Q&A Summary of Telephone Conference for the Q1 of the Fiscal Year Ending 31 December, 2019

[Points of Attention]

This "Q&A Summary" is a reference for those who would like to review the Q&A session of telephone conference hold by Pigeon Corporation on June 10, 2019..

Please note that this is not the entire text of the question and answer session at the telephone conference.

Forward-looking statements in these materials are based on management's assumptions and beliefs in light of the information currently available to it and involve known and unknown risks, uncertainties and other factors. Such risks, uncertainties and other factors may affect the Company's performance.

*Q&A are listed by Business.

Overview of Q1

Q: Please explain the factors behind the Year-On-Year (YoY) decrease in sales and YoY increase in SG&A expenses.

A: The biggest factor of sales decline is that Childcare Service Business declined its sales by JPY670 million. This is because a consignment contract with Japan's National Hospital Organization (NHO) for operation and management of on-site childcare facilities by Pigeon for NHO's employees expired on March of last year, 2018.

Other factor is a negative impact of appreciation of Japanese yen when final results are converted to JPY. We estimated the impact of yen appreciation decreased JPY320 million in Net Sales, JPY200 million in Gross Profit and JPY140 million in Ordinary Income.

In terms of SG&A, we had temporally increase due to such as the retirement benefits to directors (JPY300 million) and ERP (Enterprise Resources Planning) system-related expenses (JPY 400 million)

Domestic Baby and Mother Care Business

Q: Please tell us Q1 business performance of Japan domestic market in terms of domestic demand and sales from inbound tourists/resellers (referred as "inbound sales").

A: Our inbound sales are booked as domestic sales in the Domestic Baby and Mother Care Business only in the case of purchases made by inbound tourists and/or by resellers (*Daigou* shoppers) in Japan. Sales from inbound tourists and resellers have grown by 20% to 30% every quarter YoY, but we estimate this Q1 sales were JPY2.1 billion, nearly flat YoY. So we see other factors of sales decline in the Domestic Baby and Mother Care business in Q1.

On a monthly basis, the introduction of a new ERP in February resulted in unexpected shipping problems, which led to a sales decline of hundreds of million yen. Since then, March sales has been flat, and April has been well above from a year earlier. Regarding inbound sales, we had slightly weak sales in February but fairly strong sales in April. And we are still not sure how much impact the new EC law implemented in China this year will have on our inbound sales.

In terms of sales by product category, Nursing bottles and Nipples as well as Baby skincare are our best-selling categories as always. Looking at sales of specific product, we see that the sales weighting of products with lower Gross Margin, such as silicone-coated nursing bottles, is increasing, and as a result, Gross Margin declined.

Q: Please explain the factors behind the decline in sales of the Domestic Baby and Mother Care Business and the outlook for the future.

A: Inbound sales are not planned on the assumption that they will grow, so results for this quarter are basically in line with expectations. The unexpected effect continued until mid-March as a result of the introduction of a new ERP in February and a slight shipping problem in the logistics system. From Q2 onwards, it is aiming for a 5% increase as planned, as there is no impact from this problem. However we have faced a shipping problem with new ERP system, our "Momo-no-ha (Peach leaves) Lotion" was sold 1.03 million units in Q1. And we will closely monitor the sales of Baby food and drinks in Q2 as Q1 sales of these categories declined significantly.

Q: Sales have declined by JPY300 million, Gross Margin has declined by approximately 1 percentage point. And Operating Margin has declined by 2.8 percentage points. Does the reason for this decline include temporary expenses in addition to those caused by the decline in sales?

A: We don't have any temporary expense in the Domestic Baby and Mother Care Business. Temporary expenses we have in Q1 of this year are included in the elimination of consolidation. In Q2, we will expect July sales because July is always a good month in a year. Also, we will launch more new products in second half (Later August) of this year

Q: In the baby strollers business, the launch of a new product was postponed to the end of May. Did this delay of new product launch have a significant impact on the sales performance in Q1? Also, the Japan Fair Trade Commission recently searched two major stroller manufacturers for allegedly violating antitrust regulations. Does this make an impact on Pigeon business?

A: It was disappointing to delay the launch of new model of stroller. But the impact of delay in the release of new stroller on overall sales will be very small. We clearly say that Pigeon has absolutely no connection with JFTC's cease-and-desist order.

China Business

Q: (The reason for the slowdown in sales in the Q4 of the previous fiscal year was a change of the commercial condition with one e-commerce customer). What is their monthly sales trend after January? Please explain if Pigeon still targets 10% sales growth in China this year and what are the reasons behind?

