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Q&A Session at the Financial Results Briefing
for the First Quarter of FY22

Outlined below are the Q&As from the financial results briefing on August 9, 2022.

Ken Hata, IR Terumo: Thank you. I will call your names for questions.

First, Mr. Yamaguchi of Citigroup Global Markets Japan, please go ahead.

Hidemaru Yamaguchi: This is Yamaguchi from Citi. Thank you very much.

As you explained, the gross profit margin declined from 54.9 to 51.5 in Q1 alone. As one factor, the issue of unrealized profit on inventory was mentioned. Could you give any more details about the breakdown of factors here? This is my first question.

Hata: Thank you.

The JPY3.5 billion negative figure on page five is the effect on the gross profit margin. It is a negative figure, and if you break it down, there are about four components. Regarding the three improvements, if you look at the cardiovascular ratio, it has improved a little bit. It is a positive factor in the low single-digit range, in hundreds of millions of yen.

Also, in Q1 last year, we were still adjusting production. That has been eliminated this time, which is also a plus. Combining these two plus factors, we get a positive of about JPY1 billion.

This means that there is a negative balance of about JPY4.5 billion, which is the result of inflation. This was absent in Q1 of the previous fiscal year, and the influence this time is about JPY3.5 billion or JPY3.6 billion.

The rest is initial costs for starting up CSL Plasma Innovation. Although we are switching to mass production at the end of Q1, we have not recorded inventory up to that point, so it will also hit the gross profit stage as a start-up cost.

I think these four points can roughly explain the situation.

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Yamaguchi : No unrealized profit on inventory?

Hata: Unrealized profit on inventory is JPY2 billion. This is 1%.

Yamaguchi : Understood. Is that included in the negative JPY3.5 billion figure?

Hata: No, it's excluding the exchange rate. In this variance analysis chart, the right-most foreign exchange stock and flow are net positive JPY300 million. That would have originally been a greater positive effect without the inventory issue, which has almost offset that.

Yamaguchi : I see. I understand.

Secondly, I have heard a lot about the situation by region, but when I listen to American device companies, although their business is different from yours, many of them say that they do not have enough staff and that their business is weak despite the number of procedures returning to normal. I think a lot of companies are in that situation.

On the other hand, while your company is currently facing a tough situation in China, your company's sales as a whole have increased considerably. I think your company is bucking the general trend in China and the US. Can you explain what factors are behind that?

Hata: Sure. First of all, in North America, the main pillar of our growth is TIS. The growth of the Cardiac and Vascular business, both on a YoY basis and on a QoQ basis, is very difficult to read due to the large fluctuations in the exchange rate. If you look at it on a constant currency basis, for Cardiac and Vascular sales, both grew by about 5%. That's true whether you look at it YoY or QoQ.

In terms of regions, the figures in North America were lower than expected. I hear that what was weak in North America, as you mentioned, is the shortage of manpower. The shortage of nurses has not yet been resolved.

Also, while this is just an issue for this quarter, lack of contrast agent is preventing cases from going ahead. I don't want to say too much about individual companies, but GE has more than 1/2 of the North American market share for contrast media. It is produced in a facility in Shanghai, but the lockdown has affected production. That has had a big impact on vascular treatment interventions in North America, for everyone involved. I think there are quite a few companies that are saying they can only accommodate urgent cases.

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While this is a very rough figure, I'd say the effect of this is about 2% for TIS and about 1% for Cardiac and Vascular as a whole. I think if it weren't for this limitation on the number of procedures, the level of sales would be a little higher. That obviously goes for our competitors too. On the other hand, while we saw this effect due to the contrast media problem in Q1, the problem is expected to be resolved by September. We expect to see that reflected in results later in the year.

In China, the lockdown had an impact on Shanghai and Beijing in May and June. On a countrywide basis, the impact was about 10% at most. As you know, the VBP has increased the number of cases nationwide over the past two years due to improved access to medical care, which offset the impact of the lockdown. As a result, the number of cases has not dropped that much.

