

## **Meiji Holdings Co., Ltd. Financial Results for the Q2 of FYE March 2023 (FY2022) The Online Briefing Q&A**

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### **Presenters:**

Kazuo Kawamura	CEO, President and Representative Director
Daikichiro Kobayashi	COO (Pharmaceutical Segment), Member of the Board and Executive Officer
Katsunari Matsuda	COO (Food Segment), Member of the Board and Executive Officer
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\*This material has been edited to make it easier to understand some of the questions and answers.

#### **Q-1-1-1**

I would like to know about the outlook for high raw material costs in the next fiscal year and how you intend to beat this and return to the original profit level. This year alone, the increase in raw material costs is nearly JPY30 billion, with another JPY10 billion remaining for H1 of next year, so the total increase of raw material costs for this year and next year will be at least JPY40 billion higher. On the other hand, if we assume that the price hikes are JPY20 billion for this fiscal year and about JPY10 billion for the remainder in H1 of next year, it appears that at least JPY10 billion of the high raw materials costs has been left undone.

How much higher are raw material costs likely to be in the next fiscal year if the current market conditions continue, and how do you intend to counteract these high raw material costs that are being missed?

#### **A-1-1-1**

**Matsuda:** This year, there was a YoY increase of about JPY30 billion in raw materials, etc., including exchange rates. We are trying to beat this by price hikes and capacity changes, but as you say, there is still a little less than JPY10 billion to be counteracted.

However, in terms of prices for raw materials alone, prices have now settled down, and some raw materials have dropped somewhat. We have been able to cope with the exchange rate up to about JPY130 by price hike, so when the assumption of the exchange rate was JPY145, we were considering aggressively raising the price. However, with the recent JPY137 to JPY138, we need to reexamine this issue in relation to demand. In any case, next year, we will take care of what is left of the amount of increase so far.

#### **Q-1-1-2**

When the price was JPY145, you had to consider a second price hike, but with the current exchange rate, the yen is rapidly appreciating, and am I to understand that you are hesitant about the second price hike? I couldn't understand the nuances there.

#### **A-1-1-2**

**Matsuda:** As for the second time, in terms of cheese and dairy fat, we have already done it twice, so this is the third time for that. Especially, we hesitate to raise the price of confectioneries for the second time. We should check the trend of its demand. Or also for SAVAS series, we have to think about the risk of demand decline. Even with the price hike, we have to think about the sales volume, how much sales and marginal profit we can make as a net. Before the end of the year, we will also consider the exchange rate and raw material trends.

#### **Q-1-1-3**

I see. If it had been JPY145, you would have had to consider a more really aggressive price revision, but now that the exchange rate is falling below the current level, you are now considering internally whether to really revise the price and whether the cost reduction can really absorb the cost. Is that correct?

#### **A-1-1-3**

**Matsuda:** That's what I mean.

#### **Q-1-2**

How do you put the probiotics back in H2? Looking at your plans for H2, I do not believe that you will be able to achieve this plan unless you keep the minimal volume decrease for existing products. So I wonder why this is reversible and if there are any signs that this stalemate is changing. Could you tell me the status of probiotics separately for *R-1* and *LG21*?

#### **A-1-2**

**Matsuda:** As you have pointed out, in order to achieve our plan for H2, we need to achieve 100% YoY in sales volume for existing products with something extra in new yogurt for body fat reduction. Indeed, until recently, our feeling was that the situation was extremely worrisome to everyone. However, *LG21*, for example, has been doing well in terms of sales volume since June, around the

beginning of Q2.

As for *R-1*, since October 20, when the effects of TV advertising began to emerge, the number has been growing in terms of volume. And since there is an added effect of increase in yogurt for body fat reduction, if prices are not raised, the YoY change in sales volume is probably between 103% and 105%. This is the situation, even including today's numbers. However, since the price hike was implemented on November 1, recently the amount has decreased by about 3%.

