

First Quarter Business Results for Fiscal 2023 Q&A (for Investors)

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*Names are in the order in which questions were received.

Akahane [Q] :

The first point I would like to bring up is on page 7 of the materials received. I also took a quick look at the figures and speculated on why operating profit was this low. This reflects the unrealized gain rather than high raw material expense. Moreover, this substantially impacted a quarter of operating profit. Although it only appears this way on the books, Tsumura actually experienced a sharp drop in operating profit.

Handa [A] :

Yes, you are correct.

Akahane [Q] :

Moreover, Tsumura built up its inventory, which had previously declined. Furthermore, this was not due to depreciation in the yen's value but an appreciation

in the yuan (RMB)'s value. Naturally, profit in China expanded owing to this. I just glanced at the consolidated financial results for the first quarter, the figures for merchandise and finished goods, and work in progress are fairly high. Is my understanding correct that this reflects impact from a build-up of inventory and an appreciation in the value of the yuan (RMB) owing to the foreign exchange rate?

Handa [A] :

Regarding inventory, raw materials and supplies are impacted by foreign exchange rates. In other words, performance on the China side. The impact in Japan from foreign exchange is approximately 1.2 billion yen. I am speaking about the impact to our balance sheet.

As you know, we touched upon the issue of unrealized gains. In 1Q of FY 2022, we ran out of a fair amount of inventory due to the impact of the Shanghai lockdown. Consequently, this was a period in which we realized gains. However, in the same quarter of FY2023, we have build-up inventory in preparation for the release of restricted shipments. This triggered an accumulation in unrealized gains. Owing to this structure, in a comparison with the same quarter in the previous year, the level of unrealized gains was high in contrast, and unrealized gains are a factor that pushes up the cost in sales significantly, just as you pointed out.

Akahane [Q] :

I understand. Accordingly, profit in 2Q is naturally likely to double and instead the impact from unrealized gains is likely to become fairly mild. Once the negative impact in 1Q is deleted, in the first half, the cost of sales ratio is likely to improve slightly.

Handa [A] :

Yes, that is correct. We plan to unwind the portion of unrealize gains in 2Q.

Akahane [Q] :

I have another question. As I believed, demand for Goreisan and Kamikihito is growing among your mainstay products, as well as demand for Ninjin'yoeito, a treatment for poor appetite. I came away with the impression that the main factor underpinning demand for these products, respectively, is COVID-19, or should I say the treatment of the after-effects of COVID-19. Am I misunderstanding this?

Sorada [A] :

First, from the standpoint of the after-effects of COVID-19, Kamikihito is more frequently used for the treatment of these after-effects. Regarding Goreisan and Ninjin'yoeito, the positive impact to demand, for instance in the case of Goreisan, is that recently it is being frequently used in various fields to treat patients complaining of dizziness or headaches. Particularly in cases where symptoms are brought on by a change in climate or barometric pressure. The volume of usage has increased significantly for headaches triggered by a change in barometric pressure. In addition, in new areas, it is being used to treat edema and swelling triggered by a cardiovascular disease. In light of this, the volume of usage of Goreisan is rising.

Meanwhile, the use of Ninjin'yoeito is increasing for the treatment of frailty and feebleness in senior citizens.

Akahane [Q] :

I understand. COVID-19, itself, is winding down slightly. The after-effects seem to be continuing considerably and the change in barometric pressure is just that, a change in atmospheric pressure. In addition, we are also experiencing typhoons. Is it okay to assume that the environment (business climate) in 2Q is likely to be extremely positive?

Soradaa [A] :

We have steadily lifted restrictions, and therefore we plan to enhance our sales activities.

Sakai [Q] :

I would like to confirm the unrealized gains that was brought up just now. I spoke with someone from IR yesterday, and asked if the actual figure, in other words powdered extract and crude drugs, was more important than the impact from foreign exchange translations. We discussed the fact that the actual amount reflects the build-up of raw materials in China in anticipation of the lift of shipment restrictions, and that on a consolidated basis, this portion will naturally be offset. In other words, offset as unrealized gains. Based on this, it appears the impact from foreign exchange translations is minimal. Looking at this from a different standpoint, the actual amount is increasing. This means that the shipments from China to Japan will rise going forward. Handa-san said this is a one-off item, but will this impact the statements of income to a certain extent going forward? Or, given the one-off factor, in this case the lifting of shipment restrictions, will this portion of impact be leveled off going forward or leveled off through inventory management and will not be a major disruptive factor, though this may be somewhat of an exaggeration? Anyway, is my understanding correct that this is not a variable factor?

