



Daikin Industries, Ltd.

Q3 Financial Results Briefing for the Fiscal Year Ending March 2024

February 6, 2024

Event Summary

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[Number of Speakers]	2	
	Kota Miyazumi	Executive Officer, Responsible for Corporate Communication
	Kazuhiro Matoba	Head of Investor Relations Management Group, Corporate Communication Office
[Analyst Names]*	Yuichiro Isayama	Goldman Sachs
	Hikaru Mizuno	UBS Securities
	Kentaro Maekawa	Nomura Securities
	Tomohiko Sano	JPMorgan Securities
	Yoshinao Ibara	Morgan Stanley MUFG Securities
	Graeme McDonald	Citigroup Global Markets
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*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A or whose questions were read by moderator/company representatives.

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Presentation

Sakamoto: As we have reached the start time we will now begin the briefing on the Financial Results of Daikin Industries, Ltd. for Q3 of the Fiscal Year Ending March 31, 2024. Thank you very much for taking time out of your busy schedule to join us today.

The explanatory materials are available on the Investor Relations section of the Company's website, as well as in an email sent out today. If you would like, please have a copy on hand during the presentation.

Let me now introduce today's speakers. Kota Miyazumi, Executive Officer responsible for Corporate Communications; and Kazuhiro Matoba, Head of the Investor Relations Management Group in the Corporate Communications Office.

I am Sakamoto, of the Investor Relations Management Group in the Corporate Communications Office, and I will be facilitating the meeting. I appreciate your cooperation.

Today, Mr. Miyazumi will give a 15-minute overview of the financial results, which will be followed by a question-and-answer session. The meeting is scheduled to end at 5:30 PM.

Executive Officer Miyazumi, please go ahead.

Miyazumi: My name is Miyazumi. Thank you for taking time out of your busy schedule to attend our financial results briefing.

I will explain the Q3 financial results in accordance with the documents.

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Summary of Financial Results

Both net sales and operating profit exceeded the previous fiscal year for new record highs in the cumulative results for the year.

To ensure an increase in revenue and profits, we improved proposals for products and services promoting carbon neutrality and energy solutions while thoroughly implementing strategic selling price measures and total cost reductions.

However, demand fell lower than expected due to a slow recovery in heat pump heating demand for Europe and the impact of distribution inventory adjustments from reduced housing investment in the United States. This led to third quarter results showing higher revenue but lower profits than the previous third quarter.

- ✓ Air-Conditioning and Refrigeration Equipment: Net sales expanded in China and Asia despite sluggish demand in each region. In Japan, the Americas, and Europe, the focus was on proposal-based sales in markets identified as robust.
- ✓ Chemicals: Despite the significant impact of stagnant demand, a rising trend in profits was sustained by expanding net sales and implementing selling price measures for high-performance materials for semiconductor manufacturing equipment, in which demand was strong.

We intend to achieve our annual plan (net sales of 4.24 trillion yen and operating profit of 400 billion yen) while also steadily implementing upfront investments for future growth.

Although the current business environment is difficult, we will aim to increase revenue and profits in the fourth quarter by accelerating initiatives for key themes and expanding measures in response to the business environment, such as strengthening sales capabilities in Europe and the United States.

(billion yen)	Q1-3 Results			FX Effect (YoY)
	FY2022	FY2023	YoY	
Net sales	2,985.7	3,263.7	109%	Net Sales +116.0 billion yen
Operating profit	303.8	306.5	101%	Operating Profit +12.0 billion yen
(Percentage of profit to net sales)	(10.2%)	(9.4%)		
Ordinary profit	299.3	282.1	94%	<u>YoY Results Excluding FX Effect</u>
(Percentage of profit to net sales)	(10.0%)	(8.6%)		Net Sales 105%
Profit attributable to owners of parent	209.0	193.9	93%	Operating Profit 97%
(Percentage of profit to net sales)	(7.0%)	(5.9%)		
USD/JPY	¥137	¥143		
EUR/JPY	¥141	¥155		
RMB/JPY	¥19.9	¥20.0		

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Please see page two.

This is a summary of the current financial results.

In the first nine months of the fiscal year, we were able to secure an increase in both sales and profit, and achieve record results.

Amid the severe business environment of declining demand, we thoroughly implemented measures such as strengthening proposals for products and services, with a focus on carbon neutrality and energy solutions, which are our priority themes for the current fiscal year, strategic sales price measures, and total cost reductions.

However, for the three-month period of Q3, sales increased while profit decreased. This was due to the impact of a larger-than-expected decline in demand for heat pump heating and room air conditioners in Europe, as well as air conditioners for the residential market in the United States.

The actual exchange rates were JPY143 to the US dollar, JPY155 to the euro, and JPY20 to the Chinese yuan. The YoY exchange rate impact was a positive JPY116 billion on net sales and a positive JPY12 billion on operating profit.

The annual plan remains unchanged, and we will continue to aim to achieve operating profit of JPY400 billion.

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Although the severe business environment continues, we intend to secure short-term profits and strengthen our business structure by maximizing Q4 results by strengthening our sales capabilities through dealer development, where we have been strengthening efforts since Q3 amid falling demand, and via sales price measures and fixed-cost efficiency.

Financial Results by Segment

(billion yen)		Q1-3 Results		
		FY2022	FY2023	YoY
Total	Net sales	2,985.7	3,263.7	109%
	Operating profit <small>(Percentage of profit to net sales)</small>	303.8 <small>(10.2%)</small>	306.5 <small>(9.4%)</small>	101%
Air-Conditioning and Refrigeration Equipment	Net sales	2,733.2	3,001.4	110%
	Operating profit <small>(Percentage of profit to net sales)</small>	266.2 <small>(9.7%)</small>	262.4 <small>(8.7%)</small>	99%
Chemicals	Net sales	193.9	189.7	98%
	Operating profit <small>(Percentage of profit to net sales)</small>	32.7 <small>(16.9%)</small>	39.0 <small>(20.6%)</small>	119%
Others	Net sales	58.5	72.6	124%
	Operating profit <small>(Percentage of profit to net sales)</small>	4.9 <small>(8.4%)</small>	5.0 <small>(7.0%)</small>	103%

*Air-Conditioning and Refrigeration Equipment includes filter, refrigerator and freezer businesses.