Therefore, in terms of sales volume, we are currently over 100% in commercial products, including both existing products and yogurt for body fat reduction. Therefore, on a sales value basis, we are currently growing at about 105%, an increase of about 5%.

In addition, *R-1* is now available at drinking milk retailers and has been partially replaced by a new product called 5-Star Custom. 5-Star Custom is not included in probiotics. As for the future, *LG21* will start Function Claim labeling in December.

In addition, as CEO Kawamura mentioned earlier, we will aggressively invest in marketing. As we have shown and talked about earlier, we have solid numbers when we run TV ads. In addition, as you know, probiotics have a high rate of return, so I believe that we will be able to absorb the benefits of our investment.

#### Q-2-1-1

November is just beginning. What is the impact of this price hike on the sales volume of drinking milk, yogurt, and probiotics, or how do you see it? Also, regarding the planned loss of about JPY2 billion for the drinking milk business this time, is the price hike for milk and yogurt sufficient to cover the higher costs each?

#### A-2-1-1

**Matsuda:** Regarding the price hike situation, if I speak first of our company alone, drinking milk has not been affected at all. *Oishii Gyunyu* is growing. Moreover, since the consumption behavior of customers has changed a bit, *Oishii Gyunyu* 900 ml is doing well, but there has also been a large increase in 450 ml or smaller-volume packages, which is a very good trend since the profitability of

smaller-volume packages is comparatively higher.

However, on a YoY basis, last year included PB, so excluding that, the actual results are over 100% YoY. However, *Oishii low-fat milk*, *Oishii milk calcium*, and other types are a little out of sorts. So, if we take Meiji's drinking milk as the total, sales volume is a little over 100%.

As I mentioned earlier, the volume of probiotics has been steady, but the impact of the price hike has so far been limited to 3% for us, and perhaps 3% for other companies as well. Since we have just recently raised the prices, some of the selling prices have not been raised properly, or conversely, some customers may reject the price increase, but I believe that they will return to normal in about two months.

Yogurt is struggling very much. I think this is a product group with a high price elasticity value when it was originally struggling overall, so the composition ratio among the three major companies has deteriorated. Simply put, there is a lot of outflows to products that are still selling for JPY98. Since this was originally anticipated, we have been implementing a 30-gram increase sale on all 400-gram *Bulgaria Yogurt* from October to November, December and January, with the idea that there would be as little outflow as possible. That means we are selling 430-gram *Bulgaria Yogurt* at the same price as the former 400-gram *Bulgaria Yogurt* from October as a limited campaign. However, the effect has not yet been seen, partly because it is hard to see the word increased volume in these products. We are working on package change as soon as possible. We would also like to work on measures to put POPs on store shelves to let people know that the volume has been increased.

#### **Q-2-1-2**

I think this deficit plan of milk business means that the industry as a whole is pretty severe, and I am wondering if this price hike is sufficient. I understand that probiotics volume decline is contained at 3%, but how much is the *Bulgaria Yogurt* volume falling and how far off the story they are from your assumptions?

### **A-2-1-2**

**Matsuda:** First, the biggest reason for the budget for the JPY2 billion deficit in drinking milk is that the plant in Eniwa-city, Hokkaido, is now in operation, and with Asahikawa plant in Hokkaido, we have double indirect costs. Therefore, if Asahikawa plant closes, they will naturally disappear, so in terms of commercial milk, we are practically at about a level of breaking even.

As for whether the price hike is sufficient, we have already absorbed the cost increases of milk price and other factors, so I think it will be a matter of how far we can keep the volume fluctuations from decreasing, or increase them.

Bulgaria's sales volume is about 90% YoY so far. Originally, they have been just under 95%, so the price hike has caused them to drop a bit, and the three major companies are roughly in that range. As I mentioned earlier, we have taken measures to ensure that the sales would not drop, and we would like to maintain the previous year's level by reviewing the package and strengthening sales promotions.

### **Q-2-1-3**

I see. Unlike the probiotics, it will return after some time.