Handa [A] :

Although this has been pointed out, we maintain a slightly long range for our processes spanning from purchasing to the build-up of inventories, commercialization of products, and sales. In light of this, the impact actually reflects the movement of goods, rather than foreign exchange translations. As I explained earlier, in 1Q FY 2022 performance was impacted by the lockdown of Shanghai while 1Q FY 2023 was exemplified by the build-up of products for which shipments were restricted. Owing to the combination of these two factors, the impact from restricted shipments was immense. In this manner, I believe we can label this quarter a special period.

Meanwhile, as you mentioned, we plan to implement an equalization of inventory . Going forward, naturally there is a certain degree of time left from purchasing to sales. Consequently, it is not a matter of realizing all of the unrealized gains to

generate profit. There will still be unrealized gains on our books from ordinary business transactions for a certain period of time. In light of this, I believe a major feature of FY 2023 is the impact from the previous fiscal year and the build-up of inventory impact, which substantially emerged.

Sakai [Q] :

So, in other words, what you are saying is that even though you are talking about external sales at the moment, what you mean is the shipment of inventory to Japan. So, your assumption is “an increase in sales to Japan.” you are not talking about external sales in China, are you?.

Handa [A] :

That is correct. I am only talking about prescription Kampo sales in Japan. In that sense, we increased our inventory in anticipation of the lifting of shipment restrictions. So, we envisage unwinding these unrealized gains through strong sales of the inventory that has been built up here in Japan.

Sakai [Q] :

I have one more question. It is regarding Unisplendour. Did Tsumura suffer these unfortunate circumstances due to a misinterpretation that occurred inside the municipal office? In a way, it could be said Tsumura was a victim of these circumstances. What exactly happened due to this misinterpretation? Did the differences in interpretation result in the dissolution of the acquisition? Can you discuss this in a little more detail?

To rephrase, will this difference in interpretation impact Tsumura’s acquisitions in China in some form moving forward? You have naturally done your due diligence. Nonetheless, when these types of situations occur, I would like to know if there will be a certain degree of impact, including whether there was some difference in the level of understanding. Can you please expound on this?

Handa [A] :

This time around, the main reason was a difference in interpretation mainly of regulations related to national policy by the department in charge of government affairs at Baoji City. The regulation related to national policy I am talking about is the Special Administrative Measures (Negative List) for Foreign Investment Access. In Baoji City, there are several departments engaged in this area. I heard that this is what triggered difference in interpretation.

We had heard this before. However, the specifics on which department made different interpretations and at which point are handled within the departments associated with the government, and therefore we have not been informed about those specifics. Basically, there was a difference in interpretation of the Special Administrative Measures (Negative List) for Foreign Investment Access in Baoji City. In that sense, going back to your question about the impact this will have in China, we took fact that this was the situation in Baoji seriously and we went through with the transfer. We cannot say how this will be treated in China in general or other cities in China as this took place in Baoji City. Consequently, we determined that this incident was not likely to have a significant impact immediately or bring about a change in our policy.

Sakai [Q] :

I see. However, I believe you said that acquisitions in the crude drug platform business in China were essential to achieving your vision. Since you passed over this acquisition, I think your next candidate will naturally emerge. Do you have a short list for potential acquisition candidates? Or, are you ready to start over from square one? What is your opinion on this?

Handa [A] :

In that respect, we narrowed down our short list and were prioritizing this project. At present, it is not like I have another short list on hand. You may have more questions but we previously put out a press release in the summer of 2022. We

have not yet completed what we set out to do in that release. Also, it is not like I can say we have another list immediately ready. Nevertheless, we are not planning to implement a major transformation to policy in this business.

Kato [Q] :

I have one question regarding your cost of sales.

This is page 8 of the materials. You gave us a rundown of trends in raw material and energy expenses. In contrast with your plan at the start of the fiscal year, do you believe there is a disparity between the results for 1Q and plans for 2Q onward and full FY 2023?

Handa [A] :

This has been factored into our plan to a certain extent, so there is no major disparity. We planned raw material expenses in this manner but as I mentioned earlier, energy expenses are trending downward, having peaked in the second half of FY 2022. This downward trend is not completely factored into our annual plan. We estimate there is a likelihood of a slight difference in this area.

Kato [Q] :

Incidentally, can you explain if there is a disparity between the actual and forecast raw material crude drug procurement cost?

