



## Unicharm Corporation

Q1 Financial Results Briefing for the Fiscal Year Ending December 2022

May 9, 2022

### Question & Answer

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**[Q]:** China was minus 9%, and Baby was the main factor, and you used the term inventory adjustment ahead of time because of the shift to Japanese-made premiums. This is not to say that China is negative, but please tell us first one point about what is happening with Baby and what inventory adjustments are being made. You originally said you were going to go with Chinese products, so it seemed strange to see a stack of Japanese-made Mooney. So where does this end? In short, will it normalize?

**[A]:** With regard to the Baby Care business in China, we had accumulated a large amount of EC inventory since the end of last year, and since demand for Japanese-made Mooney products has already been declining in China, we have been working on inventory adjustment of Japanese-made Mooney products by using sales promotion expenses during the first quarter. We are moving forward with a shift to products produced within China and premium products. We expect things to be normalized around the first or second quarter.

**[Q]:** Just one more thing about raw material prices. You mentioned that the annual cost would exceed JPY17.4 billion. How much do you estimate that JPY17.4 billion would be at this point?

**[A]:** JPY17 billion plus, which is also difficult to read, but we are currently estimating an impact of more than JPY10 billion.

**[Q]:** What is the assumed rate per barrel when considering plus JPY10 billion? You have stated that you will be strongly promoting price shifting. What is your estimate of how much of the increase in raw materials you will be able to cover by price shifting?

**[A]:** Regarding the price of raw materials, although there is no simple correlation, our internal calculations assume a price of approximately USD100 per barrel. There is also a time lag, so the assumption is that they do not correlate neatly. We are trying to absorb this problem by transferring value, which is not easy to do in general because each country has its own way of doing it. In parallel with such a part and the part to increase the quantity, we are proceeding with how to use sales promotion expenses, cost reduction, productivity improvement, and absorbing it now with such comprehensive power. It is not easy to say how much for which part, and we have not been able to tally up the numbers.

**[Q]:** I believe that price pass-through is currently underway in Indonesia and North America, but how much of that was absorbed in the first quarter? Could you please give us some details on the strong progress you are going to make, such as the percentage increase in certain countries, if any?

**[A]:** We don't have a tally on the amount. In all countries, raw material prices, including logistics costs, have been rising, so we are asking them to recognize appropriate values and correct the values at the time the products are put on the market. This is in the second half, although there are some parts that we are working on now. We do not calculate the accumulation at this stage.

**[Q]:** About China, you have mentioned earlier the stagnation in supply and the impact of the lockdown, but I would like to know if there are any positive effects in terms of logistics, production, and demand, such as an increase in actual demand for masks, etc.

**[A]:** As you know, Shanghai in China has been under partial lockdown since late March, and some areas are still under lockdown in April, but Unicharm has three factories, so even if we cannot supply from Shanghai, we can supply from other factories such as Tianjin. Alternatively, the factory is also in a situation where some employees are sleeping in the factory and doing their best to supply the plant because once they go to work and return home, lockdown may start. As expected, there are cases where the logistics network has not been able to transport the products properly, so we have not been able to ship enough in April, but once this is lifted, consumers will always be prepared for such things. I understand that the term hoarding is also being bandied about in China, so I think one key point is which company can be the first to smoothly return to the logistics network and channels. In that sense, I think having three locations is a great advantage. There have been almost no sales of masks in China, so if we are talking about China only, masks are not relevant.

**[Q]:** As for China's three plants there, what about in terms of rate of operation? You mentioned earlier that the increase in raw material costs will be absorbed in the future by raising productivity, etc., but if there is a reduction in rate of operation due to the lockdown, will it not be a risk?

**[A]:** That would affect the rate of operation if it goes into lockdown. In April, regarding the total of the three bases, Shanghai was affected the most, and production and rate of operation declined by about 30%.

**[Q]:** I assume that the logistics of transporting the product to the base is not at a standstill at all but is moving? Is there any particular difference by product?

**[A]:** It seems that there are still some routes that are blocked, and the situation seems to be such that they have to be transported in a roundabout way. There is no difference by product.

**[Q]:** Regarding the inventory reduction due to the conversion with respect to Baby Care in China, what is the situation regarding the profit increase/decrease that you showed us earlier on page six? For example, since you mentioned that you used sales promotion expenses, could you tell us a little bit about whether sales promotion expenses are spent more than expected or whether it is affecting the product mix, etc.? How much was affected?

**[A]:** Affected both the product mix, etc. and sales promotion expenses. For the product mix, sales promotion expenses, rebates, etc., which are related to sales, we spent about JPY2 billion in the Baby business. You should assume that we have used positive costs.

