Summary of Telephone Conference for the Q 3 of the Fiscal Year Ending 31 December, 2019 (Flash report)

[Points of Attention]

This" Summary (flash report)" is a reference for those who would like to review the session of telephone conference hold by Pigeon Corporation on Dec 2nd, 2019.

Please note that this is flash report of the 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.

In the event of discrepancy between the English version and the Japanese version of the summaries, the Japanese-language version shall prevail.

Event Summary

[Date] December 2, 2019

[Number of Speakers] 2

Seiji Kaneda General Manager, Business Strategy Department

Yasuo Kanatsuka Manager, Business Strategy Department

Kanatsuka: Thank you for joining our earnings call. I am Kanatsuka from the Business Strategy Department.

We will first go over our business performance for the nine months ended October 31, 2019. Afterwards, we will move on to the Q&A session.

Please refer to the presentation materials as needed.

19/12期 第3四半期 セグメント別資料

Net Sales by Segment for FY Dec. 2019 Q3 (consolidated)

(単位：百万円) (¥millions)

	19/1 第3四半期（前年同期：9か月間） Year of Jan. 2019 (Result for Last Year Q3 : 9 months)						19/12 第3四半期 （9か月間） Year of Dec. 2019 (Result for Q3 : 9 months)						
	売上高 Net Sales	構成比 % of total	総利益 Gross Profit	総利益率 GP margin (%)	セグメント利益 Segment Income	セグメント利益率 OP margin (%)	売上高 Net Sales	構成比 % of total	前期比：率 % of growth	総利益 Gross Profit	総利益率 GP margin (%)	セグメント利益 Segment Income	セグメント利益率 OP margin (%)
連結計上額 Consolidated	79,394	100.0%	41,215	51.9%	16,860	21.2%	77,528	100.0%	97.6%	39,647	51.1%	13,886	17.9%
国内ベビー・ママ事業 Domestic Baby & Mother Care Business	27,301	34.4%	13,424	49.2%	5,082	18.6%	25,462	32.8%	93.3%	12,435	48.8%	4,028	15.8%
子育て支援事業 Child Care Services Business	3,499	4.4%	454	13.0%	112	3.2%	2,855	3.7%	81.6%	358	12.6%	41	1.4%
ヘルスケア・介護事業 Health & Elder Care Business	5,158	6.5%	1,665	32.3%	236	4.6%	5,264	6.8%	102.1%	1,638	31.1%	283	5.4%
中国事業 China Business	26,879	33.9%	15,242	56.7%	9,893	36.8%	26,878	34.7%	100.0%	15,192	56.5%	9,780	36.4%
シンガポール事業 Singapore Business	9,150	11.5%	4,628	50.6%	2,425	26.5%	8,781	11.3%	96.0%	4,041	46.0%	1,842	21.0%
ランシノ事業 ※ Lansinoh Business*	9,406	11.8%	5,680	60.4%	1,405	14.9%	9,964	12.9%	105.9%	5,930	59.5%	1,433	14.4%
セグメント間取引消去 Elimination of internal trading between segments	-3,021	-3.8%	–	–	–	–	-2,790	-3.6%	–	–	–	–	–
その他 Others	1,020	1.3%	129	12.7%	99	9.8%	1,111	1.4%	108.9%	115	10.4%	75	6.8%
参考）海外全体 Ref.) Overall Overseas	42,414	53.4%	25,540	60.2%	13,714	32.3%	42,834	55.3%	101.0%	25,099	58.6%	12,991	30.3%

※ランシノ上海の売上等は、ランシノ事業に含まれています

*The sales for Lansinoh Shanghai is included in Lansinoh Business Segment

ピジョン株式会社
PIGEON CORPORATION

第 63 期（今期）は2019年2月1日から2019年12月31日 までの11ヶ月決算となります。
グローバルな事業運営の推進、経営情報の適時・的確な開示による更なる経営の透明性向上、また、将来適用が検討されている国際財務報告基準（IFRS）に規定されている連結会社の決算期統一に対応するため、決算期を変更することといたしました。これに伴い、決算期変更の経過期間となる今期は下記の対応となります。

【経過期間（今期）の対応】
・ピジョン（株）及び日本国内の関係会社： 2019年 2月1日から2019年12月 31 日までの11ヶ月決算
・海外関係会社：2019年 1月1日から2019年12月 31 日まで12ヶ月決算（通常通り）
・なお連結計算上、ピジョンおよび日本国内関係会社に係る第63期につきましては、
最初の3四半期は従来通り、第4四半期が11月1日から12月31日までの2か月間となります。