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Please see page three.

These are the results by business segment. In the air conditioning business, despite sluggish demand in all regions, the Company expanded sales in China and Asia, and also identified solid markets in Japan, the Americas and Europe, and worked to expand sales of differentiated products and services.

In the chemicals business, despite being significantly affected by the slowdown in demand, the segment maintained its profit growth trend by expanding sales in high-performance materials for semiconductor manufacturing equipment, where demand is strong, and by undertaking selling price measures.

As for the amount of foreign exchange impact, the air conditioning business posted an increase of JPY108.7 billion in net sales and JPY8.9 billion in operating income, while the chemical business posted an increase of JPY7.3 billion in net sales and JPY3.1 billion in operating profit.

The status of each business and the regional status of the air conditioning business will be explained later.

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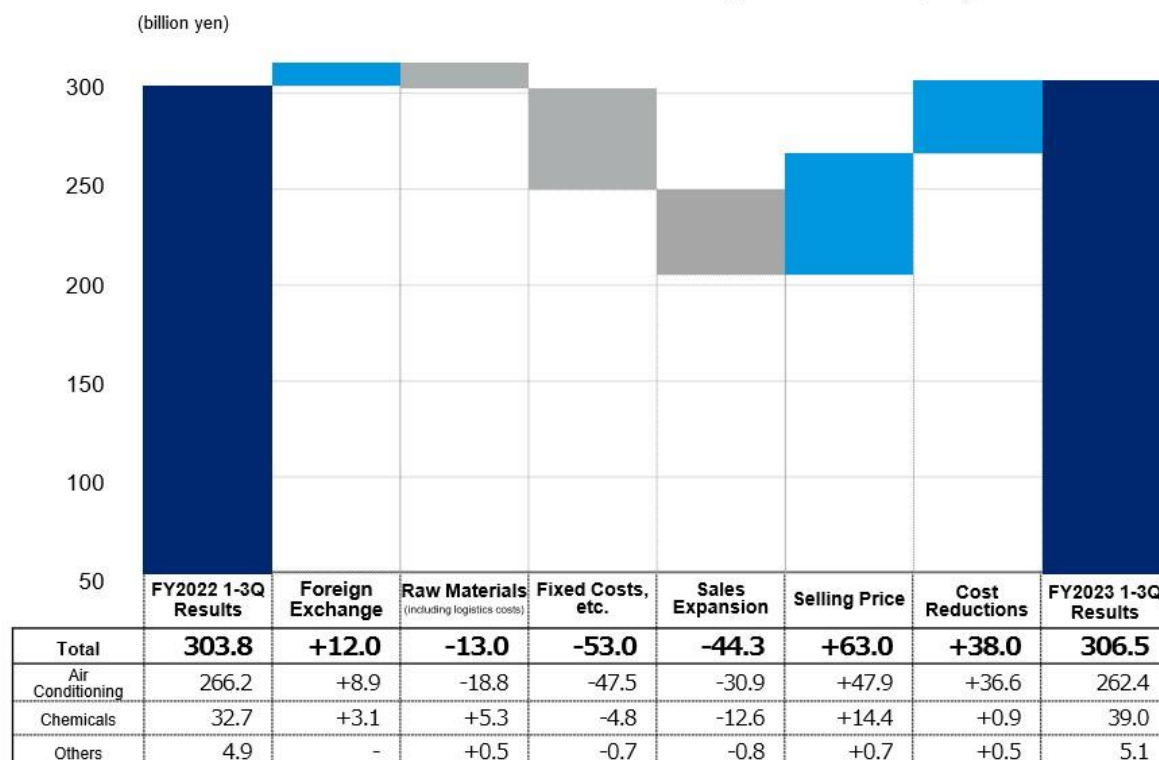
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Breakdown of Changes in Operating Profit - YoY

*Air-Conditioning business includes filter, refrigerator and freezer businesses.



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This is an analysis of YoY changes in operating profit.

In addition to cost reduction and selling price measures, the Company strived for efficient management of fixed costs by reducing expenses and curbing hiring amid the significant impact of sluggish demand.

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Net Sales by Region – Air-Conditioning and Refrigeration Equipment

*Percentage expresses year on year comparison
 *Includes refrigerator, freezer and filter businesses

(billion yen)	FY2019 Q1-3		FY2020 Q1-3		FY2021 Q1-3		FY2022 Q1-3		FY2023 Q1-3	
	Japan	104%	379.7	98%	371.2	105%	390.8	105%	410.8	107%
Europe	116%	278.9	99%	276.6	135%	372.5	124%	462.7	103%	475.3
China	97%	283.4	97%	275.1	131%	359.7	103%	369.9	105%	389.5
Americas	108%	524.2	95%	499.4	130%	650.2	156%	1,011.4	116%	1,172.6
Asia	107%	217.3	81%	175.1	117%	204.8	151%	308.9	106%	327.4
Oceania	93%	53.7	107%	57.6	131%	75.3	127%	95.4	102%	97.4
Middle East	93%	33.6	91%	30.5	141%	42.8	151%	64.6	140%	90.7
Africa	88%	5.7	96%	5.5	140%	7.7	122%	9.4	114%	10.7
Total	105%	1,776.6	95%	1,691.1	124%	2,103.8	130%	2,733.2	110%	3,001.4
Overseas Net Sales ratio		79%		78%		81%		85%		85%
USD/JPY		¥109		¥106		¥111		¥137		¥143
EUR/JPY		¥121		¥122		¥131		¥141		¥155
RMB/JPY		¥15.6		¥15.4		¥17.3		¥19.9		¥20.0

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This chart shows sales by region for the air conditioning business.

Excluding the effect of foreign exchange rates, YoY sales in real terms were 93% in Europe, 105% in China, 110% in the Americas, and 103% in Asia.

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Net Sales by Region – Chemicals

*Percentage expresses year on year comparison

*Others: Oceania, Middle East, Africa etc.