Handa [A] :

There is not significant difference between the actual raw material procurement cost and plans. In particular, we formulated our plan by factoring in market price trends and procurement trends. Consequently, although there is impact from a depreciation in the value of the yen, we formulated our plan while anticipating an appropriate degree of impact from a depreciation in the value of the yen. In light of this, at present we do not currently expect a major disparity with plans.

Akahane [Q] :

This overlaps with my previous question. Let's put aside the full fiscal year for the time being. You said that in 2Q you estimate a sales growth of 5.6% and a decline in operating profit of 18.6% year-on-year. First, as stated in your consolidated financial results for the first quarter of the term ending March 31, 2024, all shipment restrictions were lifted as of July 31, 2023. The final product for which shipments were restricted was Kakkonnto, correct?

Handa [A] :

Yes, you are correct.

Akahane [Q] :

This also grew. Sales of formulations to treat COVID-19 also rose but owing to the lifting of shipment restrictions, it is anticipated that performance in 2Q is likely to be considerably better than forecast. First, what is your outlook for sales? There will likely be benefit from the lifting of shipment restrictions in 2Q and 3Q. Moreover, the NHI drug price is rising. How should this be interpreted?

Handa [A] :

As you pointed out, sales activities have been becoming brisk since the lifting of shipment restrictions. The gap with the market has also surfaced in June. From this standpoint, we aim to maintain our strength. Meanwhile, as I stated before, we planned to lift nearly all our shipment restrictions in 1Q. Kakkonto was the only formulation for which shipment restrictions were lifted in July, later than planned. Based on this, there was no major disparity with the plan for the scheduled timing for the lifting of shipment restrictions. We aim to put plans into place for sales activities and sales accordingly. As a matter of fact, it is our intention to exert our strength.

Akahane [Q] :

President & CEO Kato has talked about this in various places. Tsumura restarted the timing of this schedule, and although there was a delay in lifting shipment restrictions on Kakkonto, Tsumura was able to resume full-fledged shipment activities around the end of June. Given shipment activities were resumed at that time, President & CEO Kato stated that Tsumura would never be halting shipments again. I would like to believe what he said.

Handa [A] :

Naturally, as a manufacturer of pharmaceutical, we must fulfill our responsibility to provide a stable supply. We apologize for the inconvenience we caused our stakeholders for the prolonged restricted shipments. We are putting our production system in order and have been building up our inventory so that we will not have to restrict shipment again. As shown, this is being revealed in our 1Q financial results. Based on this, going forward we aim to carry out operations so that we will not have to resort to this in the future.

Akahane [Q] :

In response to this, you initially presented a forecast for operating profit of 9.5 billion yen. In 1Q, there was a plethora of negative factors. Despite this, the achievement rate as of the end of 1Q was 49.3%. The performance for the top-line was satisfactory in 1Q. I am sorry to repeat myself, but the impact from the unrealized gains which clearly emerged in 1Q. This was discussed earlier and is mentioned on page 7. In 2Q, in comparison with the same period a year earlier, there is naturally likely to be a large impact from foreign exchange translations at the end of the fiscal year. However, given current trends, as I said earlier, profit is likely to be generated for two quarters. In contrast with 1Q, it is my belief that the impact is likely to be substantially reduced. This was probably not factored into the initial forecast. In light of this, operating profit in 2Q is likely to drop at least double digits. Is it feasible to increase profit in 2Q?

Handa [A] :

At the time we formulated our plans in 2023, we thoroughly grasped the trends for FY 2022. Also, as I stated before, in 1Q it was our goal to lift shipment restrictions, in other words build-up our inventory. These were all factors that were already grasped at the time we drafted our plans. Therefore we believe our estimates are reasonable.

Naturally, the monetary amount of the unrealized gains could potentially change reflecting the composition of items. In light of this, we cannot refine this to improve the precision of our forecast for unrealize gains. However, this is our forecast based on a systematic plan devised at this stage. From this perspective, the topline and operating profit in 1Q were nearly on target. In actuality, at present we have not forecast a major difference versus the first half plan we have currently announced.

Akahane [Q] :

Lastly, in regards to the current issue in China. I know there are various issues with respect to China. There is also an issue like the one involving Astellas. However, despite all of the issues this time around, it is safe to assume you are not changing the direction of the China business at all?

Handa [A] :

That is correct. We are not revising our strategy in China, whether it be our targets or the areas in which we plan to carry out operations.