The accounting period is being changed in current period
As part of efforts to promote global business management, the Company is working to achieve further transparency through timely and precise disclosure of management information. In addition, the International Financial Reporting Standards (IFRS) which are being considered for future implementation require consistent accounting periods for all consolidated companies. Measures for the transitional period is as follows:

【Measures for the transitional period (current period)】
・Pigeon Corporation and its subsidiaries in Japan: 11 months from Feb. 1, 2019 to Dec. 31, 2019
・Overseas Affiliates: 12-month period from January 1, 2019 to December 31, 2019 (as usual)
・For purposes of preparing the consolidated financial statements, the 63rd term of Pigeon Corporation and its subsidiaries in Japan consists of the same first three quarters as in the past and the two-month 4th quarter (from November 1 to December 31, 2019).

Kaneda: First, I'll give an overview of our consolidated business performance for cumulative 3Q.

As described in the summary of financial results, net sales were 77.5 billion yen, down 1.86 billion yen YoY; gross profit was 39.6 billion yen, down 1.56 billion yen YoY; and operating income was 13.88 billion yen, down 2.97 billion yen YoY.

The decline in net sales was primarily attributable to a decrease of 1.83 billion yen YoY in the Domestic Baby & Mother Care Business, which experienced a significant deceleration in sales in 3Q, with the main reason being the slump in inbound consumption.

In addition, net sales decreased by approximately 640 million yen in the Child Care Service Business, reflecting the closure of a outsourcing contract for services to childcare facilities within Japan's national hospitals as of last year, as we have noted since 1Q.

Overseas, net sales were up 7% YoY in the China Business and up 7% YoY in the Lansinoh Business, on a local currency basis, representing progress in line with the plan. However, the appreciation of the yen against the Chinese yuan and US dollar compared with the previous fiscal year had a negative impact on sales of approximately 1.9 billion yen. Therefore, on a yen basis, the increase in sales at these two overseas businesses was not enough to cover the shortfall in the domestic businesses.

Gross profit on a Company-wide basis declined 1.56 billion yen YoY, due to a number of factors related to the decrease in sales in the Domestic Baby & Mother Care Business. This includes production adjustments at some of our factories, as well as a deterioration in the product mix, resulting in a decrease in the gross profit margin by 0.8 percentage points on a Company-wide basis.

Operating income was down 2.97 billion yen YoY on a Company-wide basis, mainly attributable to one-off increases in SG&A expenses, as we have been explaining since 1Q. Specifically, we have booked one-off expenses for the discontinuation of our retirement benefit system for Directors and ERP system expenses, both of which were not incurred in the previous fiscal year.

Foreign exchange rates, compared with the exchange rates in the previous year, had a negative impact of 1.9 billion yen on net sales, 1.1 billion yen on gross profit, and 0.6 billion yen on ordinary income.

By segment, as I mentioned earlier, net sales in the China Business and Lansinoh Business were up 7% YoY, respectively, on a local currency basis. In the Singapore Business, performance continued to be solid in Indonesia, but was adversely affected by business conditions in India and the Middle East. On a local currency basis, based on a rough estimate in US dollars, net sales were down by approximately 3% YoY.

Net sales were down 6.7% YoY in the Domestic Baby & Mother Care Business, and down 28.4% in the Child Care Service Business. The sharp decline in the Child Care Service Business reflects the termination of the contract with Japan’s National Hospital Organization in the previous fiscal year. The decrease in sales in these two businesses were the main factors behind the weak overall performance in cumulative 3Q.

Along with our business results, we announced downward revisions to our full-year forecasts. Let me briefly go over the details.

We initially targeted net sales of 106.2 billion yen and operating income of 20.0 billion yen for the full fiscal year. We revised down our net sales target by 7.2 billion yen, to 99 billion yen, and we revised down our operating income target by 3.2 billion yen, to 16.8 billion yen.

In 3Q, as mentioned earlier, we saw a sharp decline in inbound demand in the Domestic Baby & Mother Care Business, combined with external factors like natural disasters and a decline in the birth rate in Japan.

In the Singapore Business, we experienced a softening of sales to the Middle Eastern region, as well as negative impacts from the economic stagnation and decline in demand in India. As a result, the overall Singapore Business was exposed to very harsh business conditions in 3Q.

These changes in our operating environment have intensified even more than we initially anticipated as we entered 2H, and we do not expect a meaningful recovery under current circumstances in 4Q. Hence, we decided to revise down our initial plan.

Although we have not disclosed the breakdown of the revised forecasts, we expect results to fall short of our initial targets in the Domestic Baby & Mother Care Business due to sluggish inbound demand, and in the Health & Elder Care Business due to weak sales of a new product since entering 2H despite solid sales in 1H.