### **A-2-1-3**

**Matsuda:** I think it will return.

### **Q-2-2**

What is your perspective on the current prospects for milk price negotiations in April for the next fiscal year?

### **A-2-2**

**Matsuda:** Regarding the price of milk for processing, we, first of all, as a top brand and leader company involved in the dairy industry, understand fully that dairy farmers are having a hard time managing their business due to rising feed and energy costs. We also feel that we must maintain

and develop the dairy industry, including the food security issue, and we feel a responsibility to do so. We are not refusing to accept their idea, but are willing to discuss it together, respecting each other's standpoint and way of thinking.

However, we need to discuss with each other whether it is a best way to raise the prices for processing next year or during the current fiscal year as a net, or whether it is acceptable when the supply and demand are very loose. We understand that dairy farmers in Hokkaido are still having a hard time even with the increase in raw milk prices for drinking milk, so we would like to make decisions based on a thorough exchange of information with J Milk.

#### **Q-3-1**

Please tell us about your profit perspective, for the next fiscal year or the year after next, or in a medium-term. This time, there is a temporary or special factor, such as the severe raw material price situation, which will cause a one-time loss of profit, but I believe that you will do various things such as responding to the price. So, please tell us about your current thoughts on the medium-term profit perspective, such as the current value of your company's earning capacity, or to what extent you are trying to see profits return for the next fiscal year and the year after that.

#### **A-3-1**

**Kawamura:** It is really difficult to look ahead to the next fiscal year and beyond. There are many very uncertain factors including the exchange rate trend. We are also concerned that domestic consumption itself and the economy as a whole is becoming very weak. Therefore, we would like to accumulate profits for the next fiscal year and beyond, of course, but this must be done in a way that is in line with the actual situation, and I believe that how to maintain competitiveness over the medium to long term is very important in the medium-term range. It is not a good idea to rush to target only profits. We believe that this is a time when it is important to maintain the competitiveness of the entire business and of our company.

First of all, we would like to consider exceeding this year's full-year profit forecast, which we have just announced, as much as possible. We are now thinking this year's full year forecast or higher

as one of our perspectives. We are beginning to prepare a next medium-term plan and other such plans for trends from 2024 onward, so we hope to be able to show what kind of medium-term business plan we have in place by next year's financial results.

### Q-3-2

With inflation and the consumption environment becoming difficult, I think that some parts of management are not changing, but some may be changing. Please focus on the areas to change, and let us know if there are any areas where you think you need to change your management strategy due to changes in the external environment.

### A-3-2

**Kawamura:** I think various things still need to be changed. In our company, now, under these very difficult circumstances, including the weak yen, the question again is the overseas sales ratio. As a result, we are on target, but exactly we need to further enhance our overseas presence in order to grow from a long-term perspective. The Group as a whole is currently working to achieve an overseas sales ratio of 20%, and we must first focus all of our efforts on achieving this goal.

In the past two years or so, the profit situation in the pharmaceutical segment has become very stable. In that sense, we were able to post a profit of around JPY20 billion last year, and we expect to be able to post a profit of JPY20 billion this fiscal year as well, based on current estimates. Therefore, we think it is true that there has been a clear cut up from the previous level for this pharmaceutical segment. In addition, I see the fact that we have begun to develop inactivated vaccines, new modalities, and other areas in our portfolio that we did not have before as one of the major positive conditions for the future.

However, as you know, the food segment remains important in supporting the Group's overall profit level. In terms of how to increase profitability, we are already moving in that direction. However, until now, our constitutions have been leaning excessively on probiotics, yogurt, etc. Now, we would like to take care of the first pillar, of course, and we believe that we are entering a certain recovery process. We will firmly bottom out in yogurt and probiotics first.



In terms of growth, we have been doing very well over the past three years in terms of nutrition, centered on three pillars. Sales of nutritional products for the elderly have been growing very steadily and our market share is expanding. In addition, although the number of births itself has not increased significantly, infant nutritional products, including inbound products, has been very responsive during the past year.