(billion yen)	FY2019 Q1-3		FY2020 Q1-3		FY2021 Q1-3		FY2022 Q1-3		FY2023 Q1-3	
Japan	94%	37.7	82%	31.0	135%	41.8	123%	51.5	97%	49.8
Americas	92%	31.4	78%	24.4	123%	30.0	144%	43.3	80%	34.6
China	92%	27.1	110%	29.9	131%	39.2	109%	42.9	98%	42.0
Asia	91%	17.5	90%	15.8	120%	19.0	132%	25.2	99%	24.8
Europe	71%	17.8	84%	14.9	160%	23.9	126%	30.1	125%	37.7
Others	82%	1.1	58%	0.6	123%	0.8	128%	1.0	85%	0.8
Total	89%	132.6	88%	116.6	133%	154.8	125%	193.9	98%	189.7
Overseas Net Sales ratio		72%		73%		73%		73%		74%
USD/JPY		¥109		¥106		¥111		¥137		¥143
EUR/JPY		¥121		¥122		¥131		¥141		¥155
RMB/JPY		¥15.6		¥15.4		¥17.3		¥19.9		¥20.0

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This chart shows sales by region for the chemicals business.

Excluding the effect of foreign exchange rates, real YoY sales in the Americas were 76%, in China 97%, and in Europe 113%.

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Business / Regional Overview – Air-Conditioning and Refrigeration Equipment

Japan

Industrial demand for Residential experienced a year-on-year decline due to consumer reluctance to purchase durable goods. Demand for Commercial fell over the previous fiscal year because of the slow recovery in demand for large-scale stores and offices.

Faced with severely decreased demand, we strengthened user proposals centered on high value-added products. Due in part to the effects of selling price measures, net sales exceeded the previous fiscal year.

✓ Residential:

With rising electricity rates and the growing need for energy savings, we increased market share by bolstering user proposals centered on **Urusara X** as well as strong sales in cold regions.

✓ Commercial:

User proposals were enhanced to focus on high value-added products such as **FIVE STAR ZEAS** and **machi Multi** because of their high energy savings and ease of workability.

YoY change (Volume basis)		Q1-3 Results
Residential	Market	95%
	Daikin	98%
Commercial	Market	97%
	Daikin	96%
Applied	Market	110%
	Daikin	135%

*Applied is based on total net sales.

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Please see page seven.

Now I will explain the status of our air conditioning business by region.

First, Japan. While industry demand was lower than the previous year, we achieved higher sales than the previous year by thoroughly implementing strategic selling-price measures and strengthening user proposals for high value-added products that meet energy-saving needs.

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Business / Regional Overview – Air-Conditioning and Refrigeration Equipment

Americas

Industry demand for Residential fell significantly due to prolonged inflation and high interest rates for home loans, and this created an adverse market environment. We worked to expand sales in Commercial and Applied products, where demand is strong, and improved sales by leveraging the capabilities of acquired sales companies. Net sales exceeded the previous fiscal year.

✓ Ducted Unitary for Houses:

Sales were lower than the previous year due to distribution inventory suppression. Progress was made in the development of stores that can handle products equipped with inverters, and sales greatly increased for our environment premium product **Fit system**.

✓ Ductless:

We expanded sales and increased market share for **VRV systems** by strengthening the sales network. Sluggish demand for Residential resulted in **RA/SKY** sales fell from the previous fiscal year.

✓ Applied:

Equipment sales expanded for the growing markets of the manufacturing industry and data centers, and sales in the Solutions business also increased, utilizing the capabilities of acquired instrumentation and engineering companies. Net sales increased significantly from the previous fiscal year.

YoY change (Volume basis)		Q1-3 Results
Ducted unitary for houses		76%
Ductless	RA/SKY	84%
	VRV	102%
Applied		151%

*Applied is based on total net sales in local currency.

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Please see page eight.

In the Americas air conditioning business, sales increased from the previous year amid a severe business environment in which industry demand for residential use dropped sharply due to prolonged inflation and high mortgage interest rates, as a result of efforts to expand sales in commercial and applied use, where demand was solid, and to strengthen sales by utilizing acquired sales companies.

In the residential unitary business, sales of "Fit," an environmental premium product, increased significantly as we developed dealers capable of handling inverter-equipped products, despite the impact of restrained distribution inventories.

Sales of Daikin North America were 101% of the previous year's level on a local currency basis. Although sales of mainstay residential unitary products declined, the Company secured an increase in revenue thanks to sales expansion through profitable sales channels, an improved sales mix through expanded sales of "Fit" environmental premium products, thorough implementation of selling price measures, and the effect of new consolidation through acquisitions.

In the applied business, equipment sales increased to the growth markets of manufacturing and data centers, sales in its solutions business by leveraging acquired instrumentation and engineering companies.

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Business / Regional Overview – Air-Conditioning and Refrigeration Equipment

China

With the lifting of the zero-corona policy, manufacturing and sales activities returned to full-scale operation for the first time in three years. Despite the severe business environment caused by the slow recovery in the real estate market and reduced consumption, We increased sales, mainly in Residential, and net sales exceeded the previous fiscal year. Operating profit maintained a high level from an increase in sales of high value-added products and efforts to reduce costs.

✓ Residential:

Sales expanded through our unique sales activities that combine user-direct offline retail sales with online activities, such as live broadcasting using showrooms, web advertising, and SNS. We responded to customer needs with the **Daikin Care Central Air System**, a new series of residential multi-split air conditioners integrating air conditioning, ventilation, and heat pump floor heating with Solutions services featuring energy-saving and air quality proposals.

✓ Commercial:

In the background of steady demand from the promotion of a carbon neutrality policy, we strengthened Solutions proposals and expanded sales for government properties, factories, green buildings, etc.

✓ Applied:

In addition to investing resources in growth sectors related to areas of infrastructure and semiconductors, we strengthened our maintenance and servicing business.

YoY change (Local currency basis)	Q1-3 Results
Residential	109%
Commercial	100%
Applied	99%

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Please see page nine.

In the air conditioning business in China, although the business environment remains severe due to the delayed recovery of the real estate market and cooling consumption, we have worked to expand sales of residential multi air conditioners, reduce costs, and cut fixed costs, resulting in sales exceeding the previous year and operating profit remaining at a high level.

