Terumo Corporation
February 14, 2022

Q&A Session at the Financial Results Briefing for the Third Quarter of Fiscal Year Ending March 31, 2022

Outlined below are the Q&As from the financial results briefing on February 9, 2022.

Questioner 1: The first question is whether there were any positive or negative deviations between these results and the numbers that your Company was looking at internally, although they were not disclosed. From what I heard, I got the impression that revenue was above expectation, but profit was a little lower.

Terumo: Thank you. Regarding the upward revision of JPY12 billion to the revenue guidance, we originally provided our guidance in a certain range at the beginning of the current fiscal year because we expected the impact of COVID-19 to remain in H1. At the end of Q1, we decided that the lower limit of the range was no longer necessary, so we came to show the upper limit alone, and now we have added JPY12 billion only for revenue. This is mostly due to foreign exchange rate effects. Most of the JPY12 billion, around JPY 11.7 billion comes from foreign exchange rate fluctuations, so in reality, the top line will slightly be above the upper limit of our expectation.
However, we did not expect the recent inflationary trend. In Q2, we mentioned that the increase in logistics costs was a factor in the decrease in profit of a little more than JPY1 billion. In Q3, while the sharp rise in logistics costs remained unchanged, we faced inflation in other areas, such as a sharp rise in materials costs, including semiconductors. Moreover, the wage rate also increased, mainly for factory workers. Up until Q2, if you remember, we saw a decline in capacity utilization at our plants in Vietnam, in both the north and south, where they manufacture TIS products and Trima kits for the blood business.
In Q3, the problem of lower capacity utilization was resolved. We were able to secure workers, but in exchange, we were paying wages at higher rates, which was also happening at North American factories. This factor worked more in Q3 than in Q2. This made an unexpected negative impact of just under JPY3 billion.
This inflationary trend is likely to continue in Q4 as well. As for the next fiscal year, we will announce our guidance after three months. However, as many other companies are probably saying, we assume that the inflationary pressure will remain in place for a long time.
Unfortunately, there are no factors that will improve the margin much in Q4, but we still believe that we can achieve JPY120 billion in operating profit. As I mentioned earlier, the impact of foreign exchange rates, mainly those of the euro and the Chinese yuan, on revenue will also work

on profit by around JPY2 billion. In reality, the inflationary pressure will have a larger downward effect. However, in Q4 we still have two months left, so we will be able to achieve the target of JPY120 billion by controlling expenses. I hope I answered your question.

Questioner 1: I understand. Just a few words. Up until Q3, I understood that revenue showed an upswing. Did profit incur a slight downswing? Or was it on track because of the exchange rate effect?

Terumo: It was almost on track. As you all know, the margins tend to drop from Q3 to Q4 every year. The operating margin for Q4 will be a little less than 15%, which is 1 percent point lower than 16% in Q3. As we are looking at this, we think that profit is on track. In Q4, considering the annual seasonal factors, we expect that profit will be able to achieve JPY120 billion.

Questioner 1: I understand. Moreover, you mentioned that there was a problem with the supply of access devices. You also said that the supply was returning in January, but how much of an impact did this have? I think that you manufacture them in Puerto Rico. Could you comment on them briefly?

Terumo: As mentioned in the presentation, revenue at C&V grew by double digits YoY and 6% QoQ. Originally, it would have increased about 8% if there was not the shortage of these vascular closure devices, or VCDs. This means that there was an impact of less than JPY2 billion, which represents a fall of around 2 percent points because quarterly revenue at C&V is roughly JPY100 billion.
The supply problem has not been fully solved, and the devices will recover toward the end of Q4. At the start of the next fiscal year, they will probably be almost back to normal. Anyway, we expect that the top line at C&V will decrease about 3% from Q3 to Q4.
In addition to the prospect that the VCD supply will probably not fully recover in Q4, and since January is already over, there was unfortunately a bit of an impact from the Omicron variant. In the C&V business, there was a low- to mid-single-digit decline in January, but we have set the revenue target based on the assumption that revenue will pick up in February and March, just as they did a year before. For Q4, we originally expect that the results decline as usual, but in other words, we believe that we will be able to achieve our guidance.

Questioner 1: Thank you very much. That is all from me.

Questioner 2: If you could explain it while looking at slide six. I'm sorry, I came in the middle of the presentation and so it may have already been explained.
I wonder if this minus six, representing a JPY600 million decrease in gross profit due to

production adjustment, is the effect of lower capacity utilization. Are you saying that most of the JPY3.6 billion decline in the gross margin is due to inflation? It would be helpful if you could explain this area referring to this chart.