In the Singapore Business, as mentioned earlier, we expect sales to remain firm in Indonesia, but we expect no change in the difficult business conditions in India and the Middle East.

Furthermore, the decline in inbound demand in Japan has resulted in a decrease in the utilization ratio of some of our factories, and we think these conditions will persist in 4Q. As a result, we expect sales and profits to come in slightly below our initial target.

In the China Business and Lansinoh Business, we expect performance to be in line with our plan on a local currency basis, but as a matter of fact, growth has been sluggish when converted to yen, due to the impact of foreign exchange rates, and we do not expect these businesses to fully absorb the shortfall in the other businesses stated above. Accordingly, we decided to issue the above-mentioned revisions to our initial plan.

During the 1H results briefing, we said that we plan to release a new skincare product in China, called Ssence, in November. However, based on current circumstances, we have pushed back the release date.

This delay in the release date until the next fiscal year is due to adjustments being made to ensure the aseptic condition at our newly established production facility, where we have been carrying out production line tests according to the latest standards for aseptic conditions.

We also note that it takes a reasonable amount of time to keep the production lines sterile, given that the equipment is very complex. Because the equipment is new, we are requiring some time until our workers get accustomed to its operation. We are now carefully making final adjustments at this facility. We will inform you separately regarding when we will be releasing the product in the next fiscal year, after we complete the tests and confirm that the test results are fine.

We understand that new product releases through e-commerce channels are most effective ahead of major events, such as on June 18 and November 11, so we are making final adjustments to our production line, while focusing on releasing the product by around June. I would like to reassure you that the delay in the product release is not due to a defect at our production facility.

Our sales forecast for the current fiscal year does not factor in any material impact from Ssence.

This concludes my explanation.

Question & Answer

Q: In the Domestic Baby & Mother Care Business, during the three months in 3Q alone, how much of sales came from inbound consumption? I recall that the year-earlier figure was 1.8 billion yen.

A: Yes, it was 1.8 billion yen last year. As we have been saying, it is difficult to calculate an exact figure. Based on our estimate, we believe sales from inbound consumers amounted to approximately 800 million yen, versus 1.8 billion yen last year, for 3Q alone. This means that we believe the decline in inbound demand was responsible for a decrease of roughly 1 billion yen in sales compared to the previous year.

Q: For which items did sales decrease? And why do you think they decreased?

A: We experienced a sharp decline in sales of bottles and nipples, which is our mainstay product category, as well as our Peach Leaves skin care product. We cannot define precisely the regions where sales have declined, because we cannot keep track of how our products are distributed beyond our own distributors. As of 2Q, we saw a decrease in sales of approximately 300 million yen, and one of the persistent factors behind this decrease has been the appreciation of the yen against the renminbi.

We believe another factor behind the sharp decline in sales in 3Q is the current situation in Hong Kong, which likely had a major impact on cross-border e-commerce purchases made through Hong Kong, in which people from mainland China had previously visited Hong Kong to buy our products.

Q: For 3Q alone, you mentioned that approximately 1 billion yen of the 1.5 billion yen decrease in sales compared to the previous fiscal year, is attributable to inbound demand. What are the reasons behind the remaining 500 million yen?

A: The remaining 500 million yen is partly attributable to the impact of a slightly lower birth rate compared to the previous year on existing products, resulting in an approximately 300 million yen decrease in sales for existing categories.

We also had shipment problems related to our ERP system in February, and this was responsible for roughly 150 million yen in opportunity losses in 2Q. We have not been able to recover these losses, and they have continued to have a negative impact on the business. This is the breakdown of the remaining 500 million yen.

Q: Okay. I'd like to return to my question about inbound demand again. You mentioned earlier that you will not be disclosing your forecasts for each business, but I would like you to explain in further detail about your outlook on the Domestic Baby & Mother Care Business in 4Q.

A: Regarding inbound demand, we do not expect any significant changes in 4Q. Note that Japan's 4Q will be an irregular two-month period for the current fiscal year, due to a change in our accounting period, and will thus cover only November and December. In 3Q, we recorded sales of roughly 800 million yen from inbound demand over a three-month period, meaning that the monthly sales from inbound demand was more than 200 million yen but less than 300 million yen. In 4Q, we typically see a decrease in sales volume to inbound tourists, and hence we expect slightly below 200 million yen per month from inbound sales in 4Q. Essentially, this means that we expect about 400 million yen in sales over the two-month period.

Q: Will you be able to tell us by how much you have revised down your full-year forecast for the Domestic Baby & Mother Care Business?