Sales of residential multi air conditioners were 110% of the previous year's level. Last year, the impact of the Shanghai lockdown was significant, and compared to FY2021, which was a strong year, we have maintained the same level of performance as that.

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Business / Regional Overview – Air-Conditioning and Refrigeration Equipment

Europe, Middle East, and Africa

Continued tight monetary policy in response to inflation has resulted in weak economy and a challenging environment. With a decline in demand for Residential and Heat Pump Heating, we endeavored to sell high value-added products and implement thorough selling price measures. Sales for Applied expanded, and net sales for the entire regions exceeded the previous fiscal year by incorporating the foreign exchange rate effect.

✓ Residential:

A summer heat wave helped boost sales in Spain, which surpassed the previous fiscal year, but a decline in demand resulting from lower consumer confidence significantly affected results in each region, leading to a year-on-year decline in sales.

✓ Commercial:

Sales focused on markets with strong demand, such as hotels and restaurants.

✓ H/P Heating:

Sales decreased due to falling gas prices and changes in subsidy systems of countries such as Italy.

✓ Applied:

Sales of medium and large chillers expanded for data centers. Similarly, sales to small businesses also expanded for small INV chillers using R32 and exhibiting high environmental performance.

✓ Freezer and Refrigerator:

Sales were stagnant because of the slow recovery in demand by food retail chains.

YoY change (Volume basis)		Q1-3 Results
Residential		82%
Commercial	SKY	97%
	VRV	99%
Heat Pump Heaters		65%
Applied		134%
Refrigerator and Freezer		67%

*Residential, commercial, and heat-pump heaters are only for Europe.

*Applied, Refrigerator and Freezer are based on total net sales in local currency.

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Please see page 10.

In Europe, the business environment is severe, with a sluggish economy due to the continuation of monetary tightening policies. Although the Company was affected by declining demand for residential and heat pump heating systems, overall sales in the region, including the effect of foreign exchange, were higher than the previous year due to sales of high value-added products, efforts to thoroughly implement selling price measures, and increased sales of applied business.

Although sales for residential use were strong in some countries, such as Spain, where sales exceeded the previous year's level due to the effects of a summer heat wave, overall sales were significantly affected by a decline in demand due to a drop in consumer confidence.

In the commercial market, we focused on sales of VRV in markets where demand is strong, such as hotels and restaurants.

Demand for heat pump heating continues to decline due to falling gas prices and changes in subsidy programs in Italy and elsewhere. We are now looking to create demand without relying on subsidies, and are working to strengthen our sales capabilities by developing new distributors, visiting stores under our distributor umbrella directly, and collaborating with companies in other industries. Applied business increased sales of medium and large chillers for data centers in addition to the R32 small inverter chiller with high environmental performance.

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Business / Regional Overview – Air-Conditioning and Refrigeration Equipment

Asia and Oceania

In a difficult business environment of low demand due to persistently high inflation rates, regional net sales increased year over year due to efforts to develop and support dealers and strong sales in India.

✓ Residential:

Despite a decline in demand, regional net sales were higher than the previous year. In India, we worked to capitalize on the greater supply capacity of our new factory to capture growing demand and significantly expanded sales. We also expanded sales in Indonesia and Thailand by leveraging the sales network that we have built over the years.

✓ Commercial:

As construction starts for projects continued to be postponed or cancelled, dealer development and support resulted in the steady conversion of demand into orders to expand sales.

✓ Applied:

Equipment sales increased by capturing growing demand for factories and data centers. In addition, we also expanded sales by focusing on the After Sales Service business, such as maintenance and servicing.

Year-on-year net sales of main countries (local currency basis)

Australia: 102% India: 119% Vietnam: 93%
 Malaysia: 103% Indonesia: 117% Thailand: 122%

YoY change (Volume basis)		Q1-3 Results
Residential		103%
Commercial	SKY	106%
	VRV	113%
Applied		141%

*Applied is based on total net sales in local currency.

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Please see page 11.

In the Asia and Oceania air conditioning business, overall sales in the region exceeded the previous year's level due to efforts to develop and support dealers in each country and to maintain strong sales in India, despite a difficult business environment in which demand remained stagnant due to high inflation rates.

Sales for residential use expanded significantly in India, taking advantage of the supply capacity created by the operation of a new plant, while many countries were affected by the slowdown in demand. We also increased sales in Indonesia and Thailand by utilizing the sales networks we have built up to date.

Sales for commercial use increased as demand was steadily translated into orders through development and support from dealers.

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Business / Regional Overview – Chemicals

Net sales fell year on year due to declines in demand for products in semiconductor manufacturing processes, the automotive sector, and fine chemicals, along with the impact of distribution inventory adjustments. Nevertheless, profits increased from the expansion of sales of high-performance materials and selling price measures.

- ✓ Fluorocarbon Gas:
Along with relatively strong demand, the beneficial effects of selling price measures led to results that significantly exceeded the previous fiscal year.
- ✓ Polymers and Fluoroelastomers
 - Fluoropolymers:
Sales declined due to a slowdown in demand in the LAN electric wire sector and to distribution inventory adjustments in the automobile sector, but sales expanded by strengthening the supply capacity of materials for semiconductor manufacturing equipment. Results exceeded the previous fiscal year.
 - Fluoroelastomers:
Sales fell year on year due to distribution inventory adjustments in the automotive sector.
- ✓ Fine Chemicals, etc.:
Sales were significantly lower than the previous year due to lower demand for anti-smudge surface coating agents, water and oil repellents, and etching agents for semiconductor manufacturing processes.

YoY change (Net sales basis)	Q1-3 Results
Total	98%
Fluorocarbon Gas	129%
Fluoropolymers & Fluoroelastomers	100%
Fine Chemicals, etc.	81%

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Please see page 12.

In the chemical business, sales were lower than in the previous year due to a decline in demand for products for the semiconductor manufacturing process, automobiles and fine chemicals, and the resulting adjustments in distribution inventories. However, operating profit exceeded the previous year's level due to sales expansion of high-performance materials and sales price measures.