Terumo: This is a bit complicated. If you look at page six of the profit variance analysis for Q3, the minus six part, we intentionally increased the inventory of TIS-related products in the previous fiscal year. This was already a year ago when we anticipated a recovery from the impact of COVID-19 and deliberately built up the inventory to avoid causing shortages. The production adjustment that will take place at the Ashitaka factory to bring this back to an appropriate level of inventory is this minus six, which is accordingly on schedule for the current fiscal year.
If you are wondering where the inflationary effect is, as you said, it is in the minus 36, the red one on the left side.
As you may remember, there was a rush of interventional cases in Q3 of the previous year before the third and fourth waves of COVID-19 arrived. We received a large number of interventional cases, so revenue in the previous year's Q3 posted a record high.
Compared to the prior-year Q3 results, this year's results were even higher. Originally, as the Cardiac & Vascular Company's sales mix has been increasing, the improvement in the Company mix would lead to a positive, not negative, effect. The impact of pulling down this effect to the minus 36, or the fall of JPY3.6 billion, is inflation. We estimate that the impact of this inflation will be a little over JPY3 billion, which includes the costs of parts and materials, rents, and logistics costs. That doesn't explain everything, but a majority, almost two-thirds, is due to this inflation.
The remaining several hundreds of millions of yen are expenses for future cost reductions as part of our VC2 initiative, value creation through collaboration, which was announced in late last year's GS26. Under this initiative, we have started to take actions to concentrate production in three regions, such as Costa Rica and Vietnam.
In addition, this minus 36 includes one-time expenses, such as those for the acquisition of an Italian distributor for Neurovascular.

Questioner 2: As you mentioned earlier, the JPY3 billion cost inflation effects will continue in Q4. However, though you quoted freight, raw material, and labor cost, I think that the transportation and raw material cost will gradually lose effect, but the labor cost will not decline. If you take only the labor cost, is there any indication of how much the increase has been?

Terumo: This is very difficult to calculate from a practical point of view partly because of the foreign exchange rates, but as you said, if the time frame for the resolution of the problem shifts, we will have to break it down properly to make our guidance for the next fiscal year. However, it is hard to say whether the situation will be resolved in the next fiscal year or not. We believe that

the problem will linger on at least during H1.
If all goes well, we may see a slight loosening in H2. It's hard to break it down here to say exactly how much or how little each part is, but I think the biggest factor may be the wage rate.

Terumo: The wage rate part is structurally significant. The first thing we did in Q3 was to make sure that product manufacturing would not be interrupted. So, we made it our first priority to maintain production. This is why we paid some higher wages to part-time workers at the plants. Once production levels off to a certain extent, there will be replacement of people. We expect this production structure to take some time, but after a certain period, we think that the impact will lessen.

Questioner 2: I understand.
The next question is about Omicron. According to the announcements by medical device companies, elective procedures were considerably affected in January and will recover in March. What was the impact of the Omicron variant on revenue in January? Do you assume that the impact will disappear in February and March?

Terumo: In January, compared to the average sales in Q3, there was a single-digit dip in the middle of the whole. We are focusing on C&V, which saw a 5% or 6% drop compared to the average of Q3. However, the number of infected people has already peaked out in most countries. It usually takes about three or four weeks for hospital resources to be restored. We expect the situation to be back to normal by the middle of February. There was a dip in January, but the demand level was higher than a year ago after all, so I'm not too worried.

Questioner 2: In short, in January, it dropped by about 5% more than usual, but from February onward, it will be back to normal, is that right?

Terumo: Yes, that's right.

Questioner 2: I understand.
Finally, I would like to make a request. Recently, briefings for medical devices have become cost briefings, and the more you explain the cost, the gloomier the atmosphere becomes.
Therefore, I think it would be helpful if you could also talk about the progress that has been made toward the achievement of the medium-term management plan, so that we can have more expectations for the future. I had this feeling at an endoscope manufacturer's meeting. I hope that you will consider this matter.

Terumo: I understand. Thank you.

Questioner 3: I'm sorry to ask this question related to a bit depressing topic, but in the financial results announced by Haemonetics last night, this company said that it will extend the contract with CSL, which was originally scheduled to end in June of this year, for 18 months until December of next year. However, Haemonetics said that the new contract will not be an exclusive one, but a non-exclusive contract. If you can give us the reason for this, is it due to your Company's matter or is there some other reason?
In addition, what is the status of the FDA's review of your application, which I think was submitted in September? How is the approval process going?
Your plasma collection product will be sold along with the Haemonetics product until 2023. Will there be price competition? Finally, after 2024, when the contract between Haemonetics and CSL expires, is there any possibility that your Company will enter into an exclusive contract with CSL?
Also, I think the CAPEX guidance for this fiscal year has been revised downward by about JPY8 billion. Is this related to this change in the contract with CSL? This is the first question.

Terumo: The last one, CAPEX, is mainly related to the C&V area, so it is not relevant to this matter.
I also heard about the presentation yesterday. However, since the timing of the changeover will finally come this year, we IR have been carefully confirming with CSL in advance, on what we disclose. So there is nothing we can newly disclose on this matter today.
What we can tell you is that, as you said, we have submitted an application to the FDA, but it has not been approved yet. As soon as it is approved, we will announce it in a press release or something.
Also, what we have been consistently announcing since the start of the collaboration with CSL in April last year is, that one of the major milestones was to start reporting revenue during H1 of the next fiscal year, and this has not changed. Unfortunately, we cannot talk about the agreement after 2024 or the price related information for the period when the two companies provide products at the same time.