A: We're sorry. We have not disclosed our revised forecasts by segment.

Q: Okay. Do you think that the prevailing conditions will continue into the next fiscal year, unless we see a change in foreign exchange rates and an improvement in the situation in Hong Kong?

A: Yes. For the Domestic Baby & Mother Care Business, we expect our business performance to be affected by foreign exchange rates and the situation in Hong Kong in terms of inbound demand.

Regarding exchange rates, we experienced a sharp appreciation in the yen against foreign currencies in the current fiscal year compared to the previous fiscal year. However, we believe that a further significant appreciation in the yen is unlikely, and we may gradually see an improvement in exchange rate conditions.

Regarding the situation in Hong Kong, we are unable to predict what will happen going forward and, thus, this is a factor that is beyond our control.

Against this backdrop, we will be announcing our medium-term plan in February 2020. We are currently making final adjustments to this plan in light of the weak inbound demand in the Domestic Baby & Mother Care Business, to work out measures that would help lift sales for existing products, such as in categories where we look to bolster sales, new products, as well as pricing strategies.

Q: Okay. I have one last question. Regarding sales in the China Business, excluding Hong Kong, could you share us any figures specifically for 3Q? Sales in the China Business had been exceeding the initial plan until 1H, but now sales are trending in line with the plan. I suppose that sales in 3Q were not very favorable in 3Q. In addition to this, have offline sales improved?

A: First of all, we do not think there has been a change in prevailing conditions in the China Business. In the China Business, the third quarter ends on September 30, and this is a period when sales fluctuate depending on the year, including September and October, in anticipation of Singles' Day in November. Therefore, we do not think that the business performance was particularly poor in 3Q.

In fact, on the so-called sell-out basis, we reported an increase in sales of 7% YoY for cumulative 3Q, of which sales in e-commerce rose by 33%. We experienced solid results through offline channels as well, particularly in the two chain baby stores. However, sales through offline channels were down 12%, indicating that performance in e-commerce is steady, but we are still slightly struggling in offline sales.

Kanatsuka: Thank you. Let's move on to the next question.

Q: First, I would like to ask about the China Business. The year-earlier hurdle in 3Q is lower than 2Q. On a cumulative basis, you mentioned that sales grew 7% YoY. Do you think that results are performing in line with the target, even in light of the seemingly low year-earlier hurdle?

A: Yes. Sales are in line with the plan. In fact, we have already factored in an increase of 10% for the full year, on a local currency basis, even though there is still one month left in the China Business, as mentioned earlier when explaining our revised forecasts.

We have heard that on November 11, Singles' Day, under the e-commerce category, sales increased by over 30% YoY. We have been told that the figures are very high. We are thus set to make a solid recovery in 4Q, and we expect to be able to achieve our full-year forecast as planned. In this context, we understand that there are no issues in terms of our sales progress toward our full-year forecast.

Q: Could you tell us the figures for the China Business over the three-month period in 3Q alone?

A: In 3Q alone, sales grew 6% YoY.

Q: If I recall correctly, I believe sales in 2Q were up 14%.

A: In 2Q alone, sales were up 10%.

Q: I see. In 2Q alone, sales were up 10%, so does that mean sales will be concentrated in 4Q when Singles' Day will contribute?

A: That is correct.

Q: Okay. Could you share with us the sales growth figures for the main product categories, which you usually provide us for the cumulative period; for example, the sales growth figure for nursing bottles?

A: Sure. For cumulative 3Q, in the China Business by product category, bottle and nipple sales, which accounted for 47.6% of total sales, were up 7.5% YoY.

Skincare products, which accounted for 18.4% of total sales, were down 1.9% YoY.

Baby wipes, which accounted for 5.6% of total sales, were up 13% YoY. Laundry products for babies, which accounted for 5.5% of total sales, were up 37% YoY.

Baby cleaning and disinfectant solutions, which accounted for 4.2% of total sales, were up 32.3% YoY. Pacifiers and toys, which accounted for 1.7% of total sales, were down 29.2% YoY.

Q: How was sales growth for e-commerce, such as on JD.com and the Tmall flagship store?

A: Our estimate on a sell-out basis is approximately 9% growth for cumulative 3Q on JD.com, accounting for roughly 20% of total online and offline sales.

Next, sales from our flagship store on Tmall accounted for roughly 8% of total online and offline sales, which reflects a growth rate of roughly 2X YoY.

As we usually mention, we have direction transactions with a chain baby store, which contribute to our offline sales. Sales from this channel accounted for roughly 8% of total sales, and this indicates growth of approximately 30% YoY.