Kawamura [Q] :

I would also like to know about your plans for 2Q. Based on the explanation you just gave, including the unrealized gains and expenses, etc. You said you have already factored in these items. You mentioned that the last of the shipment restrictions was lifted just at the end of last month on Kakkonto. I personally believe that you should be seeing demand for various Kampo formulations given the progress you have made. Despite this, on a quarter basis, sales in 1Q and 2Q were

basically flat, which I find difficult to comprehend. Can you explain why it appears sales are not growing despite the shipment restrictions was lifted and the energies you are pouring into sales?

Sorada [A] :

As you know, many pharmaceuticals are currently undergoing restricted shipments and shipment adjustment in the pharmaceuticals industry, not just at Tsumura. Amid this backdrop, although we have announced that Tsumura has lifted shipment restrictions, this has not been fully conveyed to medical practitioners, particularly physicians. In light of this, there are medical institutions that are still restricting the issuing of prescriptions. That is one factor. We plan to quickly solve this issue through our information provision activities. However, it is not easy to get out of this situation.

In addition to this, the intense heat this summer is also an issue. Regarding formulations that are prescribed during the summer, demand is currently trending smoothly. We are playing catch up in these situations that are not easy to get out of while at the same time aiming to firmly boost sales in line with plans.

Kawamura [Q] :

Can you supplement your explanation on the issue you just mentioned? I would like to ask about pharmacies and other minor parameters. I have heard there are difficulties filling Kampo prescriptions at pharmacies. Are conditions truly sufficient at the moment to properly deal with shipping? I would appreciate it if you could talk about the forefront of your sales activities.

Sorada [A] :

We are solidly implementing shipments to wholesalers. Wholesalers are also properly providing support. Amid this, as I mentioned earlier, there are some pharmacies who do not fully realize that shipment restrictions have been completely lifted. The other day, we experienced this exact situation. We were told that Kampo

products were not being delivered. I explained the situation, and an order was placed and a shipment went out the following day. It is our belief that there is no quantitative issue and that distribution is functioning smoothly.

Kawamura [Q] :

The Unisplendour project took an unfortunate turn this time around. At the previous presentation, it was mentioned that you would be releasing a new Medium-Term Management Plan, or should I say a new version of the current Medium-Term Management Plan. It appears that this have been fairly postponed or we should not expect to see the release of a new version?

Handa [A] :

At the previous briefing, I mentioned the possibility of releasing a new version, a Version 2, of our current Medium-Term Management Plan. This was because the current Medium-Term Management Plan did not include business operations owing to acquisitions so we planned to add this. That is why I mentioned the possibility of releasing a new version. From this standpoint, there are no acquisitions, the situation has returned to the way it was before. In addition, we will immediately report any progress or changes in our business operations should the need arise.

Haruta [Q] :

My question includes some points of confirmation. Once again, looking at domestic pharmaceutical product sales trends for the months of April, May and June, sales in June rose but does this mainly reflect contribution from products for which restrictions were lifted? What products contributed to this rebound? Do you anticipate recovery from 2Q onward? Also, I believe there are likely several elements that will come into play. This includes common cold formulations, the spread of COVID-19 during the summer months, the after-effects of COVID-19, and the intense summer heat. What impact do you believe the lifting of shipment restrictions had? Regarding the full fiscal year plan, what was your estimate of this impact? Can you put this in order?

Sorada [A] :

In June, the market was largely driven by Bakumondoto, for which shipment restrictions were lifted. This formulation was a substantial impetus for earnings. There was a spread in COVID-19 around the time restrictions were lifted on this formulation. There was a spread in COVID-19 so there was a fair number of people suffering from coughing as an after-effect. It was around this time that Bakumondoto was used to treat these after-effects.

Of course, the summer heat was also incorporated into our plan. We basically incorporated an annualized growth of 5% to 7% for these formulations into our plan.

Haruta [Q] :

What forecasts did you incorporate for common cold formations in anticipation of restricted shipments and for the 8th wave of COVID-19?

Sorada [A] :

As for COVID-19, we did not know if it would spread or not so we did not incorporate it into our sales forecast at the start of the fiscal year. However, during an ordinary winter season, there is demand for Kampo products used to treat symptoms from the common cold. Based on calculations that took into account previous trends, we incorporated a forecast for sales for an ordinary year.

Haruta [Q] :

Incidentally, I surmise that shipment restrictions were lifted assuming inventories for common-cold formulations were at a level to handle the COVID-19 spread during the summer of 2023. Is my understanding correct?

Sorada [A] :

That is correct.

Haruta [Q] :

Next, I would like to discuss sales in China. In the crude drug platform business, you planned to secure prices while improving profit margins given the recent growth in sales. Is your performance smooth owing to contribution from sales activities in this business?