Sales of fluoropolymers increased from the previous year due to strong sales of high-performance materials used in semiconductor manufacturing equipment, although sales of fluoropolymers for automobiles and the information and telecommunications sector, such as LAN cables, decreased. Fluoroelastomers were significantly affected by distribution inventory adjustments in the automotive market.

In fine chemicals, sales of anti-smudge surface coating agents, water and oil repellents, and etching gases declined.

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Business / Regional Overview – Filters

Despite efforts to strengthen sales of high-performance filters, net sales decreased year on year because of the significant impact of lower sales due to the withdrawal from low-profit businesses in the United States.

✓ Air Filter:

In the United States, we strengthened sales of high-performance filters for the hospital, pharmaceutical, and data center markets. In Japan, sales to the pharmaceutical market are also strong. In Europe, sales for buildings continue to be strong due to rising awareness of energy savings and air quality.

✓ P&I (※):

Sales of special filters for oil fields remained strong. Efforts, including shifting resources to the After Sales Service business, were made to improve the business structure.

*P&I: commercial-use dust collection systems such as for gas turbines and large-scale plants

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Please see page 13.

In the filter business, sales of high-performance filters increased in each region, but it was significantly affected by the sales decline in the US due to the withdrawal from low-profit businesses, resulting in lower sales than in the previous year.

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Capex, Depreciation and R&D Cost

(billion yen)	FY2022		FY2023	
	Q1-3 Results	Total Forecast	Q1-3 Results	Total Forecast
Capex	162.2	210.0	228.3	315.0
Depreciation	105.7	125.0	124.4	170.0
R&D Cost	73.1	85.0	90.0	115.0

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Please see page 14.

The results of capital expenditures, depreciation, and R&D expenses for the nine months ended December 31 are shown in the table.

Investments in production capacity expansion, upfront investments in product development and other areas, and investments in IT and other enhancements for future growth and development are being executed as planned.

That ends my explanation.

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Question & Answer

Sakamoto [M]: We will now have time for questions and answers.

We have already received a large number of raised hands. We will call them in order. Due to time limitations, we apologize, but we would appreciate it if you could limit your questions to no more than two at a time.

Mr. Isayama of Goldman Sachs, please ask your question.

Isayama [Q]: Thank you very much.

My first question is, I was looking at the breakdown of changes in operating Profit, and I am wondering if you could explain some of the things that I find a little strange. It's on page four. I think the sales expansion effect here is minus JPY26.7 billion in Q3 alone, of which minus JPY24.8 billion is in the air conditioning area alone.

Last year's sales of air conditioning for Q3 alone were just under JPY880 billion, and this time it is JPY945 billion, so I think you are up a little more than JPY60 billion. Even after subtracting the foreign exchange and selling price effects, the nearly JPY20 billion decrease in profit, despite the increase in sales, is due to the sales expansion effect.

Is this because the severe decline in European heat pumps and the US portion of the market is causing a minus in the mix, or is it due to production adjustments, or are there other factors that are contributing to the decline?

Even on an LC basis, air conditioning sales should have increased, but profits have decreased significantly, so I am hoping you can explain what effects, other than sales and volumes, have been responsible for this. This is my first question. Thank you.

Matoba [A]: This is Matoba. Thank you for your question.

As for the factors contributing to the decline in profits in Q3, we believe that they are as you just pointed out, the decline in the highly profitable business was significant. Although sales increased compared to the previous year, sales were made up mostly by businesses like applied products that still need to improve their profitability, and not by the high-margin businesses such as heat pumps in Europe and residential unitary in the US that performed very well in the same period of the previous year. The difference in sales of these products compared to last year is significant.

In addition, there is the production impact that you mentioned. We had originally planned to keep operating rates low in H2 of this fiscal year, and we have been proceeding according to this plan. For reference, the operating rate, which is usually around 85%, is around 70% in H2 of the current fiscal year. In addition to such a drop in sales, I hope you can understand that the impact of production has also had an effect.

Isayama [Q]: Thank you, Mr. Matoba.

Regarding the reduction in capacity utilization, is it correct to understand that the sales situation in Europe and the US during H1 of this fiscal year has led to a further reduction in production than was mentioned in the announcement of the H1 financial results?

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Matoba [A]: In H1 of the year, I think we talked about production reductions and production adjustments. In H1, operation rates averaged around 80%. In H2, as I mentioned, we are planning for an operation rate of around 70%. This is the original plan rather than a response to changing circumstances.

Isayama [Q]: In that case, regarding downside factors in Q3, I have the impression that the sales expansion effect is particularly large, but if anything, what is being generated by the mix is larger than planned?

Matoba [A]: Yes, that is correct.

Isayama [Q]: Thank you very much.

Is unrealized inventory included in the sales expansion effect or in the cost price?

Matoba [A]: It is mainly in the area of sales expansion effects.

Isayama [Q]: Has unrealized inventory also had a negative impact in this third quarter?

Matoba [A]: Yes, that's right. It is occurring, but compared to the previous fiscal year the amount of impact is smaller.

Isayama [Q]: I understand. Thank you very much.

This is my second question. It is about the growth rate in the Americas. You mentioned that the residential unitary business increased 1% year-on-year in the cumulative Q3, but could you give us a breakdown of that increase?

At the same time, regarding inventory trends in North America. I would appreciate you indicating whether the inventory problem has already been resolved and if you will be able to start next fiscal year with a clean slate. Thank you.

Matoba [A]: I understand.

The Q3 total will be the breakdown of DNA Inc. (Daikin Comfort Technologies North America, Inc.) In total, the Q3 cumulative total was 101% of the previous year's total. The quantity is roughly minus 23 points. There's a positive four points from selling price, and the effect of new acquisitions and the effect of new consolidations added three points to the total.

Then there is the change in product mix. This is due to changes in the composition of sales routes, the composition of the product mix, the relationship between sales markets, and other factors. Together these amount to an addition of about 17 points with the total ensuring that sales are positive.

Isayama [Q]: What can you tell us about inventory trends and their outlook?

Miyazumi [A]: In the case of the US, we are still reducing our inventory a bit right now. For residential use, the 30-year mortgage rate is now down to about 6.6%, but I remember it was in the 2% range when interest rates started rising in 2021, so it is still quite high. We believe that one key point will be to see where interest rates start to fall.