And the biggest growth in the last five to six years has been in sports nutrition. The nature of sports nutrition is changing considerably, and although SAVAS powder is the most visible part of sports nutrition, sales of ready-to-drink product, SAVAS *milk* is now almost on a par with powder. In addition to this, we are introducing various products such as bar type and jelly.

In that sense, we are beginning to expand from the traditional powder SAVAS for professionals. Among these three pillars, I believe it is important to develop Nutrition as a second major pillar that can generate solid profits from all perspectives.

#### **Q-4-1**

The plan is to increase marketing expenses for yogurt and cheese by JPY4.2 billion for the full year, and I think this is a major strategic turning point for the Company. So I would like to know your thoughts on this. I believe that up to now, you have been cutting back too much on necessary investments in marketing in order to secure a solid profit. And you are planning to increase these investments. Is this a major strategic turning point in terms of making the probiotics, yogurt and cheese category a more solid earnings pillar in the medium to long term?

#### **A-4-1**

**Matsuda:** I think the first point is about yogurt, especially probiotics. You point out and ask whether we are going to invest this JPY4.2 billion in marketing to make a transition, but in the first place we have been cutting market investment very much and creating profit for the past year or two. The idea this time is to take it to another stage by aggressive marketing investment, including in highly profitable product line.

In addition, there were many causes during this period, but the lack of new products for a long time

was also a major factor. We launched yogurt for body fat reduction this time, and we are investing in marketing to make people re-recognize *LG21* and *R-1*. And we are planning new products for next spring and beyond. We believe that probiotics consumers recognize the value of probiotics. However, various values are spreading among this diversity. While launching new products that can respond to these various values, if we can communicate its essential value once again through the media, not just through TV advertising, the value of probiotics and yogurt as a whole will increase.

Speaking of the value of yogurt, we recently announced meiji New Action 002 under the theme of “Meiji pioneering a new age for yogurt.” Most consumers used to think that yogurt equals lactobacillus and lactobacillus equals yogurt, but the lactobacilli business and the yogurt business have developed completely differently recently, so we are reevaluating the original power of yogurt and promoting its power.

The power of lactobacillus is of course necessary. However, we want to make the effects of yogurt EPS, which is produced by lactobacillus in the process of making yogurt, well known to the world and to promote it. Moreover, we would like to appeal the power of yogurt, which is of course to take in not only lactobacillus but also protein as nutrients in a tasty manner, and in addition, to improve the intestinal barrier, improve the entire body itself and enhance the immune system.

In that broad sense, we see this as a turning point for new developments in yogurt and probiotics.

#### **Q-4-2**

We heard about the consumption environment after the November price hike for drinking milk and yogurt, but I believe that there have been price revisions in various other areas during H1 as well. Could you explain these movements after the price hike, focusing on the major categories?

#### **A-4-2**

**Matsuda:** As for the price increases other than drinking milk, we have many different categories, and since this spring we have raised the prices of many items every month. As a big category, we were the only ones who raised the confectioneries earlier, and during that time it was very difficult.

Naturally, since confectioneries are sold through sales promotion, we were hardly allowed to take good places in the sales floor in May and June, but since then we have taken them firmly, and now we are almost at 100% in sales volume.

Also, we raised prices for SAVAS series through capacity changes this time. What is troubling about price changes by other companies is that before their price hike in EC, some manufacturers sell them cheaply. Then that product will sell at a tremendous rate, and only for that month. After that month, that manufacturer will not sell at all, and the top brand SAVAS will be left to suffer the consequences. We had thought that the capacity change would not change the sales volume, but the sales volume dropped by 5% to about 95% due to such an effect.

Instead, as mentioned earlier by CEO Kawamura, SAVAS *milk* has grown to more than 110%, so the net growth was about 105%, but in terms of price increases, that was tough.

**Q-4-3**

I would like to ask one more question. I think that you are going to appeal for various evidence from now on, so I have high expectations. I think it was mentioned earlier that *R-1* is also under negotiation for Functional Claim, but what is the progress there?