Handa [A] :

Our topline is definitely doing well. The topline is formed based mainly on raw material crude drugs. Obviously, without a certain degree of sales volume, we would not be able to cover our fixed expenses. From this viewpoint, one desirable model is to absorb fixed expense with topline growth.

However, a portion of our income was impacted by expenses for promotion activities that crossed over the cut-off period. In light of this, coupled with this factor, we interpreted this lower-than-expected expense as income. Based on this, we definitely saw progress in line with our expectations, even if the positive contribution from the portion of expenses carrying over into the next period. I just want you to realize that our progress includes these types of factors.

Hyogo [Q] :

I have one question. Regarding the dispute over a PBR below 1x, which is seen as an undervaluation, how do you plan to proceed in-house? Various industries are dealing with in various ways. Unfortunately, in the pharmaceutical industry, valuations are declining overall. It is my recognition that Tsumura is in a situation where it is not finding it easy to correct its PBR of below 1x. Is the Board of Directors making headway with discussion on how to handle this? How do those in the frontlines actually perceive this? Please explain how you are dealing with this.

Handa [A] :

The issue of a PBR below 1x is an important theme not only for myself and is naturally being discussed by members of the management team and the Board of

Directors. Even for corporate governance, this is a key theme for the Board of Directors in FY 2023. The Board of Directors previously focused discussions on five themes, including former themes such as progress with the Medium-Term Management Plan, the China business and governance. However, changes were implemented from FY 2022. In FY 2023, one of these key themes now focuses on the issue with capital. Previously we talked about this as our capital policy but we are now focusing on how to hike our PBR to above 1x and discussing returns as part of our capital policy. We are taking up these matters and seriously discussing them.

With respect to the details, we will naturally inform everyone once decisions have been rendered. What I wanted you to know is that we are making this matter a key theme and welcoming in new outside directors, and discussing how to solve this issue. Also, at some point, when the timing is right, I will discuss the details with all of you.

Hyogo [Q] :

I look forward to a release to be put out at some point outlining your ideas and opinions.

I have an additional question. Is it correct to assume that the decision-making carried out this time around concerning the China business is the result of governance functioning properly at Tsumura?

Handa [A] :

Yes, you are correct. We believe governance is functioning sufficiently. We do not see this as a flaw or issue with our governance.

Hyogo [Q] :

In any case, the question was brought up by someone earlier, and you are saying that your point of view for the China business has not changed. However, from the eyes of someone outside the company, the question now is what is going on with the China business. I think the business climate has changed since you initially

commenced operations. I think that it is definitely an option to properly explain your situation at some point. I strongly desire this.

Given the substantial changes in the external environment it is likely difficult. However, I think there are still many questions that remain unanswered, including current acquisitions, deals you have withdrawn from, is there truly an internal rate of return from the initially drafted plan given all that has happened, and is the business operating based on a business value basis. I would appreciate it if you would address these issues in some fashion.

Handa [A] :

Thank you for pointing this out. I understand your objective. We will at some point in the near future provide an explanation in that sense.

Akahane [Q] :

Regarding page 14. You explained this to a certain extent. In your presentation materials, you wrote that given the number of cases of detailing impact, there was positive impact to MR activities from the downgrading of COVID-19 to a Class 5 infection disease, and the lifting of shipment restrictions positively impacted e-promotions. I believe these e-promotions consisted mainly of video streaming. This was previously restricted therefore these e-promotions have recently sharply increased. Is this simply the result of the lifting of shipment restrictions? Is there a high level of interest among physicians regarding inquiries on what became of restricted shipments? This reflects MR activities with respect to infection diseases. However, these activities are not increasing much. Is this simply due to a decline in MR activities? Or due to a lack of sales activities since COVID-19 was downgraded to a Class 5 infectious disease? What is the correct understanding regarding this?

Sorada [A] :

First, regarding e-promotions in 4Q FY 2022, video streaming implemented on our medical site and via platforms, including the platform provided by M3, was zero.

We increased video streaming to three times in April and then to five times in and after May. The impact from e-promotions is increasing the most.

Regarding MR activities, we have basically been able to continue information provision activities for general practitioners, but even after COVID-19 was downgraded to a category 5 infectious disease, hospitals still have strict restrictions on visits by MRs. These are areas that are currently being impacted.

Akahane [Q] :

Is it okay to anticipate benefit from e-promotions going forward?

Sorata [A] :

Yes, I think we will see benefit.

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