Sales growth at mom and pop shops, which account for the majority of offline sales, was around negative 20%.

Q: Thank you. My second question is about your explanation about the Middle East and India. You mentioned that demand has declined in India. To what extent do you think this condition is unique to 3Q, or do you think this is a structural issue that will continue? Please give us some more details on the business conditions in the Middle East and India.

A: First, the prevailing operating conditions in the Middle East have been exposed to political uncertainty. In light of these conditions, we believe that a recovery will be unlikely until these external circumstances settle, and we see the possibility of these conditions growing slightly prolonged.

Next, regarding our business in India, we do not have a clear picture at this point on how the economic stagnation in the domestic Indian market will recover next year. That said, we have plans worked out for the next fiscal year and beyond to roll out products at a reduced price range targeted at the middle class in India, such as nursing bottles and nipples. We thus aim to inject stimulus into the business by expanding the target customers to the middle class, from only the upper class previously, in order to restore business performance.

Kanatsuka: Thank you. Let's move on to the next question.

Q: I would like to confirm three simple points. Regarding the questions from the two previous analysts, were you sharing the figures for China sales excluding Hong Kong? Or, do they include the figure for Hong Kong? You mentioned that for 1H, sales were up 8%, and for cumulative 3Q, sales were up 6%. Do these figures include Hong Kong? Moreover, what are your views on the impact of Hong Kong on sales?

A: The figures that we have shared up to know, on a local currency basis, include sales in Hong Kong. However, the sales volume in Hong Kong is marginal in relation to the overall China Business, and therefore, sales growth in Hong Kong has no material impact on sales growth in the China Business.

That said, as we explained earlier, sales in Hong Kong have slightly declined in 3Q. Hence, if we look at 3Q alone, sales in Hong Kong has had a negative impact on the overall China Business, albeit modestly.

Q: Okay. So the impact is small. Earlier, you mentioned sales via Hong Kong as one of the reasons for the decline in inbound sales. Could you explain this in further detail?

A: This is only our assumption. Basically, we are unable to grasp the full picture of how our products in the Domestic Baby & Mother Care Business are sold to our domestic distributors, and through what kind of sales channels take these products over to China, or Hong Kong.

One of the reasons why we mentioned sales via Hong Kong is because we understand that there is a large number of our Japanese products that are being sold at stores in Hong Kong, and we are also aware that there are a considerable number of people from mainland China who visit Hong Kong to buy these products. The recent instability in the situation in Hong Kong has been a factor behind the decline in tourists from mainland China to Hong Kong.

Another reason is because of the presence of purchasing agents. We have heard that a number of these purchasing agents are buying our products via Hong Kong, and there are businesses in Hong Kong that also distribute our products on e-commerce sites in mainland China. We believe that these two sales channels—domestic stores and purchasing agents in Hong Kong—are being adversely affected by the current situation in Hong Kong.

Q: In either case, does this mean that at the root of this issue are domestic distributors who are wholesaling the products to Hong Kong?

A: Yes. That is what we conjecture.

Q: Okay. I understand this point. Next, my other two questions. The results for the Lansinoh Business appear to have improved in 3Q. What are the factors behind this improvement?

A: We experienced ongoing growth in Europe and Lansinoh Shanghai, where sales were very strong and grew in the double digits.

Moreover, in 2Q, our sales to Amazon had temporarily dropped in North America, but we have seen a modest recovery in sales to Amazon. Hence, the slight increase in sales in North America was a factor behind the overall recovery.

Q: What about the DME—durable medical equipment—sales channel in the US? Could you give us just a brief explanation?

A: Sales in the DME channel were up 20% YoY for cumulative 3Q and came in ahead of the plan.

Q: Please update us on this again later. Lastly, looking at sales in each country on a yen basis in the Singapore Business, sales were down 10% in Taiwan and also down by roughly 10% in South Korea for the cumulative period. Sales in the overall Singapore Business were down 8%, and you've explained that sales in India were down 10%. Are there any points that we should be mindful of in terms of sales in Taiwan, South Korea, and Singapore?

A: First of all, Taiwan and South Korea are in the territory of the China Business. In Taiwan, there has been a sharp decline in the number of births, and the economic conditions in Taiwan has not been favorable. Our business performance has been affected by these circumstances, but the sales volume is not very large.

In South Korea, we have been adversely affected by the anti-Japanese sentiment. This situation has been prolonged, and even though we did not feel a material impact in 1H, we are beginning to see a growing impact after entering 2H.

In addition, the number of births in South Korea has declined significantly, and our share of the Korea market is very high. These are factors that have been behind the sluggish sales in South Korea.

