

Financial Briefing for 3Q Results (for Investors)

【date】13:00-13:45, February 6, 2023

【presenter】 2 persons

Director, and CFO

Muneki Handa

Executive Officer, General Manager of Prescription Pharmaceutical Sales Division

Yukinori Sorada

【questioner】 3 persons

Credit Suisse Securities

Fumiyoshi Sakai

Sawakami Asset Management

Ken Oiwa

Sumitomo Mitsui Trust Asset Management Shinichi Koguchi

[Q] Sakai (Credit Suisse Securities):

I know that it is not good to ask a “woulda, coulda, shoulda” type of question but supposing that restricted shipments had not been implemented, would you have seen better sales performance in FY 2022? On the other hand, would operating profit in FY 2022 have ultimately declined assuming the cost of goods had risen incrementally with an increase in sales? One factor would likely have been Tianjin China Medico Technology (China Medico). This company had nothing to do with the restricted shipments in Japan, but I remember you said before that the company would have likely had to release the inventory it had externally. This means a growth in sales in the China business in FY 2022 but zero profit. Can you explain these comings and goings up to 3Q? In 4Q, I do not believe this structure is likely to change. However, I would like to know if, moving into FY 2023, the inventory issue at former China Medico will be properly resolved.

[A] Director & CFO Handa:

As for the issue of “if there had been no restricted shipments,” according to the calculations based on our internal standards, we estimate there would have been

an impact to our top-line of approximately 1.0 billion yen. Meanwhile, assuming the cost of goods was also impacted by this, this portion of cost of goods would naturally have risen. However, if there were sales then we would naturally see that degree of profit. This profit would not be entirely cancelled out. On the other hand, as you pointed out, unrealized profit is still being accumulated at the former China Medico. As such, this paper profit has not been fully realized. With respect to the issue of China Medico for FY 2023 you pointed out, its inventory will be fully cleared out by FY 2024. Based on this, these unrealized gains will become realized profit and fully contribute to earnings on a consolidated basis in FY 2024.

[Q] Sakai:

In this case, in the China business, you forecast a 400-million-yen loss in FY 2022. So, am I correct to understand this includes the unrealized profit at China Medico?

[A] Handa:

Yes. However, this unrealized gain will switch over to the domestic business, rather than be a part of the China business, and contributes to the consolidated result. In light of this, the loss of 400 million yen in the China business initially forecasted in FY 2022 reflects mainly external sales volume of raw material crude drugs and upfront investments. In the final year of the Medium-Term Management Plan, we naturally aim to achieve profit, as I commented earlier. However, we are at a crossroads heading into the next fiscal year and we recognize that figuring out how to get past these crossroads is a major issue.

[Q] Sakai:

Another issue is Long-COVID, which is a strange term, but at the moment, there is a shortage of cold medications, including pain relievers, in stores. This may be a result of shopping binges for these products. I understand that the long-term effects of COVID are quite severe and the symptoms, including coughing, are related to the respiratory system. So actually, are common cold remedies that are on the

market, on drugstore shelves, i.e., OTC, having an impact on Tsumura Kampo products when they are fully back to the market or should we recognize these Kampo products as having completely different properties as opposed to common cold medicines? The length of Long-COVID might also be a different topic. I think Tsumura's Kampo products are different from OTC medicines as they are prescription drugs. So, is it correct to assume that Tsumura's prescription Kampo products will be properly prescribed to a certain extent?

[A] Handa:

I believe that what you said is about OTC products under our classification. As you pointed out, demand for our common cold-related formulations is growing substantially owing to the impact of Long-COVID. While this is also a factor, but rather than this having a direct impact to prescription Kampo products in Japan, I think people who are in the stage prior to receiving medical treatment or who think there is no need for medical treatment purchase OTC medicines. So, in regards to the question you just asked, I believe this will not have a major impact on prescription Kampo products.

[Q] Sakai:

Regarding the use of Kamikihito to treat Long-COVID symptoms, such as insomnia, are there two or three other typical formulations such as this?

[A] Executive Officer Sorata, General Manager of Prescription Pharmaceutical Sales Division:

In the case of Long-COVID, there are a variety of symptoms. Consequently, for instance, Bakumondoto is used to treat a prolonged cough, Hochuekkito and Kamikihito for fatigue and sluggishness, and Kamikihito, which was just brought up, is used for anxiety. In addition, I understand that Kamikihito, Yokukansan and Yokukansankachimpihange are frequently used to treat insomnia.