Also, in the case of the US, the used home market has remained overpriced. In essence, this is a situation where used homes are not selling because people borrowing at lower interest rates are not refinancing at higher rates. As a result, there has been no demand for renewal for a long time.

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As for the US, we see it as a cyclical issue. When the bottom will be reached will depend on interest rate trends.

Isayama [Q]: Thank you very much.

Regarding the selling price trend, based on what you just said, do you mean that you will raise the selling price next year as well? Or do you expect only improvement on the mix side?

Miyazumi [A]: We would like to raise the selling price a little, but we will keep an eye on market trends.

Isayama [M]: I understand. Thank you very much.

Sakamoto [M]: Thank you very much.

Next is Mr. Mizuno of UBS Securities. Please go ahead.

Mizuno [Q]: I am Mizuno, from UBS. I would like to ask two questions.

My first question is what is Daikin management's current perception with regard to heat pumps in Europe? I would like to confirm that the YoY decrease in heat pump heating sales in the Q3 cumulative total was 35%, but if you look at just the three months of Q3, I think the decrease is probably about half.

If the margin of error against the Company's assumptions is within the scope of the strategy, I think it is effective to take immediate measures and make corrections from the bottom up, as Daikin always does, but if the margin of error becomes too large, I think it is necessary to stop and fundamentally reexamine the strategy. I think this view may apply to your heat pump business, but what is the current understanding of Daikin's management team?

In particular, in the area of production capacity, if there are any current internal discussions about the pace or scale of production that need to be reviewed in the ever-changing business environment, I would appreciate it if you could share them with us.

Miyazumi [A]: I understand.

Regarding the European market for heat pumps for heating and hot water supply, the current situation is that demand has fallen by about half from the figures assumed when the second half of the "FUSION 25" plan was formulated.

When the second half of the FUSION 25 plan was formulated, we expected an annual growth rate of about 27% over the three-year period from FY2023 to FY2025. As a result, we were projecting sales and demand for about 3.5 million units in FY2025. The number has now been reduced by half, and is expected to be around 1.6 million units.

Regarding our view of when demand will recover, we see that it will probably be shifted back two years, maybe three years, then planned. However, since last fall the European Commission has been instructing countries to give another round of subsidies. Since the beginning of this year, there have been some subsidies in some countries, and we have expectations for that part of the market.

If the assumed demand of 3.5 million units in FY2025 is delayed by three years, i.e., until FY2028, the annual growth rate over the six years from FY2023 to FY2028 would be roughly 13%. Growth of 13% is quite strong, and it is possible that the forecast figures for the European heat pump industry that came out the year before last were too high.

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I am sure the heat pump industry will come out with a review of those numbers. Daikin will naturally be adapting its plant utilization and operations in line with that review and the current situation.

As a point of reference, and this is something that the heat pump industry has also pointed out, gas prices are now plummeting compared to last year. But it is a fact that electricity prices remain high. So, this difference between gas and electricity prices is quite large now.

The price of electricity for households in H1 of last year averaged roughly €29 in Europe. But the price of gas was roughly €12, so in terms of price difference, the cost of electricity is about 2.4 times the cost of gas.

This would put heat pumps, which use electricity, at a significant disadvantage. If the price difference here does not improve, it will be difficult for the consumer to be motivated to buy a heat pump. Because of these compounding factors, I do not believe it is a simple matter.

In any case, demand will lag, but we believe that the next two years or so will be the time for us to prepare the foundation of our competitiveness in relation to our competitors, while anticipating a recovery in that demand.

Mizuno [Q]: I understand. I know you are building a new plant now, but are you going to reconsider that schedule?

Miyazumi [A]: The factory is under construction as planned. How many lines will be built and how many will be moved will depend on market demand trends.

Mizuno [Q]: Thank you very much.

I would also like to ask about the margin of your company's DNA, which the market continues to focus on. In H2 of the year, I think there is some seasonality, but I recall that the Company's assumption was just less than 10%. I think the level is a little over 10% for the year, but can this be raised next year?

There is also the product development aspect of responding to the refrigerant regulations, and perhaps inventory adjustment in the residential area will be delayed to H1 of FY2024, although this may not be too worrisome since it is the season of demand. Considering such things, I wonder if it will be a little difficult to realize the scenario of the medium-term management plan, which is to improve profitability through FY2025.

In contrast, if you look at the next six months or one year, what are the Company's plans for improving profitability, and what can you tell us about DNA in North America? Thank you.

Miyazumi [A]: Regarding the US, several variables are coming into play. Naturally, the same is true regarding refrigerants regu, but as we look ahead from this year to next, we are beginning to consider internally what the risk scenarios are for what might happen if Trump is re-elected.

If Trump is re-elected, which means that environmental regulations will be loosened, we have to assume that there will be headwinds for sales of heat pump products.

Then there is the issue of tariffs and the natural possibility that nationalistic moves by the US, such as imposing tariffs on imports from Mexico, may emerge. So, we are beginning to examine internally what the risks are from a macro perspective.

On the other hand, in terms of the economy, we see that interest rates will probably start to fall, which means that the economy will probably be somewhat firm.

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In this context, it is difficult to say where housing demand will bottom out because of the trend of interest rate cuts, but since interest rates have been raised at such a rapid pace, we believe that the macroeconomic impact of the rate hikes is just now being felt. We are of the view that once we enter a phase of interest rate cuts, consumer and investment sentiment will gradually recover.

If the Trump administration were to take office, it would last four years, so there is a possibility of some game-changing events. We would like to move forward in line with the risks and opportunities involved with that.

In terms of the environment, even if a Trump administration were to be elected, there are parts of the country, such as California, that have advanced environmental initiatives at the state level, and we will provide high value-added products for the environment there. It is a little difficult to foresee when such a trend will move from the state level to the federal level, but I think it will progress slowly.

Mizuno [Q]: Thank you very much.

What was DNA's OP margin in Q3?

Matoba [A]: DNA's OP rate is in the 9% range for Q3 year-to-date.

Mizuno [Q]: Is that a little low?