**A-4-3**

**Matsuda:** We are still preparing and submitting the necessary documents to the authorities and waiting so that we can receive approval.

**Q-5-1**

I have the strong impression that your company's tolerance for cost inflation is weak this time. I think you can improve your profit level to some extent by raising prices, etc., for next year, but I am afraid that unexpected cost increases may hit you again. Therefore, I think it is necessary to strengthen your tolerance, your ability not to be defeated, or your immune system in preparation for such a situation. You mentioned overseas earlier, but what else is the President thinking about, and what measures, policies, preparations, etc., are you making?

For example, your company has a variety of very promising bacteria in the food pipeline, and you could speed up the process of developing such bacteria. Or there is room for a more drastic review of fixed costs. What is your company trying to do to strengthen its resilience when the next cost increase hits? That is the first question.

#### A-5-1

**Matsuda:** This somewhat overlaps with the explanation given by Mr. Kawamura earlier, but the characteristics of the positive and negative impacts of this cost increase on competitors or food manufacturers, are as follows: those with a positive impact have a high ratio of overseas sales, while those with a negative impact mostly have a low ratio of overseas sales. As can be seen from these facts, we need to increase the ratio of overseas sales when it comes to foreign exchange. Phenomenally, that happens to be foreign exchange, but in analyzing the original portfolio, of course, in the food business, overseas is only 5%. Therefore, we are taking measures to expand our business in China, including the opening of a plant in Tianjin next spring, a confectionery and fresh dairy plant in South China next fall, and an ice cream plant in Shanghai in the spring of 2024. Also, while doing a good job with our cube-type initiatives in Europe, we would like to expand our overseas business.

In Japan, although the exchange rate has nothing to do with it, in terms of the ratio between consumer and commercial use, we have only 7% of our commercial use. So this is also very low. Recently, we have been working to change our business model in the commercial sector by building an application center and by shifting our focus for milk and cacao from sales of raw materials to processed foods made from raw materials with as high a degree of processing as possible.

In addition, I believe that in the Japan market, we should have strong products that can pass on higher costs to our customers, or foods and products with strong value. We believe we have enough and considerably more than our competitors or other manufacturers. However, we must not rest on our laurels, but must strive to create even stronger products.

**Q-5-2-1**

You mentioned earlier that the cost increase in the next fiscal year will be somewhat easier or lessened compared to the current fiscal year. For example, this fiscal year, the cost increase is at a level of almost JPY30 billion, but how much should we expect in the next fiscal year?

**A-5-2-1**

**Matsuda:** Regarding the cost increase for the next fiscal year, we are now a bit more relaxed about raw materials viewed regardless of exchange rates. So all that remains is to see how far the exchange rate can return to a stronger yen. We would like to respond to prices with that in mind. As for the raw materials, for now, we have already beaten back the increase in the raw materials-only portion. Only the exchange rate part was a bit hard to beat back, so we see no problem with that part next year as long as it is at the same level as this year.

**Q-5-2-2**

If you say that the portion of raw materials other than foreign exchange has settled down, does that mean that the cost level for the next fiscal year will be about the same as the current fiscal year if we take out that portion alone?

**A-5-2-2**

**Matsuda:** Yes, that's right.

**Q-5-2-3**

Considering the impact of foreign exchange rates on top, do you think that next fiscal year will have a much smaller impact than the nearly JPY30 billion cost increase in the current fiscal year?

**A-5-2-3**

**Matsuda:** Rather than the impact becoming smaller, we have included this impact into the price hike implemented this fiscal year, so there should be no problem. We have been able to handle all

of the portion of the high raw material prices, excluding foreign exchange, by changing capacity and responding to prices. The previous year's negative JPY10 billion is mainly because of the foreign exchange, so it is only that portion in this H1.

**Q-5-2-4**

So, leaving aside the exchange rate issue, are you saying that additional price increases do not need to be seriously considered under the current circumstances?

**A-5-2-4**

**Matsuda:** The current situation is that if the exchange rate goes to about JPY130, we do not have to consider or even implement the plan at all.