**[Q]:** Was this situation planned from the beginning? Or was it decided by looking at the situation in the 1Q of 2022?

**[A]:** The decision was made while looking at the situation after the published figures for FY2022 were formulated and the situation in the 1Q of this term. There was a sharp increase in costs after the initial plan

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was made, so we had to shift to core products as soon as possible. Therefore, I would like you to consider that we have positively taken inventory.

**[Q]:** As for the raw materials, you mentioned that the cost of raw materials will be more than JPY10 billion higher than expected, but are you sure that you expect to be able to cover the cost of the raw materials in your countermeasures? Which area is likely to be a large number that can absorb a large portion of this area?

**[A]:** We will be reviewing the size of the budget internally in the second half of the year, but based on the figures we have received from various countries, we believe that we will be able to absorb these figures. What will contribute greatly will be Top line growth and value-added product offerings, a mix of these areas. In an environment where deflation has made it difficult to raise prices, especially in Japan, and where consumers have become accustomed to such an environment, we believe that there are products that need to be corrected to an appropriate cost or value. Our stance is to ask for a re-correction of the price of items whose value is recognized and to have their value recognized.

**[Q]:** Could you be more specific, for example, in which countries, and I think you mentioned that Japan only raises prices for Pet Care?

**[A]:** We will review all categories, not only Pet Care, although the focus will be on Japan. We will proceed to absorb cost increases other than those initially anticipated.

**[Q]:** How much does that mean, and does it mean that the price of existing products in Japan will also be raised? Does that mean you are going to raise the price higher than you had anticipated in the first place? Or are you talking about increasing the number of products?

**[A]:** We are proposing to increase the value of the product, including pricing, with respect to the launch and renewal products. I think that Japan, China, North America, India, and these places will be the center of the market in terms of amount.

**[Q]:** You mentioned earlier some things about China, such as logistics and the disposal of Baby Care inventory, and I believe that you originally planned for a 5% to 10% increase in sales. What is your estimate of the amount of this? I think Baby Care is losing a lot of revenue, and you said that it would continue throughout the first half of the year, but I think you were still talking about 5% to 10%, and logistics as well. So you are saying that sales are a bit difficult, but profit is not a problem?

**[A]:** (For China overall) We are now thinking in terms of being able to achieve what we originally planned. Sales may be a bit difficult, but in terms of profit, we will change our cost structure and continue to grow Feminine Care, so we will be able to compensate in that area.

**[Q]:** Regarding the impact of soaring raw materials, you mentioned that the overseas ratio was about 70% at the time of the annual plan. Could you tell us the domestic and overseas ratio of 7.1 billion yen due to the impact of soaring raw materials? You have stated that it may increase by a billion yen in the second half, but if possible, could you tell us by each area? In another related point, the comment about the JPY7.1 billion in the first quarter and the JPY11.9 billion in the first half being in line with expectations makes me wonder if there is that much volatility in the quarter, so I think this JPY11.9 billion in the first half may be a bit on the upside. Could you please comment on this as well?

**[A]:** The impact ratio of soaring raw materials is about 40% in Japan because the yen is depreciating and the price is on the upside. Of the JPY7.1 billion breakdown of raw materials, we estimate that JPY6 billion is the originally anticipated raw material price portion and JPY1.1 billion is the foreign exchange impact. So, if we double the JPY6 billion in the first quarter, it will be JPY12 billion, which is in line with the amount we initially

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expected. In the first half of the year, we generally set prices semiannually, so I think this area is in line with our initial expectations.

**[Q]:** If you include foreign exchange, it is likely to be above JPY12 billion in the first half of the year as well?

**[A]:** Even if the exchange rate has a negative effect on these raw materials, it will eventually have a positive effect on the conversions. So, even if the negatives here become larger, they can eventually be counteracted by the conversion.

**[Q]:** Will the effect of the foreign exchange rate be included in the quantity, etc. for page 6 of the financial results briefing material?

**[A]:** The exchange rate goes in the quantity. Exchange rates are all in each of these overall things, including product composition, etc.

**[Q]:** Do you have a breakdown of what would cause that JPY10 billion or more upward swing, domestically (Japan) and internationally? Would it be correct to say that it is already roughly 40%, 60%, domestic and international?

**[A]:** Yes, that's right.

**[Q]:** In terms of costs, logistics costs also seem to be progressing a bit quickly for 1Q, but how much do you expect per year?

**[A]:** Indonesia and other countries are the most affected among these. Indonesia has been exporting products to India in the first quarter, and logistics costs have been affected by this. However, this is scheduled to be completed in the second quarter or so, and since the plant in India has been reconstructed and equipment is now being installed sequentially, the aforementioned portion will decrease, so I do not think it will simply be 4x this JPY2 billion.

**[Q]:** About high price of raw materials, in the end, when do you think the worst-case scenario will be? Please let us know when you expect the impact of this profit pushdown to peak out.