Matoba [A]: Yes, that's right. However, we understand that the level is not significantly down when seasonality is taken into account.

Mizuno [M]: I understand. Thank you very much. That's all from me.

Sakamoto [M]: Thank you very much.

Next is Mr. Maekawa of Nomura Securities. Please go ahead.

Maekawa [Q]: My name is Maekawa, from Nomura Securities. I would like to ask two questions.

The first is about the Americas. I understand that the demand environment is difficult right now, especially in the housing market. However, at the time of the H1 results announcement, we were told that dealer inventories had normalized to some extent. I understand that the move to optimize inventory levels may not have led to an improvement in shipments, and I would like to confirm the current status of your company's production and shipments based on a review of the current status of distributor inventories in the Americas. Thank you.

Matoba [A]: Thank you for your question.

We believe that the distribution inventory of residential unitary in the US had almost normalized as of the end of September last year, and for the following three months the situation has basically remained unchanged and is at an appropriate level.

Contrary to our expectations, the distributors did not move to increase their purchases. This is due to sluggish real demand. Looking at the three-month period from October to December, demand was on par with the previous year or slightly below the previous year. Under these circumstances, although inventory levels were not high, distributors did not increase their purchases, which did not increase our shipments.

Maekawa [Q]: I see. So, the negative effects of the inventory adjustment have ended, but you are still waiting for real demand to turn around, and as you mentioned earlier, you are assessing the trend of interest rates and other factors?

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

Maekawa [Q]: I understand.

Next, I would like to ask about Europe. What is the status of the distribution inventory of air conditioners and of heat pumps, and what is the status of subsidies for heat pumps? Since you mentioned earlier that there have been some movements in this area, I would like to know what kind of moves are being made in which countries. Thank you.

Matoba [A]: Distribution inventory in Europe is very high for both room air conditioners and heat pumps. The situation is that the decline in sales is having a significant impact.

Our company, too, has not yet caught up with the production adjustments I mentioned earlier with regard to Europe. Production adjustments for Q3 are proceeding as planned, but sales have fallen far short of the plan, and the effect of this has been to raise the level of manufacturer and distributor inventories.

Maekawa [Q]: What is happening with subsidies for heat pumps?

Matoba [A]: Although there have been moves in some countries to increase subsidy rates, there have been no developments that have had an impact on the financial results for the past three months.

Maekawa [Q]: Which country specifically raised this subsidy rate?

Matoba [A]: In terms of recent announcements, Germany. The announcement was made to increase the tax refund to 70% from the original 35%.

Maekawa [Q]: I see. Does this mean that there is no particular movement in Italy or the UK?

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

Maekawa [M]: I understand. Thank you very much. Goodbye.

Sakamoto [M]: Thank you very much.

Next is Mr. Sano of JPMorgan Securities. Please go ahead.

Sano [Q]: Thank you. My name is Sano, from JPMorgan. I would like to ask two questions.

First, let me ask about the risk of not achieving the plan in Q4. Operating income for Q4 is at a level of more than JPY90 billion, and if we look at only the sales expansion portion for Q4 in particular, you need to generate an additional JPY29 billion compared with last year, which I think is a bit of a hurdle looking at the Q3 result. Can you please talk about the risks in how you see factors of change that affect profit and whether you will be able to thoroughly accomplish this plan from Q3 to Q4?

Miyazumi [A]: We have not changed our annual sales figure of JPY4,240 billion, but we recognize that profits will not be easily achieved unless we increase sales.

In light of the sales situation of heat pump heating systems in Europe, we honestly recognize that the hurdle is quite high. However, we believe it is important to expand sales by strengthening our sales capabilities in each region, especially in Europe and the United States, and by thoroughly implementing sales price measures.

Sano [Q]: Thank you very much.

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My second question is about heat pumps in Europe. I think the results on a volume basis are as written, but I would like to know what the performance is on a sales basis. For example, I would appreciate an explanation of how effective the sales price and mix changes have been.

Matoba [A]: In addition to capturing the selling price effect, we are continuing our efforts to raise the composition of high value-added products and to focus on sales in countries with relatively high selling prices, such as Germany, so structurally, not much has changed.

For Q3 year-to-date, volume was 65% of the previous year's level, but sales were 77% of the previous year's level on an LC basis. We hope you understand that about half of the difference is in the selling price and half is in the improvement of the product and regional mix.

However, the sales trend itself has been very severe. Quarter by quarter, LC-based sales for Q1 were up about 10%, but for Q2, sales were down about 30%. For this quarter, Q3, sales were at about half the level, so the situation is becoming very severe.

Sano [M]: Thank you very much. That's all from me.

Sakamoto [M]: Thank you very much.

Next is Mr. Ibara of Morgan Stanley MUFG Securities. Please go ahead.

Ibara [Q]: My name is Ibara, from Morgan Stanley.

First, can you give us a monetary image of how severe the JPY70.7 billion operating profit for the three months of Q3 was compared to the company's original assumption? I think it is a bumpy situation, with heat pumps in Europe and unitary in the US doing poorly, and China and other countries doing well. Could you explain the monetary image for Q3 and that bumpy situation?

Matoba [A]: Thank you for your question.

For operating income for the three months of Q3 alone, the situation is below the expected level by more than JPY10 billion.

Although it was difficult to produce positive results during this period, the applied products business, which I mentioned earlier in the sales section, exceeded the plan. As expected, sales were lower mainly for heat pump heating in Europe and lower in the US residential market, where conditions are severe.

Japan and China are in line with the plan, with some positive growth. As for Asia, the total was roughly on schedule, but Q3 was a bit tough.

Ibara [Q]: Thank you very much.

My second question is about inventory on your side. At the time of the H1 closing, you mentioned that you wanted to reduce the amount by about JPY100 billion toward the end of the fiscal year and that half of the reduction would be in North America and the other half in Europe. The actual situation may differ slightly from this, as I believe there is some foreign exchange conversion at the end of the period, but I believe that the amount on a yen basis was reduced by about JPY16 billion from Q2 to Q3.