In addition, in our case, since we are selling our products to distributors, they were also buying a lot in anticipation of the post-lockdown period. When we looked at our top line alone, there was no decline at all. I am a little concerned about July and August, because I wonder if there might be a rebound, but looking at the July figures, there was no decline at all. Even if some rebound effect occurs, I do not expect it to be that big of a drop.

That is all.

Yamaguchi : Understood. Thank you very much. That is all.

Hata : Next question from Mr. Kohtani, Nomura Securities. Mr. Kohtani, please go ahead.

Motoya Kohtani : I am Kohtani from Nomura Securities.

I would also like to ask about the chart on page five, and the gross profit effect and the increase in general and administrative expenses. If we look at the annual forecast, the gross profit effect is JPY4.1 billion, and general and administrative expenses are JPY12.5 billion, so the gross profit effect will probably be quite positive in H2 of the year. Both the new product effect and inflation were already having an effect last year. Responses to inflation are already moving forward, so the effect in Q1 may be the largest. If so, will your company still be on track to achieve the JPY4.1 billion figure forecast at the beginning of the year?

Also, in terms of the increase in general and administrative expenses, minus JPY4.5 billion is quite a large proportion of the full-year forecast figure of JPY12.5 billion. I think this is due to upfront expenses for Rika and other items, so the expenses may drop later in the fiscal year. That's my impression. In short, which parts so far are different from the

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Company's forecast, and what caused those discrepancies? For example, how has the level of inflation compared to your expectations?

Hata: Sure. In the waterfall chart, there isn't much that's far removed from our forecast. The effect of inflation has been the only real discrepancy. Until this last quarter, we had said that the impact of inflation would be at most a little less than JPY3 billion per quarter. However, it was larger than expected, and has resulted in this JPY3.5 billion figure in Q1. That is unexpected.

However, as I mentioned earlier, the start-up cost for CSL Plasma Innovation is included in the minus JPY3.5 billion gross profit, so about 10% of the total of SG&A and R&D costs is made up of CSL Plasma Innovation start-up costs. It has had an effect here too.

Therefore, the effect of inflation is a little higher than expected, and although we want to avoid it where possible, we will continue passing these cost increases on to customers through H2. The amount passed on has only been about JPY200 million so far, and we are assuming that this number will increase as we move toward H2. We are preparing these options and taking action.

Kohtani : In the initial forecast at the beginning of the period, you included about JPY2 billion for price pass-through, as I recall, so that means that this is progressing as planned and will increase?

Hata: Yes, it will increase as the fiscal year continues.

Kohtani : Understood. I was aware of the impact of the contrast media shortage, but I still want to confirm that, although distributor demand was strong in China, assuming that there is no rebound decline in Q2, the biggest risk seems to be the contrast media shortage. Do you see any new risks in the July-September period and beyond?

Hata: Case numbers are low in the summer to begin with, but looking at July sales, they are not down compared to the Q1 average at all. We are not sure about August, but since the lockdown has been lifted, we have a good idea of the inventory levels at our distributors.

We have not seen any large variability in sales so far, which suggests to us that distributors still have some capacity. As a result, we do not expect a major rebound.

Kohtani : Lastly, there is talk of a shortage of personnel in the US. Some American companies are saying that hospitals have already begun to respond to some extent, just

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like they did in the COVID-19 pandemic, by adding extra procedures that would not normally be included in anticipation of cancellations later. Are you seeing any response to address the staffing issues with respect to the number of endovascular procedures? Thank you.

Hata : You mean things being done by hospitals.

Kohtani : Is there any action on the hospital side? Of course, they are trying to hire personnel, but also if we are seeing any other actions, such as a slight increase in bookings, or something like that.

Hata: I am not aware of anything like that. I think I mentioned this last time, but I have heard that hospitals are bringing back nurses on a part-time basis who have left the workplace, even at a slightly higher rate of pay. I've heard that staff are shared between acute hospitals, and that they are hiring these experienced nurses. That's ongoing. However, I am not aware of anything like that affecting surgical cases.