**[A]:** I can only give you my expectations, but there is also the impact of Russia and Ukraine, and I hope that the oil price itself will peak out in the first half of this year.

**[Q]:** Although top-line growth is mentioned as a response to changes in the environment, there is a risk that the environment will deteriorate due to inflation in each country. I think the high value-added shift will be delayed a bit. In other words, as people's lives become more difficult, there is a risk that they will trade down their needs for lower-priced products, or perhaps even save a little money. However, can I assume that such signs are not currently visible?

**[A]:** Consumers are very different from one another, so it is difficult to say what the major trends are, but one of Unicharm's strengths is that we are a specialized company, so we have a two-brand strategy in some countries, and in Thailand, as in the original Uni-Charm Thailand and DSG Thailand, we offer products in two price ranges. In the case of Unicharm, we have a repertoire of products to suit each country's economic situation. Since these are daily necessities, we do not expect the total volume to change that much, and we believe that an increase in total volume will contribute to our business performance.

**[Q]:** If this value-added shift does not proceed as expected, what options are possible?

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**[A]:** I think that is because it is a daily necessity, so I don't think there is any choice not to buy it. It's also about the relationship with our competitors, but we will have customers understand our products. In order to encourage consumers to buy products based on their quality, it is necessary to advertise not only products but also to appeal to the five senses, and in the current DX context, it is also necessary to propose products that catch consumers' attention, reach their hands, and anticipate their purchasing behavior.

**[Q]:** First, you mentioned that shipments are only down 30% in capacity utilization due to the lockdown in China, other than the fact that your company is adjusting itself, but have you been able to do well since April? There may be a reactionary increase or special demand in the second quarter after that, but after April, please tell us first whether there will be any impact on the inventory that has accumulated due to logistics problems but cannot be shipped at this time or not.

**[A]:** Shanghai is the most affected area, but shipments are being made to Tianjin and Yangzhou, so overall the situation is down, but it has not stopped at all.

**[Q]:** Are you saying that the percentage of Shanghai is not that large?

**[A]:** That's right. In China as a whole, Shanghai is about 10% or less.

**[Q]:** It's not a population ratio, is it, regarding your company's shipments? Is your company's shipment strong in rural areas?

**[A]:** It will be a coastal urban area rather than a rural area. If you look at the area only in Shanghai, it is around 10% of the entire China.

**[Q]:** The Company's plan, which I think was left unchanged from the original plan, originally targeted a core operating margin of 14.9%, and last year's was 15.6%, so I think we should only see a 0.7 percentage point deterioration. Sales are expected to be on the upswing, partly due to the effect of the weak yen, but the bottom line is that sales must deteriorate by 0.7%, but at this point, even if you earn about 0.5% point from advertising expenses, the operating profit margin is still down about 2.5 points because gross profit is down about 3 points. Therefore, even if you had been able to offset all the additional raw material costs, at the current pace, it still seems very difficult for the operating profit margin to be as expected, but I wonder if there was an event waiting, such as a special major product launch from the beginning of the term to the second half of the year, which is more than just price shifting. Were there any other factors that led to the significant improvement in the second half of the fiscal year? In addition, I was wondering if there are any additional factors that would convince you this time that you can raise prices, such as the fact that the prices are so high that it will be easy for consumers to understand, and Japanese retailers haven't had any resistance lately, or if there are any other aspects of improvement that are better than expected, even better than planned at the beginning of the term, or anything like that. This is because you said that you will raise the price in Japan.

**[A]:** In terms of the environment, I think the distribution environment, including consumers, is relatively more accepting of prices.

**[Q]:** At the beginning of the period, there was an atmosphere of great difficulty in Japan, but when Kao announced that it would raise its list price by 10%, your company followed suit, and an atmosphere that it would be possible to raise the list price by that much was fostered among retailers, was that right?

**[A]:** We are still in the beginning stages, but we have confirmed that for Pet Care products and other premium products that have already been launched and have a high market share, consumers are not leaving even if prices are raised. We will not set a uniform percentage, but we will review and correct the prices in accordance with the timing of the market launch.

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**[Q]:** Looking at the POS data, I don't see much of an increase in disposable diapers, I understand the situation about pets somehow, but do you feel that price increases in sanitary products and disposable diapers in Japan are accepted?

**[A]:** We still have a long way to go, but I think that sanitary products are doing relatively well. Regarding the fall transition and children's diapers, some new products were originally planned, so pricing in these areas will be important.

**[Q]:** For Pet Care in North America, the 31% increase in revenue is a very large increase, but you commented earlier that cat treats contributed to the increase, and I think you mentioned that there were some price increases in some areas. I would like to know more about this part.

**[A]:** North America is a relatively price-approved market, especially as prices rise, and in the case of Unicharm in particular, we sell unique products, so our premium cat treats are doing very well. Distribution such as Wal-Mart, etc. has enough sales floors, and online sales are also strong. The main reason for this is that the category as a whole is growing, and prices have been adjusted.