In terms of progress in this area, you mentioned earlier that there has been a slight production adjustment in Europe, but it is delayed due to poor sales. I believe the initial plan was that the company's inventory would be optimized by March of this year and begin the following fiscal year with an optimized inventory. Could you please explain whether that will be delayed or if there has been some progress?

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Matoba [A]: We have not changed our plan to make a JPY100 billion reduction in H2 of this fiscal year.

The factory utilization rate itself is moving in line with our plan. However, sales were tough in Q3, and manufacturer inventory levels are higher than expected.

In Q4, we will continue to monitor the situation and continue another round of inventory reduction. Factory utilization rates may also be considered and reviewed, especially in the US and Europe.

Ibara [Q]: If you prioritize inventory reduction and, for example, reduce the factory operating rate in Q4 further to 50% or 60%, I think inventory will decrease. However, I feel that the effects of sales expansion and other factors will worsen further, and the achievement of business results will be more difficult.

As a management priority, even if the current fiscal year's performance was a little difficult, do you prioritize reducing inventories first in preparation for the next fiscal year, or, since the announced figures are a commitment, is it important to achieve short-term performance and inventory reduction may be delayed a little? Which is it? It would be wonderful to be able to do both, but I would like to hear which is the company's view of priority in this regard.

Matoba [A]: Regarding our plan for Q4, our first priority is to secure sales volume and return to increased sales and profit in Q4. We would like to focus on how we can secure sales rather than inventory.

Ibara [Q]: I think that the operation rate was originally the lowest in the October to December period, and the January to March period is the time to increase it for next year's preparation. According to your current plans, do you plan to raise capacity utilization, which you just lowered to 70% for Q2, for the January to March quarter as you normally do ahead of spring, or do you plan to keep it low?

Matoba [A]: This is just an image, but I hope you can understand that the image is that we will not raise it too much.

Ibara [M]: I understand. Thank you.

Sakamoto [M]: Thank you very much.

Next is Mr. McDonald, of Citigroup Global Markets. Please go ahead.

McDonald [Q]: There was mention earlier about China being as planned, and excluding foreign exchange, China was plus 5% for the nine months and plus 2% for H1. Earlier you said that residential multi-split air conditioners were up about 10%, but how did China do in Q3, and what do you envisage going forward? I have learned from newspaper reports that China is quite tough, but I also have the image that Daikin is growing through the efforts of its sales companies. Even though the real economy is quite difficult, I think Daikin grew by about double digits in Q3. Can you tell us if the same situation will continue in the future and if profitability is being maintained?

Miyazumi [A]: Regarding China, I think you are aware that the macroeconomic environment is also difficult. In the midst of a particularly difficult real estate market, we are growing through the sales of residential multi-split air conditioners.

Basically, the market pie is not growing that much, but we are working on direct marketing and thoroughly utilizing online and offline marketing.

We are based on direct marketing, in other words, we are working on direct response marketing, which is a cross between systems and human tactics to thoroughly connect with customers who have inquiries online.

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Daikin China has been working in a direction completely opposite to mass marketing, which is to go after individual demand. We have been focusing on this for about 10 years, and so far we are doing well even though demand is not growing.

At the same time, however, there is naturally a push to sell at low prices, so we are also working to ensure profit margins by being selective about our customers. Right now, we see Daikin China maintaining a profit margin of about 22% to 23%.

McDonald [Q]: Thank you, Mr. Miyazumi.

I think originally, as of H1 of the year, you were aiming for China to be plus 1% in local currency terms for the full year, but will this be slightly higher?

Miyazumi [A]: It is difficult to see, but the Q3 results for residential multi-split air conditioners grew nearly 20% YoY, and we hope to continue this momentum in Q4.

McDonald [Q]: You mentioned direct response marketing, and various online and offline approaches, but is this still your sales collaborating with Pro-shops?

Miyazumi [A]: Yes, that's what I mean.

McDonald [Q]: Have your sales structure and sales approach not changed much?

Miyazumi [A]: The basics are the same.

McDonald [M]: I understand. Thank you very much.

Sakamoto [M]: Thank you very much.

The next person will be the last to ask a question.

Mr. Tai of Daiwa Securities, please go ahead.

Tai [Q]: My name is Tai. Thank you very much.

Looking at the bigger picture, if your company did not reach its initial plan in terms of profit this year, it has not happened very often in the past 10 years, and the last time that happened was about 10 years ago in 2013.

What I would like to ask is, what is Daikin's thinking? Would you emphasize short-term profit, and for example, I believe that in Europe, they are now starting to reduce the number of employees, and I wonder if they will expand such efforts globally to protect profits. On the other hand, for the next couple of years, will you operate with the idea that it is okay to fall a little short of JPY400 billion this year?

I'm sorry to be so vague, but I think this is probably the first time in a long time that Daikin has seen such a big difference between strategy and reality, so I was wondering what kind of discussions you are having about this.

Miyazumi [A]: It is difficult to say, but there are two ways of thinking. One is that it is necessary to make a profit in the short term basically, but on the other hand, it is also necessary to prepare for the future, in a sense, there is a need for a leveling off. I think we will be operating while keeping an eye on both of these issues. However, management's thinking is to not force the creation of numbers.

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Tai [Q]: As an extension of that, there was a lot of talk about heat pumps, but I have a feeling that heat pumps are very difficult to differentiate, which is different from residential multi-split air conditioners in China. Not only your company, but all of your competitors are saying that they have accumulated a lot of inventory and that things will not be good for the time being. Even if demand moves in the direction of what you just mentioned, I wonder if you will not end up in a price war and an unprofitable business. I don't know if it is possible to create a mechanism for this or not, but what do you think about this?

Miyazumi [A]: For heat pump heating and hot water supply, the price of the equipment is basically a commodity to some extent, since Chinese manufacturers and others are also involved, of course.

On the other hand, in Europe, especially with high labor costs, the cost of installation can be quite high. That part of our approach is basically to strictly train our installers so that they can lower installation costs and beat the competition by keeping total costs down.

Tai [M]: I understand. Thank you very much. I look forward to working together again.

Sakamoto [M]: Thank you very much.

With that, I would like to conclude the financial results briefing.

Thank you very much for your participation to the end.

[END]

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