**Q-5-3**

We have heard some very interesting stories so far, such as the commercial application center and the yogurt EPS you mentioned earlier. How long should we expect for a more exciting timeline, or for these things to manifest themselves in your company's performance?

**A-5-3**

**Matsuda:** I would really like to see EPS and other stories take effect in a short period of time, but it is very difficult to get that part right now. Such as expressions in advertising are under strict regulation, so I think we need to make a steady effort as well.

**Q-6-1-1**

In China, I think the scale of production will go up next year, but what I am concerned about is that, as in this case, you mentioned earlier that the competitive environment for home milk and yogurt is as tough as ever. Please give us an update on this China business, what the situation is now and whether there is any possibility of improvement for next year, since production will also be expanded.

#### A-6-1-1

**Matsuda:** Our business in China is in the fresh dairy industry, as well as confectionery and ice cream. Fortunately, ice cream has not been affected by COVID-19 at all, and more specifically, everyone can eat it at home because of COVID-19, and we were good at family pack, so it is doing very well. As for ice cream, we are on the edge of production capacity, so I think we can spread it out just in time for the new plant in the spring of 2024.

Production of confectionery has been a bit slow in COVID-19, but again, except for that part, the situation is expanding steadily, including Meiji products.

On the other hand, fresh dairy is a bit tougher. Originally, Meiji was the only chilled milk available, and to take it to the extreme, only Meiji tastes good. However, with the efforts of local milk producers, their milk is becoming tasty in its own right.

Also, because of the drop in demand for commercial use in COVID-19, if you were able to keep the production volume of raw milk, there was a lack of demand, so there was some surplus there, just as there is in Japan today. In China, as in most countries, dairy farmers and dairy manufacturers are one and the same, so the main reason for the sluggish growth of our drinking milk was that commercial milk was sold at a low price in order to dispose of the surplus milk.

Originally, we were trying to respond to this by adding caps to new products and renewal of products, but this has also been pushed back by COVID-19. So, we have already launched in October, but I think that is the reason for the very poor results for our H1, or Q2 and Q3 over there.

As for the future, including the plant in Tianjin next year, for example, we will also launch nonfat concentrated milk. And we will also launch products fortified with vitamins. As I mentioned earlier, we will strive to expand sales by improving containers and other measures. This time, when we produce nonfat concentrated milk in Tianjin, we will be able to produce cream, which will be sold in Shanghai for commercial use, and so on. Finally, not only this one fresh dairy plant, but two, or three will be built in time, so I think that if we can expand the area of the fresh dairy business by making good use of these plants, it will grow greatly.

The reason why the profit/loss is not good so far is that the growth of fresh dairy has slowed down due to COVID-19, as I mentioned earlier, and the indirect expenses of the plant in Tianjin, which

has not yet been built, have been incurred. We hope to grow it significantly from next year onward to meet your expectations.

**Q-6-1-2**

You have explained that unlike Japan, chilled milk in China is quite profitable, but is it correct to assume that profitability will be maintained to some extent through various comprehensive strategies as you have just explained?

**A-6-1-2**

**Matsuda:** Yes. Of course, we are the top brand in terms of price range for fresh dairy, so while ensuring profitability in that area, Tianjin has a product lineup that includes drinking milk, yogurt, probiotics, different types of milk, and other products that are not limited to so-called white milk. We are considering measures to increase productivity and profitability compared to the conventional plant in Suzhou.

**Q-6-2**

I would also like to ask about pharmaceutical. You are working on inactivated vaccines, and you also want to introduce messenger RNA technology in a new modality. What are your future business prospects, and on that basis, are you considering acquiring new technologies and new modalities to be introduced from other companies? You also mentioned that it would be within this fiscal year, so if you have any specifics on that, please let us know your perspective on that as well.