**[Q]:** Is the first quarter particularly too good to be true?

**[A]:** No, I don't think it is too good to be true. Since last year, the Pet Care business in North America has been growing steadily, and since the acquisition of Hartz, we have changed our product categories considerably, reorganized our portfolio, and have been able to expand Unicharm's original products, such as cat treats and dog pads, into new product categories. It means that these items have actually become big chunks.

**[Q]:** Can you give us a breakdown of the percentage of sales, for example?

**[A]:** Roughly half of our sales are now cat treats. The rest is flea and tick repellents, toiletries such as dog toilet sheets, and these should each account for about 10% of the total.

**[Q]:** In Southeast Asia, what are your thoughts on the risk of down trade, even if you are going to appeal to the value appeal associated with high value-added products here in the future? If that were to happen, please let us know what measures you would take to deal with it. Prices are rising all over the world, and if consumers were to narrow down the amount of money they spend in each category, there would inevitably be a slight discrepancy between your policy of appealing to value and the market trends. In such cases, you have utilized the DSG brand, for example, in the past, but I would like to know what your policy is and whether it is safe to assume that there is no down trade phenomenon at this time.

**[A]:** As I said, we have several brands, so those who cannot easily reach us in terms of price will shift to the cheaper ones. I think it is common among ASEAN countries that Unicharm products can be purchased.

**[Q]:** In such cases, do you think that it is possible to offset the mix by reducing costs in low-cost areas?

**[A]:** If such a trend leads to an increase in the volume of cheaper products, this will again have the effect of mass production and cost reduction volume, so I am not sure that there is much difference in terms of profitability.

**[Q]:** Is it okay to say that your company is changing your pricing to the same level as your Global competitors?

**[A]:** We have not raised the price by a flat amount at all. Since we are trying to find out how much consumers will recognize the value of each product we are planning to launch and at what price, we do not calculate a uniform price or a total price as an allotment. The products that are selling well are those that have a good balance between value and price, or are accepted by consumers, so I think we can say that such products

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would be a bit more expensive in terms of value. We would like to manage it after carefully assessing the situation.

**[Q]:** Briefly, you mentioned earlier about the operating status in China, but I would like to know if there are any other countries, including those in Southeast Asia, where the operating status is declining due to the impact of the coronavirus. Also, you mentioned earlier that the supply from Indonesia to India will end in the first half of the year, but can I assume that by doing so, the impact of the drop in Indonesia's capacity utilization will be offset by India's capacity utilization?

**[A]:** As for the reduction in capacity utilization due to the coronavirus, there are no countries where the entire plant is locked down like in China. Some employees are unable to come to work, but we have not heard of any overall impact on plant operations in any of the countries. As for the negative impact of reduced exports from Indonesia to India, Indonesia is a country that is still producing at full capacity in terms of volume, so the loss of exports to India will result in an increase in its own production volume. Therefore, I believe that Indonesia's profitability will increase.

**[Q]:** This time, in the Financial Results discussion presentation page 6, the increase in profit was JPY9.1 billion in increased sales volume, which I believe is a significant increase. I think it is probably growing in comparison to your plan, but looking at the discussion sheet, it appears that the increase in revenue is slowing down a bit, with China Feminine Care being plus 5%. I believe you originally explained that from last year to this year, the biggest impact or contribution in terms of profit was from Feminine Care in China, but how was this first quarter, and which country or which product line contributed the most to this increase in profit? And I think that will be done in the future with price increases and various other things such as mix improvements, but I would like to know how it will change.

**[A]:** In terms of volume, I think Japan is the largest contributor, especially in the first quarter of last year, when the market for Feminine Care and wet wipes was sluggish, or rather, the market shrank due to the impact of the coronavirus.

**[Q]:** What is your outlook for the future? Do you feel that Japan will continue to be the most effective in increasing profits, especially in Feminine Care and wet wipes since China is on lockdown?

**[A]:** That's right. I think that is the trend for this second quarter and the first half of the year. Also, in terms of overall volume, it is Indonesia. In India, the focus is on Baby Care, but other Feminine Care products are still small in terms of value, but they continue to grow at more than 20%, and in Indonesia, the volume of Feminine Care alone has exceeded 20%. I think we can say that overall volume is contributing to the growth.

**[Q]:** Is it correct to say that Feminine Care in China, plus 5%, is likely to return to double-digit percent growth once the lockdown and other factors are lifted?

**[A]:** Double digits may be a bit too much, but I think it can be in the high single digits. Feminine Care in China, was a hurdle for last year's first quarter. Sales last year grew about plus 15%, so sales are a little higher.

[END]

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### **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.*
2. *This document has been translated by SCRIPTS Asia.*

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