[Q] Oiwa (Sawakami Asset Management):

I would like to ask about the building of an e-platform which was mentioned on Page 16. I believe there is a joint venture with Ping An related to this. I understand there are synergies with this joint venture and that its apps are fantastic. Can you elaborate on this?

[A] Handa:

As pointed out on Page 16, our objective is to implement domestic promotions as efficiently and effectively as possible. The joint venture with Ping An, in other words the joint venture with the Ping An Group, we established a corporation in China. The Ping An platform you pointed out right now is being undertaken by the Ping An Group, therefore it is part of the China business and slightly different from what is covered on Page 16. Page 16 discusses only domestic activities. I think the General Manager of Sales, Mr. Sorata should comment of this.

[A] Sorada:

In April 2022, we established the Medical Site for medical practitioners. We aim to provide services that are suited to the needs of each doctor. As such, among our e-promotions, we are using the Internet to offer an online salon and a Kampo salon. We are also offering seminars on how to use Kampo in the form of Web lectures. Or we stream other videos that doctors likely have an interest in and let them study on their own. Also, we are creating a site that implements a format where doctors can test and check their knowledge on Kampo. In addition to this, we are also integrating information on safety and all information related to medicine that uses Kampo medicines. It is our goal to create a format that will allow doctors to obtain and use information on their own.

[Q] Oiwa:

The second part of my question has to do with 2Q. This might seem a little too late. However, since no one else bothered to ask I decided to pose this question on my

own. Based on my own calculations, the 30 billion yen bond issuance was carried out at fairly low interest rate. Can you give us a summary of how you plan to use the funds you procured?

[A] Handa:

As you pointed out, we issued 30 billion yen in bonds in September 2022. This consists of two bond issuances of 15 billion yen, a 7-year note and a 10-year note. We procured a total of 30 billion yen. As for your question on how we plan to use the funds we procured, we plan to use this capital to fund our current medium-term management plan. We plan to make an investment of 115 billion yen over the three-year period for capital and DX investments. This comprises investment in the domestic business of approximately 100 billion yen. The prescription Kampo market in Japan is once again growing smoothly and we plan to set up production facilities to address this growth. This is our principal investment. We plan to allocate the funds we procured for this investment. We also plan to refinance a portion of the funds raised from the 30-billion-yen bonds we have already issued. This refinancing will be for the 15 billion yen in bonds scheduled to mature during this medium-term management plan.

[Q] Koguchi (Sumitomo Mitsui Trust Asset Management):

First, I would like to ask about the last part of Page 9. You said that shipment restrictions are expected to be sequentially lifted from March and thereafter. You explained that if conditions change, there will be fluctuations. To begin with, what assumptions is this based on? Can you explain in a little more detail why you expect to lift restrictions from the end of March?

Secondly, did the lockdowns in China have an impact on the M&A negotiations mentioned on Page 18? Will negotiations progress more smoothly once the process returns to normal going forward? What are your views on this?

[A] Handa:

First, our premises for lifting shipment restrictions reflect the shipments we have planned in our medium-term management plan. In addition, given the current impact from COVID-19 and the extra factors that are accumulating, our premises (assumptions) are based on the following three factors. Our first priority is on supplying products to patients that are currently undergoing treatment. In other words, we aim to deliver products to customers that are undergoing treatment. Our second priority is on supplying products to hospitals and doctors, who are existing customers. In other words, we envisaged our existing patients. Our third priority is on the stable supply of products that has no substitute formulations. There are some formulations that are only handled by Tsumura. We aim to carry out operations smoothly after restrictions are lifted in and after the end of March, ensuring that we achieve these priorities on the assumption of a roughly 5% growth.

Secondly, there definitely was an impact from the lockdowns in China. Given the implication of your question, I believe it is related to M&A. I will omit the lockdown in Shanghai in 2022. We are currently in concrete negotiations with several companies. The number of COVID-19 patients rapidly rose due to the lifting of the government's zero COVID-19 policy, and to be honest, negotiations during that period tended to be rather suspended. As you are aware, a fair number of people contracted COVID-19. However, it can be said that, conversely, COVID-19 has become ordinary in China. From this standpoint, communications are also resuming. Going forward, we believe there is little probability of a substantial negative impact or that things will not go smoothly. In that sense, as you pointed out, the impact from lifting the zero COVID-19 policy was likely temporary. The reality is that many people became infected and the situation is finally returning to normal.

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