In the Singapore Business, the main factor behind the results, as we have been mentioning, is the Middle East. The Middle East accounts for a large portion of sales in the Singapore Business, and sales have been sluggish in this region.

Meanwhile, we do not think the domestic market in Singapore has an impact on the overall business that warrants attention, because our market share in Singapore is already very high, and this is not a market where we expect any significant growth from the previous year.

Q: So, sales in Taiwan and South Korea are categorized under the China Business, correct?

A: Yes, that is correct.

Hirozumi: That is all from me. Thank you very much.

Kanatsuka: Thank you. Let's move on to the next question.

Q: I would like to ask about business in mainland China in further detail. You mentioned that sales growth in 2Q for the China Business was 10%. However, you also mentioned that, for mainland China, sales growth was 8%, indicating that there is a slight difference. Could you first tell us the sales growth figure for mainland China in 3Q alone?

Also, the gross profit margin and the SG&A-to-sales ratio appear to have considerably deteriorated in 3Q. What are the reasons for this deterioration? Also, please share us your views on 4Q, especially in light of the impact of Singles' Day.

A: First, regarding your question about sales growth in mainland China, where you pointed out that sales growth was 8% for cumulative 2Q, and 10% for 2Q alone, the results are more or less the same even if you include the results for Hong Kong. Sales increased by about 5% in 1Q, 8% for cumulative 2Q, and 10% for 2Q alone. For mainland China, sales increased by 7% for cumulative 2Q and 6% for 3Q alone.

Q: I thought you said that sales were up 8% in 2Q alone? When looking at the figure for mainland China, and after adding other items, this figure would be 10% for the overall business.

A: Even if you include or exclude Hong Kong from the figure for mainland China, you should basically arrive at the figures I just mentioned.

Q Okay, then that means I heard the wrong figures. I also recall hearing that Hong Kong provided a significant boost to sales in 1H, but I will clarify the details about this point during our follow-up interview, so that's fine. At any rate, sales increased by 6% in mainland China for 3Q alone, correct?

A: Yes. Sorry, there might be some discrepancies in the information, because there are multiple factors that come into play, like cross-border sales to Hong Kong, so it's quite difficult to grasp an exact number.

Q: Next, could you share with us the background as to the deterioration in gross profit and SG&A expenses, as well as your views toward the profit margin in 4Q?

A: As for China, we are roughly in line with our plan in terms of both gross profit and operating income. While bottles and nipples continue to account for a large portion of sales, sales have been gradually increasing for skincare products. We are seeing a steady growth in sales for these two high-profitability categories, so we have been able to maintain a high level of profitability.

However, sales growth was 7% ahead of 4Q, when Singles' Day takes place, and there wasn't a significant change in the growth rate from 2Q. Hence, the profit margin is also unchanged from 2Q on a local currency basis.

As for 4Q, we have heard that sales were very strong for Singles' Day, and we also heard that sales growth of 10% can be achieved for cumulative 4Q, so we believe that sales will grow significantly in 4Q.

We also think that gross profit will show a steady growth, as gross profit essentially moves in tandem with sales for bottle and nipple products, as well as other products, though we cannot say anything for certain until we check the product mix and other information.

Another point that requires attention is the expenses that arise in the form of SG&A expenses for Singles' Day, given that this has become quite a large event. We have not received the final figures from China with regards to these expenses, so there is nothing we can say for certain at this point, but it is likely that the operating profit margin will fluctuate by a little depending on how much expenses have been incurred.

Q: The gross profit margin deteriorated in 3Q alone, while the SG&A-to-sales ratio increased. Looking at the gross profit margin in 3Q alone, the margin deteriorated by over one percentage point. What are your views on this point?

A: Although the impact is insignificant in terms of the overall China Business, a factor that is gradually starting to have an impact is the slight decline in sales in South Korea. This has had an impact on sales, and accordingly it has had a slight impact on operating income.

Another factor is shipments in October and November for Singles' Day. We have frontloaded some shipments in China in anticipation of Singles' Day, and we have been building up some inventories at our factories. These conditions likely had a modest impact on the profit margin in 3Q alone. In short, the deterioration in profit margin partly reflects the preparations we made in anticipation of 4Q, so if our inventories are worked down steadily, then the profit margin should be restored.

Q: Thank you. Lastly, I don't recall you commenting so much on the birth rate in the past. But, this time, you referred to the declining birth rates in China, Japan, and other areas.

Some sources have reported that the birth rate has declined in the double digits this year in China. Could you comment on this topic and share us your views on the impact it might have on the next fiscal year?

