs in turn, and platform production is also underway, so you can continue to expect significant cost reduction effects.

MC [Q]: Now, I would like to introduce the next question. This is a question from Mr. Kawashima of SMBC Nikko Securities Inc.

In the three months of Q3, in the international LWT business, ASB, GROHE, and the segment as a whole saw increased revenues and decreased profits. What are the factors behind this and what is the outlook?

Seto [A]: Basically, last year's Q3 was good because of the pent-up demand, of course, but the biggest thing was that the cost went up.

For both ASB and GROHE, we have raised prices three or four times, but especially in Q3 from October to December, the cost of logistics rather than materials has risen significantly. In some cases, there were situations where we needed to airlift to get things delivered, so the basic factor was cost, and conversely, because of cost, I believe this was a temporary part of the problem.

However, for containers, costs will probably continue to be high until at least September of this year, so we will continue to pass it on to our customers.

Compared to Japan, both ASB and GROHE can raise prices digitally to some extent, so I don't think there will be the same time lag as in Japan.

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But of course, as for the difference between the contract sold and the delivery, that cannot be raised in follow-up. When we are at the stage of recording revenue, if raw materials in stock go up, let's say, or if we have to use high-cost things when we produce after selling, we can't always maintain cost. So basically, with regard to so-called commodities, we are always passing on, and I believe we will be able to pass on in the future as well.

However, something unpredictable in advance could happen in the future, such as a container being delayed and airlifted. But I don't think there are any particular factors that will make it worse in the future compared to Q3.

MC [Q]: Now, I would like to introduce some questions that we received by e-mail.

Mr. Omuro of BofA Securities Japan Co., Ltd. asked three questions, which I would like you to answer one by one. The questions are partly overlapping with earlier ones. First of all, regarding the price revision, please explain the timing and the range of the price increase in the future for each product.

Seto [A]: We have already announced it, so Ms. Hirano will explain it later.

However, in fact, there is a good chance we'll add more in the future. Then, depending on the product, we may change to digital, as I mentioned earlier, so we don't have everything covered, and it's not all set in stone. However, we will make announcements as needed, and they will be posted on our website.

MC [Q]: Next, I would like to introduce the second question. Regarding raw materials prices, until what month are copper and aluminum covered by futures?

Matsumoto [A]: Let me explain. Basically, we are thinking of covering futures contracts for the next 12 months, not 100% for the next 12 months, but in stages.

So, on average, we are covering about six to nine months of futures.

MC [Q]: Next, regarding the reduction of SG&A expenses, you emphasize the reduction of SG&A expenses, but what specific items have you reduced?

Seto [A]: As for the reduction of SG&A expenses this time, the biggest item was the reduction of personnel expenses, mainly in the New Life, voluntary retirement program. Total labor costs have gone down. This is one of the big things.

Secondly, since we have basically changed to telecommuting, we don't have to pay for business trips, meetings, dinners, trade shows, and so on.

As for trade shows, for example, in Europe, the ISH trade show was the biggest item, which was held in Frankfurt last year, but we stopped this and replaced it with digital presentations. In Japan, we basically cancelled all the large scale renovation fairs and things like that.

How much of this will be permanently eliminated and how much will be restored? We're thinking of eliminating a significant portion of it permanently.

Our company has made the decision to basically focus on working from home. Therefore, even if COVID-19 pandemic returns to normal, it is unlikely that we will spend as much money on offices and other facilities as we had in the past. In that sense, the fact that we decided to relocate our head office and selling our head office building will have an effect in the future.

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However, there are some trade shows that are held by the entire industry, and we will continue to hold trade shows if they are cost effective enough, but I think that only some of them will come back.

MC [Q]: We have one more question from Mr. Omuro.

What do you see as the drivers for increased profits in the next fiscal year? Are there any other risk factors besides COVID-19, raw materials, and supply chain?

Seto [A]: As the first driver of the profit increase factor, we can expect an increase in revenues. We have been taking various measures, and we are on a full growth trajectory in Europe and the Americas.

As for Asia, the growth of pent-up demand will come from the fact that the COVID-19 pandemic ended. In addition, growth in Southeast Asia has been suppressed for the past two years, so I think that will naturally come into play.