A: The image of monthly sales in the e-commerce channel is gradually improving from January to February and March. Especially after March when the revision of the terms of transactions was resolved, the situation turned out to be extremely positive, and the situation continued in April. Year-on-year comparisons are not disclosed on a single month basis, but the e-commerce channel as a whole is growing by around 20% YoY, continuing to be extremely strong. On the other hand, conditions in the offline channel (transactions at actual stores) were difficult, falling below the results of the same period of the previous fiscal year. However, overall sales (Online and Offline) achieved our forecasts thanks to robust e-commerce channels and full-year plan (up 10% in sales) will not be changed.

Q: Can we assume the Offline channel is shrinking by nearly 20% if the e-commerce channel is growing 20% YoY and the proportion of e-commerce sales is also getting higher?

A: Offline sales are not bad. Actually, sales of some department stores, supermarkets and small baby shops are decreasing but some of our direct customers of chain baby shops are growing.

Q: Do you think China business now got back on the right track?

A: It seems China business is getting back to normal since we agreed to change the business conditions with one e-commerce customer. But we need to focus on what will happen in future in the market. We are paying close attention to what will happen in the e-commerce day on June because we had great sales in that day last year. Also, we have expected that expansion of Online channel will affect Offline channel negatively. So we are now working on how to prevent sales decline of Offline channels and hope to see good results in Q2.

Q: What is your outlook for SG&A and marketing expenses?

A: We invested aggressively into marketing in Q1 because we launched some new products at online and offline stores. In Q2, we will make an appropriate investment as we have done in the past because we will have a big e-commerce day hosted by some of our e-commerce customer in June. In general, we are positive about investing for growth in China business as Operating margin in China business is very high.

Q: According to Pigeon's plan, full-year margin is expected to improve compared to the previous fiscal year. Do you mean you will improve margin toward the second half of this year?

A: Yes, we will. It is because we plan to launch some new products in the second half of this fiscal year. Also, we had temporary slowdown in sales in Q4 of previous fiscal year but we don't expect that will happen in this fiscal year.

Q: What made Baby skincare products decline YoY?

A: We understand this is due to the completion of the initial effects of the extremely strong sales of new products launched in the same period of the previous fiscal year. In line with this, we will introduce new products in the second half of this fiscal year.

Q: Please tell us why the sales of Nursing bottles are growing even more than in the same period a year ago, when designed bottles with Disney characters drove the sales growth.

A: We have two reasons. Regional expansion and increase of market share.

Lansinoh Business

Q: Please tell us the factors behind the 11.7% YoY sales increase.

A: The North American region led the great Q1 result with 15% sales increase YoY on a local currency basis. We have two reasons of great result. One is significant sales growth at e-commerce channels due to effective marketing activities. And another one is the growth in the DME (Durable Medical Devices) channel. The DME channel is growing by about 30% YoY. In addition to DME channel, the new hospital channel is beginning to grow sales, 5% YoY in Q1.

Q: DME sales were affected by the entry of competitors in Q4 of previous fiscal year. What is the latest update of competition in DME channel? Also, Lansinoh launched a new product in DME channel in Q1 of this fiscal year. Do you think introduction of new product drive great result of Q1?

A: We see the entry of competitors does not affect our performance because our market share in the DME market is still small. We expect these figures to show how much we worked to implement our sales promotion and marketing campaign. We achieved 30% sales growth YoY in DME which almost align with our expectation. We know we still have huge opportunity in DME channel and we will keep investing our resources there to gain more market share.

Q: Please tell us about the performance of nipple cream in Q1.

A: Nipple Cream is one of core products in Lansinoh business because it is very profitable item. Market competition is getting severer because lots of major retailors launched nipple cream product under their private label. But we achieved 2% sales increase YoY in Q1 and gained more market share.

Singapore Business

Q: Gross Margin seems to decrease. Please tell us what caused a gap between these results?

A: In the Singapore business, the Thai factories are the largest contributors to our income, but it is affected by trends in inbound sales for nursing bottles for Japan.

Others

Q: Why are corporate eliminations (Elimination) worsening in the breakdown of operating income, and what are your perceptions of these results relative to forecasts? What do you think about the next fiscal year and beyond?

A: The company-wide elimination includes temporary SG&A expenses, approximately JPY700 million that includes retirement allowances for directors and ERP-related expense. This amount is not bad compared with our Q1 plan. From the next fiscal year onward, although there will be no temporary retirement benefits for executives, it is expected that maintenance and amortization cost for ERP will continue to rise.

Q: Inventories on the Balance Sheet increased from JPY10.6 billion at the end of the previous fiscal year to JPY11.4 billion in Q1 of this year. Please share us Pigeon's perspective on inventory increase..

A: Inventories increased in China Business at the end of the previous fiscal year, and in Domestic Baby and Mother Care Business. In China, production adjustments were made at the factories, and inventories declined and returned to normal. However, in Japan, shipment problems in February caused inventory increase. From Q2 onwards, we will work on to normalize inventory level in Japan domestic with making production adjustments.

Over