A: Some online sources reported in mid-November that the number of births this year will be around 11 million people. We are confirming with our representatives in China about the details of this data.

In fact, no official data has been released yet. Today, there was likewise an online report that estimated this year’s number of births between 11 million and 13 million people. Thus, the data on the number of births in China need to be taken with a grain of salt, and we will continue to verify the data with our China Business.

That said, we have long expected that the number of births in China will not grow and will continue to decline, so we have been aggressively expanding our target market, such as by attracting more of the growing middle class and older children. Our policy is to make an even stronger push to expand our E-Commerce Business, which is growing. In these ways, we intend to respond to the decline in the number of births.

Looking at prevailing conditions, where sales on a sell-out basis have increased 7% YoY for cumulative 3Q, we believe the results of measures that we have rolled out have manifested, despite recent figures that of course indicate that the number of births is declining. Thus, we intend to continue to focus on these measures.

Q: Does this mean that you have not changed your target of achieving a 10% increase in sales for the next fiscal year onward?

A: I believe you are talking about the target in our medium-term plan to be announced next year. We are currently looking into a growth rate in the vicinity of 9% or 10%. We will be announcing our medium-term targets in February next year, so we will of course make preparations, such as working out strategies and countermeasures against the downward trend in the number of births and other issues.

Kanatsuka: Thank you. Let’s move on to the next question.

Q: Earlier, you mentioned that the product launch of a new skincare product has been delayed. Although you mentioned that the sales volume was not large, you stated previously that it was going to be one of the featured items during this year’s Single’s Day. Singles’ Day has already ended. Did the delay in the product release have a significant impact in business negotiations for Singles’ Day, or did you have to make any changes in your strategy?

A: The new product was only scheduled to be sold at our flagship store on Tmall. It was not scheduled to be sold on JD.com or other sales channels, so there weren’t any business negotiations that had been planned. Therefore, we think there was virtually no impact.

Q: Okay. Thank you. When I visited you at the exhibit during the previous results briefing, you mentioned that you are selling high-end skincare products in Japan and China . I believe the names of these products were Filbaby in Japan and Filaggrin EX in China. Could you tell us about the market’s response and evaluation of these products?

A: First, these products have been posting steady sales in China. Therefore, they are starting to gain traction in the Chinese market. We have heard from our representatives in China that sales have been growing in line with expectations, so we understand that these products are making steady progress.

Meanwhile, these products have only been released in August in Japan. Shipments were generally robust the first time around, but our honest feeling is that we still need to build the brand profile. Thus, the latest figures for sales growth has been slightly sluggish.

Various measures will be rolled out to build the brand profile of these products so that they will gain broader penetration in the Japanese markets, and these efforts are currently underway.

Q: Although you already touched on this, could you give us the growth rates for skincare products in China for each three-month period in 1Q, 2Q, and 3Q once again?

A: In FY2019, sales were down 13.4% YoY in 1Q alone, up 5.7% YoY in 2Q alone, and down 1% or almost unchanged YoY in 3Q alone.

Q: Do you think that there has not been a significant impact from new products on numerical figures?

A: We released Filaggrin EX in August in Japan, and in May in China. Therefore, the product was released in 2Q in China.

Q: I see. My last question is regarding a rough estimate of the breakdown of this 3.2 billion yen in your downward revision. Please give us a rough idea of what percentage of this revision is from inbound consumption, the Middle East, and India.

A: Please note that the figure is on a converted basis into Japanese yen, so you would have to take the exchange rates into account.

The biggest factor is Japan. We forecast the results in the Domestic Baby & Mother Care Business, where exchanges rates do not have an impact, to come in around 1.4 billion yen short of our initial target. We also expect the Singapore Business to come in around 900 million yen short of our initial target, mainly attributable to losses incurred at our Thai factories.

The negative impact from the Singapore Business was just mentioned, but the profit margin in India is still not high. Most of the impact was from the decline in profits at the factories of our two Thai companies, stemming from the decline in sales of bottles and nipples in the Domestic Baby & Mother Care Business. If you take this into consideration, our Domestic Business is also having a strong impact on other businesses.

The remainder of the shortfall versus the initial target can be broken down into modest shortfalls in other businesses, but China is the next biggest contributor. We expect a roughly 400-million-yen shortfall versus our target, partly due to the adverse impact of exchange rates.

A: I understand. Thank you.

Kanatsuka: Thank you. Let's move on to the next question.

Q: I would like to ask two questions. First off, I'd like to confirm one point. Is it correct to understand that the downward revisions to the full-year sales forecasts for the China Business and Lansinoh Business are purely the result of taking exchange rates into consideration?