As for Japan, as I mentioned earlier, the quality of renovation will change, so I am expecting that. Demand has been high only for water-related renovation until now, but renovation demand for the metal areas is expected to increase as well, so sales are the first factor.

In terms of profits, we will pass on the costs for raw materials and supply chain, so I think that will be another factor in increasing profits.

Finally, as for SG&A expenses, we are planning to continuously reduce them every year, so that will naturally be a factor.

In terms of risk factors, the one that scares me the most is that the spread of the virus in China, especially the Omicron variant, will cause a lockdown in many parts of China, which will lead to insufficient supply of parts.

But again, this is the area where we have worked the hardest to hedge our risks, so we are proud of our ability to respond to a certain extent.

In any case, I think it is naturally possible that there will be shortages of products that we cannot imagine or envision.

Then, in addition to COVID-19, raw materials and supply chain, there are two other basic issues that I should probably mention: natural disasters and power shortages, and country risk.

I don't think I need to tell you about natural disasters, but also, as we have seen in China, power shortages may occur in many countries, causing products to consume more electricity. As a result, the cost of raw materials may increase, and the products themselves may not be produced in sufficient quantities.

For example, there is a lot of talk about lumber shortage right now, but I think it is quite possible that there will be a shortage of glass, concrete, and other common raw materials this year, and we are taking measures to deal with that.

Finally, there is country risk, or geopolitical risk. There are many issues that could arise, such as the current problems in Ukraine, and between Taiwan and China, as well as cyber-terrorism and attacks on systems. There are many to mention, but these are the risks that we can realistically assume.

MC [Q]: Now, let me introduce some of the questions we received in the chat.

There are several questions from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management Co., Ltd. I would like to divide them into three parts.

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The first question. What is the background of the shortage against the plan for housing services and how do you recover from it?

Seto [A]: In our housing services, the largest company is LIXIL Housing Research Institute, Ltd. LIXIL Housing Research Institute is in the business of supplying commercial materials to relatively small construction companies and providing know-how on construction methods as a franchise.

In the midst of the lumber shortage, it was difficult for such small construction companies to build enough houses, and we ourselves were not able to supply enough products to them. To be honest, I think that we were not strong enough in LIXIL Housing Research Institute.

In addition, LIXIL REALTY, Corp. is our next largest company, and we have a real estate division where we buy houses, renovate them, and sell them, but such activities were halted due to COVID-19 and other factors.

› BUILDING TECHNOLOGY AND HOUSING & SERVICES

Core earnings increased due to continued structural reform measures and operational efficiency gains

Apr-Dec In JPY bn	Q3 FYE2022 (Results)	YoY	
Revenue	65.7	-7%	<ul style="list-style-type: none"> Core earnings margin improved by 1.9pp year-on-year due to the progress of structural reform measures and operational efficiency gains An ongoing improvement in core earnings is expected from FYE2023 onward since building projects gradually recognize profits, leading to the difference in timing in taking measures and recognizing improvements
Core earnings	2.0	+155%	
Margin	3.0%	+1.9pp	

› Revenue and core earnings decreased due primarily to the impact on divestment in previous year

Apr-Dec In JPY bn	Q3 FYE2022 (Results)	YoY	
Revenue	22.7	-38% ⁽¹⁾	<ul style="list-style-type: none"> Revenue decreased due to the impact on divestment and one-time gain from the sale of real estate in the previous fiscal year CE turned negative due to impact of divestment and continued higher raw material prices, offsetting ongoing SG&A cost control improvements
Core earnings	-0.5	-	
Margin	-2.4%	-7.7pp	

LIXIL (1) -7%YoY excluding impact from divestment measures

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Matsumoto [A]: This question says, “shortage against the plan,” but in our document, we provide a comparison against the previous year. As you can see on page 13 of the document, we made divestment in the previous fiscal year.

Also, LIXIL REALTY sold a large property last year, but there was no such sale this year in Q3, which is the main reason for the 38% decrease in revenues compared to the previous year.

MC [Q]: This is the second question.

Where do supply chain logistics problems settle? Please tell us about the trend of demand in Japan and the timing of normalization of supply.