Kohtani : Understood. Thank you very much.

Hata : Next from Mr. Sakai, Credit Suisse Securities. Mr. Sakai, please go ahead.

Fumiyoshi Sakai : I am Sakai from Credit Suisse.

Was there any unrealized profit elimination in Q1? This is brought up a lot with respect to other companies. I notice that you didn't mention it.

Hata: You mean the elimination of unrealized profit on inventories. Sorry, I've been referring to unrealized profit on inventory with an abbreviation. That is what I meant by the JPY2 billion negative impact related to foreign exchange stock.

Sakai : So I understand that the JPY2 billion itself was the elimination of unrealized profit?

Hata: Yes. Sorry.

Sakai : Understood. Thank you very much.

I understand that it will fade after Q2, and that this will affect product costs.

Hata: Yes, that's right. This affects gross profit, and it's having an almost full effect in Cardiac and Vascular. That's why this segment profit margin is down about 2%. While

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we don't expect the segment profit margin to be high, the rate used is the rate at the end of the last day of Q1, so it's at JPY137 to the US dollar, or something like that. That indicates the degree of loss.

If the yen returns to a slightly stronger level, there is a possibility that the elimination of unrealized profit will return as a positive amount in the future. Also, I don't think the negative amount will be as large in this quarter.

Sakai : From Q2 onward, whether it will be positive or negative, is it correct that if you think about it in terms of this waterfall chart on page five, there will be more of an effect on the increase in gross profit due to this increase in sales?

Hata: Since this is eliminated by the exchange rate, in this case, the right-most part, which is positive JPY300 million, includes both the flow and stock portions. So, if there were no elimination of unrealized profit, the positive flow would have been JPY2.3 billion.

Sakai : So, that's where it comes out.

Hata: Yes. All of the currency exchange effects are reflected in that bar.

Sakai : I see what you mean. I understand. Thank you very much.

I have one more question. In China, there are indications that the impact of the volume-based procurement system on medicine sales has run its course. How about in other areas, such as medical devices? If you have any recent information, please share it with us.

Hata: In terms of our products, drug-eluting stents took a major hit about two years ago. The market price was reduced by more than 90%. That was the two-year national tender. It will be happening again soon, but I don't see it falling any further.

After that, PTCA balloons were also affected, but the negative effect was almost entirely absorbed by distributors, so there was no negative margin impact on manufacturers like us. Talking purely in terms of our products, I don't see any further large effects.

Sakai : Understood. So are you saying that your situation is a little different from other companies? Or that the degree of effect is different?

Hata: Yes, every time we check in the field, we ask if there are any other concerns that the effect might spread to other areas, but so far we have not found any effects on products that are of major concern.

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Sakai : I understand. Thank you very much.

Hata : Next from Mr. Mori of Mizuho Securities, please go ahead.

Takahiro Mori : I am Mori, Mizuho Securities. Thank you.

My first question is about BCT. The Company has seen a fall in profits. Factors such as inflation, the strong dollar, and preparations for Rika are all potential factors. Regarding the Rika preparations, I imagine it'd be about JPY1 billion in gross profit, and the rest is sales promotion and R&D expenses. Is that about right? It will be up and running from August, so I wonder what the effect will be in Q2 and beyond.

Hata: In terms of a YoY margin drop, it has gone from 21 to 10, so we are down about 10%. I think this can be roughly divided into two halves: one is the effect of inflation and the other is the cost of air transportation. This is usually done by ship, but we used air transportation to prevent shortages.

The remainder was for the setup of CSL Plasma Innovation. That was about the same as the impact on gross profit and the impact of the lower part of the gross profit. It's quite a big effect.

This is why, as I mentioned a little earlier, we are starting mass production. From now on we will record what we make as inventory stock, so as we clear the points that were dragging down the margin, we expect the margin to improve from here.