Questioner 3: Thank you very much. I know this may be difficult to talk about, but is it correct to say there is no change in the story that the machine itself is a product pending FDA approval made by your Company, and that you will be replacing all machines at CSL's US centers?

Terumo: Yes, that's right.

Questioner 3: I see. It's the columns changed to a contract that Haemonetics will continue only supply until the end of 2023. Is that right?

Terumo: I heard it announced that way.

Questioner 3: I understand.
The second question is about the situation in China. First, I would like to know any update on centralized purchasing, or volume-based procurement, of stent, balloons and guidewires. I understand that access devices were not covered by this centralized purchasing, but I wonder if there is any chance that they will be covered in the near future.
Finally, with regard to the preferential treatment of domestically produced products, until now it was a rather gray area as to whether or not products made in China by foreign manufacturers would be treated as domestic ones. In October, however, the Chinese government issued an official statement that it will treat those products as domestic ones. Is there any plan for your Company to accelerate local production in China based on this statement?

Terumo: Originally, even before we heard about this, we prioritized major products for local production and transferred them sequentially to China. We are moving forward with that, so we are going to proceed as originally planned. I believe that the ratio of varieties to be produced locally will increase in the future, as we have implemented this so far, and will continue to do in the future.
There hasn't been much progress, or change, in this volume based procurement, or VBP, matter. In Q1, we filled up the supply shortage of some local manufacturers of drug eluting stents. The high wave of orders stemming from this calmed down in Q2 and we saw the same level in Q3. Revenue remained almost flat, such as a change of 1% or so. The access devices are not covered by VBP due to the same reason as previously. However, there are no local or even foreign manufacturers that can produce the same number of products with the same quality as we do. If these products become the objective of VBP, they will not be able to handle interventional cases in China, so we do not assume as before that there will be too much concern in the near future.

Questioner 3: I understand. What percentage of your revenue in China does come from locally produced products or those sold under the local Essen brand?

Terumo: It's very small. That's less than 10% of JPY50 billion annual revenue in China.

Questioner 3: Most of them are imported?

Terumo: Yes, that's right.

Questioner 3: You are producing outside China and exporting them into China?

Terumo: That's right.

Questioner 3: I understand. Thank you very much.

Questioner 4: We have heard that in the USA, the shortage of nurses has become a very serious problem. If possible, could you tell us about what kind of impact this will have on your TRI (trans radial intervention) practice in the current situation and the outlook for the next three years? If possible, please let us know the feedback from medical practitioners.

Terumo: I think there is a logic that TRI will solve the shortage of manpower and improve the medical economy. It is quite difficult to predict the next two to three years by looking only at the current situation and its factors. However, I can say that the shortage of labor will not be a disadvantage for us.
Meanwhile, as for the concern that nurses and doctors will be infected with COVID-19 and that there will be no one left to provide medical care, although this does not answer your question at all, but looking at Omicron, I think that this concern has peaked out. This is especially true for Europe and the USA, and there will be regional differences going forward.
In Japan, when a person is infected with Omicron, he or she is required to stay at home, which is relatively strict compared to Europe and the USA. This is also the case in the medical field. If a doctor becomes infected and the person who performs the procedure is put on standby at home, the elective cases will be postponed. However, in Europe and the USA, people are already trying to coexist with COVID-19, so I don't think that there will be too much concern in the future.

Questioner 4: Thank you very much. May I ask what the TRI ratio is in the USA?

Terumo: There has not been a big change since it reached 50% or so. I'll confirm it later.

Questioner 4: Thank you very much.
The second question is about SG&A expenses. There are various negative impacts on gross profit, but you are trying to control costs. What specific costs are you trying to control in this Q4?
I understand that the current situation of high costs will continue in the next fiscal year, but I would like to know if management is planning to control costs to some extent even under such circumstances.

Terumo: We have required each indirect department and company to conduct this cost control as a message from management.
As for the main part of the Company business cycle, it is related to sales promotion expenses. Although the forms of events have changed considerably with COVID-19, we are seeking

efficient management of costs and, although this is not the same thing as costs, we are also seeking a strict increase in revenue.
At our head office and indirect departments, majority is personnel costs, which is fixed costs, so the main target is the variable part. In the future, we will review the estimates of the parts to be supervised, review the variable factors, review the content and the timing.
In the next fiscal year, for example, we will not only cope with the external costs in terms of logistics costs, but we will also take various measures to achieve the best possible costs by reviewing the balance between ocean freight and air freight.

Questioner 4: Thank you very much.
One additional point. I was very impressed that the medium-term management plan came up with talks about improving the operating margin and reducing costs across the board. Can I also ask you whether such an announcement has raised awareness within your Company of the need to tighten costs?

Terumo: The other day, as part of our organizational changes, we established the CAFO office directly under me. As the head here, we have set up a dedicated unit to lead the profitability improvement program.
For the main target, GBS, we are working on the scheduling and other details. This is an important area for the future, so we are now discussing the schedule and the scale of the project including overseas.

Questioner 4: Thank you very much.

[END]