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Seto [A]: People all over the world have already responded to the reports in various ways. The most optimistic people think that the situation will settle down after the Chinese New Year, or after the Olympics, but the people who are watching the situation to remain the longest think that it will continue until at least September.

I don't think that my opinion means anything in any way. It's just something that can only be speculated about. I'm basically assuming that things are going to be tough this year.

In terms of trend of demand in Japan, I believe that intrinsic demand is basically very strong. However, for example, because the supply of water heaters has been unavailable for more than 1/2 a year, renovation and new construction projects have been postponed. Also, due to various problems such as lumber shortage, small construction companies are shifting their demand backwards.

So, in a sense, I think that the general view now is that the next problem will probably come up significantly as pent-up demand, once we see some normalization of supply.

Then when is the timing? As for our products, we can make assumptions. But for water heaters, dishwashers, and IH, for example, each manufacturer is more knowledgeable than us, so it would be very difficult to answer that question.

However, for products that we are able to do on our own, we are basically already in the normalization phase. For example, in the case of toilets, they are already becoming normalized this month, and depending on the product, they can be released under normal conditions such as with one or two days of the ship date.

MC [Q]: Next, I would like to introduce the third question.

What are your thoughts on the timing of the mid-term plan review?

Seto [A]: At this point, we don't feel that the creation of a new mid-term plan has any particular positive implications for the business.

Internally, we are already talking about this direction in the form of a Strategy Playbook. We will concentrate on core assets, sell off non-core assets, and simplify the organization as much as possible. And we will change our business so that our business in Japan can generate cash. As for international business, we will invest intensively in areas with high profit margins to grow that business. Finally, through innovation, we will create new businesses, as we have shown you examples of various innovations.

We don't think we should do anything more than to do this in a straightforward manner.

MC [Q]: Next, we received a similar question from Ms. Okada of Goldman Sachs Japan Co., Ltd. and from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management so I will introduce them in one.

There are concerns about rising interest rates in the US. Is there any possibility that your business in the Americas, the US housing market, or sales of shower toilets will be affected in any way? Or will the impact be minor because of the high weighting of existing home renovation? What is your outlook for the future?

Seto [A]: First of all, it is true that the weight of existing house renovation is high. In this sense, our sales channels, such as retail and wholesale, are also basically renovation-oriented. The US market itself has a high weighting of existing home renovation, so I think it is possible to say that the impact on the US market is minor because of that. However, the rise in interest rates itself may have an impact on housing starts in the US and on the overall economy, so I think it is possible that there may be an impact on the business.

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However, as far as we can tell from the current sales and order situation of the American Standard brand, we are not in a particularly anxious situation at all. In fact, we are now receiving very strong demand, and are rather focusing on how to cover the production and how to meet the demand.

MC [Q]: Next, we received a question from Mr. Takegawa of Sumitomo Mitsui Trust Asset Management. Is there any change in demand in the Americas and Europe?

Seto [A]: So far, we haven't seen any significant changes. However, given that Europe has been strong for a long time, I think it is possible that there will be a break in Europe at some point. Right now, our strongest area in Europe is Eastern Europe. In terms of Eastern Europe, we are somewhat aware of geopolitical risks.

On the other hand, with regard to the Americas, in relation to the previous question, from a common-sense standpoint, if interest rates continues to rise, there is a possibility that demand would decline, especially among low-income segments, and that the economy would decline. However, we do not feel that at all. In fact, we are currently forecasting stronger orders for our products than for the overall economy. In terms of inventory levels, we would like to accumulate more.

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

Other companies in your industry seem to be having difficulty procuring parts for hot-water washing toilet seats. How about your company?

Seto [A]: Our parts procurement is fine. There is no problem at all in producing the same level as last year or as usual. However, if we are to be able to increase production, we can only do so by a maximum of 10 percent.

In addition to our own capacity problems, we are not in a position to procure parts inexhaustibly, so we are procuring parts and selling in various ways.

In that sense, we are in a position to increase production, although there are some impact on costs.