A: As mentioned earlier, we have received reports that the target will be achieved in the China Business on a local currency basis, so the downward revision in the China Business is purely due to the impact of exchange rates.

However, we have received reports that the target will not be achieved in the Lansinoh Business even on a local currency basis, so the downward revision for the Lansinoh Business is not purely due to the impact of exchange rates.

Q: Okay. Thank you. When looking at the China Business in 3Q alone, both sales and profits have declined. Does this mean that both sales and profits have declined in China due to exchange rates, excluding the slightly negative impact of business in South Korea?

A: Yes, that is correct. The profit margin has been at elevated levels, so the exchange rates have also caused profits to decline.

Q: I would also like to ask about shipments for Singles' Day. Is it correct that there were virtually no shipments for this purpose in 3Q? When looking at the business results of other companies, shipments for Singles' Day have been reported in 3Q, as well as a considerable amount of corresponding expenses; many of these companies have reported a decline in profits in China. Has this situation occurred at Pigeon in 3Q?

A: There have been shipments for Singles' Day in 3Q, but the overall impact was insignificant. Therefore, products have likely been shipped from October onward.

Q: In that case, would that mean that figures for 3Q do not reflect this shipments, and thus expenses for these shipments have not been accounted for in 3Q?

A: That is correct. Shipment expenses for Singles' Day have not been booked in 3Q.

Q: Okay. My second question is about the Lansinoh Business. You mentioned earlier that shipments to Amazon have started to pick up again. Do you see this as a cyclical factor, given that shipments were good in 1Q, not very good in 2Q, and then good again in 3Q?

A: Shipments to Amazon in North America are difficult to predict, because their business model is to purchase from us in bulk, and then work down those inventories. Once those inventories need to be replenished, they once again place an order with us. Therefore, these orders fluctuate from one period to another.

Starting from this year, we have been pushing ahead in earnest on various initiatives with Amazon in the US, but we are still grappling with the issue of how to predict the order cycle from Amazon in our business transactions.

That said, we think that these fluctuations will continue to take place over the near term, and business will likely take place amidst this fluctuation between quarters.

Q: How much were sales for Lansinoh Shanghai as of 3Q?

A: Converted to Japanese yen, sales were roughly 1 to 1.1 billion yen for cumulative 3Q.

Q: Sales grew by that much?

A: Yes, sales grew considerably in 3Q.

Q: Does this mean that the profit increase in the Lansinoh Business is largely attributable to Lansinoh Shanghai?

A: Sales certainly grew very strongly in China, but as I mentioned earlier, sales have now only grown in China, but also very strongly in Europe as well. In addition, though sales in North America did not grow much from the previous year in 2Q, sales grew slightly in 3Q, albeit very modestly. As a result, sales grew for the overall Lansinoh Business.

Kanatsuka: Thank you. Let's move on to the next question.

Q: I just want to ask two simple questions. First, regarding the downward revision to operating income, how much of this is attributable to a shortfall in profits up to 3Q, and how much of it is attributable to what you expect will occur in 4Q? Could you provide us with a rough estimate on how you would allocate the shortfall versus your initial target?

Second question, Earlier, you mentioned about the number of births. I believe that a number of scenarios can be conceived, even amid the declining number of births, given that sales have grown in the past despite a shrinking number of births. For example, competition could intensify, as was the case in Japan, or we might see a growing oligopolization, resulting in a recovery in the profit margin over the next few years.

I believe that what will transpire in terms of earnings or profits will not necessarily be correlated with the number of births, as the number of births decline more than planned in the future, in light of our experience in Japan. Could you share us your views on this point?

A: First, in terms of the allocation of the downward revision to the profit margin to 3Q and 4Q, we believe they are divided almost equally between both quarters. However, due to the irregular accounting period in which there will only be two months during 4Q in Japan for this fiscal year, in actual terms, we expect conditions to be slightly tougher in 4Q than in 3Q.

Regarding your other question about the correlation between the number of births and sales, as you say, there is not an absolute correlation between these figures. However, we will be making an active push to grow sales, such as by rolling out new product categories, and shoring up existing categories that still have a low market share.

Overseas, there are still many countries where the target users of our products are a limited group of wealthy people, so we intend to expand our target users to the middle class. In order to do so, as we have always been saying, we will need to roll out new products that are geared for these middle-class users in countries like Indonesia and India. We still see room for further growth if we can properly follow through on the expansion of our user base through these activities.

Kanatsuka: Thank you. We've reached the scheduled time, so we'd like to end the earnings call. For further inquiries, please contact our Business Strategy Department.

Thank you for your participation today. We ask for your continued support.

[END]