**A-6-2**

**Kobayashi:** Right now, we are working on two new COVID-19 vaccines in the pharmaceutical segment. One is the development of KD-414, as mentioned in the presentation. Since the emergency approval system had been passed, our initial intention was to somehow take advantage of it and obtain approval before the end of the fiscal year. However, as you are aware, antiviral drug has been in negotiations to be covered by the new law, and the difference in thresholds between



the authorities and us, the manufacturers, regarding the criteria for estimating efficacy, is quite large. We are analyzing the situation in detail, and we are going through all the data again, thinking that it will be difficult to bring the product to the approval stage unless we can provide solid Phase III study data.

Initially, data on KD-414 suggested that it might be somewhat weak because it was inactivated. However, the results of the Phase II and III studies showed that the neutralizing antibody titers increased sufficiently to verify the superiority of KD-414 over AstraZeneca's *Vaxzevria*. Now that we have the results of the ongoing Phase III study in the Philippines and good results from the pediatric study, we hope to have the full package of data ready for submission in Q1 of FY2023 at the earliest.

I understand that some may wonder whether inactivated vaccines are necessary when there are other messenger RNA vaccines, but we expect this pandemic to become an endemic disease from next year onward, requiring repeated vaccinations, just as seasonal influenza does. We would like to develop this highly safe inactivated vaccine, as influenza vaccines are also inactivated vaccines, using the same modality, and especially in the pediatric field, we are looking at simultaneous inoculation and one-package inoculation. We hope to somehow make this development a success. The other is a novel next generation messenger RNA vaccine, ARCT-154, which is under discussion with Arcturus. We have already received the results of the Phase III study in Vietnam. Looking at the contents of this product, it is one-tenth the volume of conventional messenger RNA, and looking at the results of the Phase III study in Vietnam, the number of adverse reactions was also about one-twentieth, so we hope to start Phase III clinical study in Japan within this year.

The concept is a booster vaccine that is a single-flavor formulation and can be used against mutant strains such as Omicron, etc. We are currently discussing with the authorities the scale of the Phase III study. The comparator drug will be the existing messenger RNA, so we hope to start as soon as possible, by the end of the year, and get results on this in H1 of next year.

ARCALIS is engaged in the CDMO business in Minamisoma-city, Fukushima, to produce its bulk drugs, and has already started construction of a building for the bulk drugs. We have applied for dual use at both companies, and our application has been accepted. We would like to build a

formulation building here, and by March 2024, we hope to somehow break ground on a formulation building and establish a system to provide the necessary volume in Japan.

As you know, messenger RNA is not a modality for COVID-19. The LNP technology to produce this is very challenging, but there are various antigens that KM Biologics already has. I think it is very important for national security that vaccines can be produced in-house by acquiring the technology to convert them to RS, influenza, etc., and I would like to contribute to this effort somehow.

#### Q-7-1

I understand that the inactivated vaccine is more effective against AstraZeneca, but how does it compare to Pfizer and Moderna, and could you tell us if this is in response to Omicron and other new strains in the first place?

#### A-7-1

**Kobayashi:** The KD-414 is currently under development for Wuhan strain. Naturally, the Omicron strain response will be required. However, we will first prove the effectiveness of the vaccine with the Wuhan strain and then get it approved as a vaccine, and now we are actually dealing with inactivated vaccines in combination with the Omicron strain-compatible vaccines. We are almost at the point where we can get the performance we are looking for, and we expect to have an Omicron-compatible inactivated vaccine model ready by about January of next year.

How to do this: inactivated vaccines are currently used for influenza, but each year they are required to respond to mutant strains. As long as the method of making them is the same, if the vaccine is proven effective in vitro, you can prototype an existing vaccine and use the same manufacturing method for approval. This is one good thing about inactivated vaccines. We hope to utilize this somehow to complete Omicron response for inactivated vaccines while obtaining the approval for prototyping.