MC [Q]: Next, we have a question from Mr. Nakagawa of Mizuho Securities Co., Ltd. ASB's core earnings margin declined in Q3 compared to Q1 and Q2. What are the factors other than logistics-related costs?

Also, inflation is accelerating in the US, but is there any impact on demand?

Seto [A]: It is true that logistics-related costs are still the largest. In fact, as I mentioned earlier, we do things like airlift and get priority to containers by paying a little more for them, so that is the biggest factor.

In terms of American Standard products, we use steel plates, resin, and copper, so, of course, prices have risen, but we have been able to respond by raising prices in a very flexible manner.

MC [Q]: Next, we have a question from Mr. Teraoka of Daiwa Securities Co. Ltd.

Please summarize the factors behind the continued decline in sales of housing sashes. Can we expect a turnaround with the introduction of new products and a focus on renovation?

Seto [A]: By raising the prices, we were able to negotiate to secure profit on business that was previously too unprofitable and unreasonable. As a result, the quantity has dropped in some areas.

However, as a result, costs have risen since then, and we are glad that we didn't continue with our former way of business, but even so, we are now seeing a return of orders.

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Therefore, in terms of orders and future prospects, sales of housing sashes will increase in the future. I believe that the numbers will be very good, especially in the spring.

MC [Q]: Here are some questions we received via e-mail.

From Mr. Yagi of Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. What are your thoughts on the margins for LWT and LHT for the next fiscal year? Is there potential for a significant improvement compared to this fiscal year due to the effects of the price hike and other factors?

Seto [A]: To tell the conclusion first, we are not satisfied with the margins for this fiscal year. This fiscal year, especially in Japan, the gross profit that we should have earned from both LWT and LHT was eventually overtaken by the price hike of commodities, which was particularly significant for LHT. We are naturally trying to improve that part.

However, there is a possibility that the price of commodities will continue to rise, so we need to consider the time lag, but, of course, there is potential for significant improvement.

In Q1 of this fiscal year, we were able to raise the price in line with the increase in the price of commodities, and we believe that it was the most appropriate price. Considering its price, we think there is a lot more room for improvement at all.

However, improving margins is not necessarily just about raising prices. We have been making efforts to reduce costs by using platforms and to reduce SG&A expenses, and, of course, as productivity increases, the number of factories can be reduced. In that sense, we have reduced the number of factories.

Also, in relation to the earlier question, we have already stopped doing unreasonable business, so we have been working comprehensively. As for whether there is room for improvement this time, we believe that we can still do it.

MC [Q]: Now, let me introduce the next question from Ms. Katsuyama of Morgan Stanley MUFG Securities.

Considering the progress rate of core earnings against full-year forecast and the seasonality of the business, should we consider it a little difficult to achieve the full-year plan of JPY80 billion?

Seto [A]: We are doing it as we think we can. It is true that Q3 was a bit tough, but to be honest, I think we were able to do it within our plan to some extent. In that sense, I think we can do it in Q4 as well.

As for the seasonality you mentioned, in the past, the profit margin in Japan would be lower at the end of the year due to adjustments, but this time we are very strong in our international business, so I think we can do our best in that area.

We are naturally assuming that we can achieve JPY80 billion. In the previous question, there was a question about how much room there is for growth.

To tell you the truth, the results for this fiscal year have been quite good, if we take into account the price hikes in commodities, which have been higher than we had expected, the logistics problems that we hadn't anticipated, and the fact that we had to produce at factories in Japan alternatively that we hadn't anticipated. I believe that we had the ability to generate core earnings of over JPY100 billion, far exceeding the JPY80 billion forecast for this fiscal year.

In that sense, I feel a little disappointed, but we will try to achieve the numbers we set at the beginning of this fiscal year as much as possible.

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MC [M]: Since there are no more questions, we will conclude the question-and-answer session.

This concludes the financial results briefing for Q3 of the fiscal year ending March 2022 of LIXIL Corporation.

We look forward to your continued support of LIXIL. Thank you very much.

[END]

Document Notes

1. *Speaker speech is classified based on whether it [Q] asks a question to the Company, [A] provides an answer from the Company, or [M] neither asks nor answers a question.*
2. *This document has been translated by SCRIPTS Asia.*

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