It should get better into H2. The contribution to the margin that we originally saw is a long way off. This is something that we will gradually see after the complete rollout of the CSL center. I believe that a negative impact is inevitable, at least through this fiscal year and 1H of next fiscal year.

Mori : Since you are saying that what is made is recorded as inventory, does that mean that there is not much of an increase in SG&A or R&D expenses as a direct cost?

Hata: Yes. The impact on gross profit will not be as large as it is now because the inventory will be accounted for as it is made. However, SG&A expenses will remain at the same level as before, so we will not see a change there. I'm sorry, I appreciate that it's a little confusing.

Mori : In that case, since the yen is now weak against the US dollar, should we expect the cost of BCT in the US to be higher than expected due to the weaker yen?

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Hata: We record it in US dollars. We are now trying to transfer the production from the US to Costa Rica, actions are being taken to reduce costs at the same time.

Mori : Understood.

Second, I would like to ask about TMCS. I think inflation will have an effect here, but the appreciation of the yuan and exchange rate conversions will not help. Since this is for domestic businesses, for example, should we consider that the effect of the price increase would be quite difficult to achieve?

Hata: Margin deterioration here, too, is tough because inflation is actually quite high. The TMCS business is the one that uses the most petroleum-derived raw materials. In addition, with the current appreciation of the yuan, the cost of products made in Hangzhou is becoming more expensive. We are now in a situation where we have to be patient.

However, as I mentioned earlier, price pass-through is a zero-sum game in the healthcare ecosystem as a whole, which is not a good thing. However, we cannot afford not to do it, so to the extent we can, we will do it in the areas where we can, in the projects we can, without limiting the regions we do it in. Of course, that means that it is also possible in the Japanese market.

Mori : And in terms of price increases for domestic products, would that be for products where there is some freedom to increase the price, but not for those where there isn't?

Hata: Yes, that's right. We can only do what we can do, and that applies in overseas markets too. We also have contractual obligations preventing us from raising prices in some areas. Putting those aside, we are not limiting which products or regions are in scope for price increases.

Mori : Understood. That is all. Thank you very much.

Hata : Next from Mr. Tokumoto, SMBC Nikko Securities. Please go ahead.

Shinnosuke Tokumoto : I am Tokumoto here.

First I would like to ask about demand in the Cardiac and Vascular area. In an earlier question, it was mentioned that from the point of view of distributors, North America and China have been reasonably strong recently. However, more specifically, how can we imagine the difference in performance between the April-June period and July? Are you able to provide any figures in relation to those statements?

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Muto : You mean beyond the April-June period?

Tokumoto : The situation in July, in North America and China.

Hata: One place where we have seen demand lower in July compared to Q1 is in the TMCS business in Japan. The effect of the COVID-19 pandemic has been slow to appear in Japan, and we saw it somewhat in July.

Conversely, there has been no drop at all in other areas, not even in the cardiovascular sector. Although I was worried that we might see a fall in sales in China, as I mentioned earlier, there has been no drop. There is nothing to be too pessimistic about at this point, including the current situation on the ground.

Tokumoto : Understood. Your comment gives the impression that the overall situation is steady, rather than picking up.

Hata: Yes. That is the outlook.

Tokumoto : Understood.

Secondly, this is quite a specific question, but I believe there was mention of impairment of technology assets in the brief. Can you tell us which area this falls under and what the future impact will be?

Hata: Thank you for paying such careful attention to our reports.

We have held a review of our portfolio. We have some growth drivers, including TIS, and we are proactively making decisions to close down products that are struggling or have little potential in order to better allocate resources.

This may have caught your eye because the targets are not stated, but it doesn't include any of the growth drivers presented in the recent GS26. So, for example, we are not talking about renal ablation, drug-eluting balloons, or anything like that. We will continue to review our portfolio, but as I said, these types of products do not fall within that scope. Thank you.

Tokumoto : Thank you. That is all.

Hata : It seems we have no other questions.

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It is a little early, but we will end the session here. Please do not forget to hang up your phones.

Thank you very much for your participation. Thank you.

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