So far, regarding the confirmation of the basic performance as the vaccine for the Wuhan strain, it is only *Vaxzevria* that is indicated as the comparator drug. We believe that we can verify our superiority for this. If we develop this vaccine for pediatric use, since there are currently two

pediatric vaccines, Pfizer's vaccine and the Moderna's vaccine, I assume that they will naturally ask for a comparison with these. However, in addition to the high neutralizing antibody titer, if we include not only the initial preventive effect, but also the basic performance of the vaccine, including tolerability, and prevention of severe disease, I believe that we can sufficiently compete with the messenger RNA vaccine.

There are various axes of comparison, such as 70% fatigue, 50% fever, or 60% to 70% prophylactic efficacy but little fever, or for example, long-lasting neutralizing antibody titers. Although the numbers of high neutralizing antibody titers and prophylactic efficacy are now being used alone in the pandemic, I believe that we will be able to respond adequately in the future in terms of overall performance. We would like to develop in this way.

#### Q-7-2-1

I would like to ask about the probiotics. As an actual result, sales decreased by 9% in H1, but how much was *R-1* sales and how much was *LG21* sales? By October, the rate of change is quite high, where it has grown very much due to the effect of TV commercials, etc., so I was wondering what you are actually doing about it. I would like to know more about sustainability.

#### A-7-2-1

**Matsuda:** Regarding the H1 sales of probiotics for *R-1* and *LG21*, first, the total sales of LG, including home delivery, is 96% YoY. In terms of products sold commercially, Q1 was 93% and Q2 was 100%. In Q2, as I mentioned earlier, since we started advertising on TV, we have been able to achieve 105% to 106%, including at present compare to the sales before the advertising.

*R-1* total for H1 was 90.4%, but I think that only for those sold commercially, it is also between 93% and 94% in supermarkets and convenience stores. However, since October 20, the price has been raised, so the sales value has remained at around 108% to 109% including at present compare to the sales before the advertising.

Regarding sustainability, *R-1* used to weigh 13 gram, but all containers have been made thinner and the weight has been reduced by 8.6 grams.

In addition, since August, the beginning of the quarter, we have been selling label-less products in six-packs of *R-1* in the Kanto and Chubu regions, and now nationwide. Sales of this product are not growing as fast as we had expected. Handling rather than sales has not increased. We had high hopes for this product as a sustainable, SDGs-conscious product, but it has been difficult. Especially the more rural the area, the more the distributors understand the need for the product, but we have not yet reached the point as a commercial product.

We would like to work on this while carefully explaining the purpose of the launch or its background. Of course, we want sales and profits from this, but since this is a product based on our Meiji philosophy and embodies our thinking, as I said, we would like to take our time to explain and develop the product.

**Q-7-2-2**

I wanted to ask you about the sales momentum. Since this October, you have seen an increase in sales volume due to sales promotions and TV commercials, and now in November, you said it is negative 3%.

**A-7-2-2**

**Matsuda:** That is, the reverse effect of the price hike, or roughly 3% of the sales volume dropped due to the price increase.

**Q-7-2-3**

I see. In terms of *R-1*, if you can maintain the 108% to 109% sales by changing marketing measures, I am not sure how long the impact of the price hike will continue, but would you say that the sales will grow at least to the mid-single range for now?

**A-7-2-3**

**Matsuda:** That's what I mean. I am not sure what will happen in the future, but at least for the 10 days from November 1 to 14, or rather until last week, the sales volume was down about 3%, and

the price hike was 5%, so of course the monetary base is sure to reach 100% YoY. Our current desire is to somehow exceed 100% in sales volume.

**Q-7-2-4**

I see. The budget for probiotic sales for H2 is a 7% increase, so as you mentioned, if you go with a flat sales volume, you calculate that you can achieve this with this 5% and new products.

**A-7-2-4**

**Matsuda:** Yes, that's right. As for the new product, yogurt for body fat reduction is over 103%, so if we can keep 100% with the current existing product, I believe we can show something more than 103%.

**Q-7-2-4**

But it is a new product, so there is no previous year, right? What is 103%?

**A-7-2-4**

**Matsuda:** It is for probiotics in total. The added effect on the total can be calculated to be 3%, and that is included in the figure.

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