

Meiji Holdings Co., Ltd.
Financial Results of FYE March 2023 (FY2022)
The Online and In-person Briefing Q&A

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Presenters:

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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

What is the background behind the severe performance of your mainstay products against the plan? You explained that marketing investment will be expanded for mainstay products but how do you intend to implement recovery measures for these products?

A-1-1-1

Matsuda: For functional yogurt, the Q4 assumption for functional yogurt business was sales growth of 10% or more. When making plans for H2, we referred to the health anxiety index from external data. This is because sales of functional yogurt products are highly correlated with this index. Based on our experience, we planned to increase sales by more than 10% by calculating the increase in the anxiety index growing from H2 and the impact of advertising.

Until around December of last year, the media was reporting about 50/50 on flu and colds, as well as electricity and price hikes, but since the end of the year, the ratio has been about 1:5, with most reporting higher energy costs and product prices.

Influenza epidemic has been delayed a bit, and colds and flu have no longer appeared as topics at all; in tandem, the health anxiety index has dropped dramatically. Because of this, we could not sell as much as we had hoped. However, despite price increases, its sales increased by 4% to 5%.

Sales of Meiji Bulgaria Yogurt were below the plan because of severe selling price competition. The selling prices of competitors' products were not increased. Unfortunately, plain yogurt was a commoditized product with a higher price elasticity value than we thought.

The price hike in November was in the midst of weak overall yogurt consumption. As a leading company, we conducted sales promotions to permeate the price hike. However, our competitors did not change their selling prices before the price hike although they have raised their delivery prices. Under such circumstances, *Meiji Bulgaria Yogurt* was around 90% of the previous year, or at times even fell below 90%. From mid-January, the selling prices of other companies' products have been adjusted to match the price hike and sales of our products have exceeded by 90%, and it is now between 93% and 94%.

I believe the rest of the reason why we did not reach the level of the previous year is the private

brand (PB). I believe that once the selling price of PB is firmly raised, we will be back to where we were. As for what we will do in the future, we are still advertising functional yogurt. *LG21* has grown several percent since we changed packages claiming to be recommended by doctors, and it has grown significantly since it became Foods of Functional Claims packages. For *R-1*, we will launch new products in June and this autumn with a stronger concept, and we will also strengthen advertising. We plan to expand our lineup of other functional yogurt products and increase sales even more than before.

We have changed the manufacturing method of *Meiji Bulgaria Yogurt* since March to make it smoother and to prevent whey from releasing water, so we have been promoting this new method. Currently, we are appealing with Disney packages, which are contributing about 3% now. Since we will be celebrating our 50th anniversary of *Meiji Bulgaria Yogurt* this autumn, we will be putting up a major campaign. As such, I would like to appeal for essential value while doing sales promotion. I would like to get back on a growth trajectory.

Q-1-1-2

I think the raw milk price will go up quite a bit, but how about the risk this year that the selling prices of other companies' products will not go up after your company does in the same, etc.?

A-1-1-2

Matsuda: First of all, functional yogurt and chocolate have not fallen as much as our marketing department had expected when we raised the delivery and selling prices. I believe, value-added products with the Meiji brand, and the product brand, each of which is strong, did not fall short of what we expected.

However, commoditized products or products with strong price elasticity, such as the 400-gram of *Meiji Bulgaria yogurt* and the chocolate bars I mentioned earlier, have fallen more than expected. The reason for this is the same as I mentioned. We raised our prices in May and our competitors did not. Therefore, sales of our products surprisingly dropped, by 20% year on year. However, it is now back to normal.

For the raw milk price hike in the coming August, we have already made sufficient self-help efforts, of course, so we will have to raise the price for the increase. However, I am not in a position to comment on what our competitors will do, but based on the reflection of the FY2022, I believe that if they can't pass it on to the price, they will probably be in a tough situation. We believe that the higher the selling price, the more positive it will be for us in a competitive environment.

Q-2-1-1

One question on page 24. In ROESG management, you mentioned strengthening market creation capabilities, and I believe that is exactly what the CEO was explaining earlier. If this can be done, of course, corporate value will increase.

Are there any special or new initiatives that your company is taking that will lead to this, such as new initiatives that have never been done before to enhance this creativity, or to create a framework and firmly motivate employees to enhance their creativity? Please explain this point a little more.

A-2-1-1

Matsuda: We have been actively working on group companies and liquidation by reviewing our original business portfolio. In addition to this, we are thinking of reducing SKUs after analyzing the capacity utilization rate, operating rate, profitability, and future potential.

To strengthen our creativity, we are now trying to develop businesses that create new value while co-creating with competitors and people from completely different industries in our DX initiatives. Since the year before last, one new business has already started as we have been working on in-house value creation programs and working with startups. Although the business scale is still small and in the trial stage, we are trying to create new value.

Regarding co-creation with different industries, we are working on baby formula, yogurt, and lactic acid bacteria to enhance health. Another example is chocolate cacao, which is linked to the sustainable cacao concept.

In addition to creating a sustainable society, we are trying to create new values with business potential in mind.

Kobayashi: For pharmaceutical business, there has been a structural change in the pharmaceutical market globally, before and after the pandemic. To be more specific, the market structure of what used to be a good thing has been largely lost, and what used to be neglected is now in the spotlight following this pandemic.

Due to changes in the industrial structure, the drug discovery platform has changed considerably. In the past, each drug manufacturer has been creating drugs based on its own unique technology. However, it has become clear that even multinationals cannot achieve drug discovery based on recent new modalities and new technologies by the strength of a single company alone. So we should adopt the horizontal division of development and open innovation in an agile manner.

After the pandemic, the previously neglected area of infectious diseases has been thrust into the global limelight and policy guidance has been provided. We take advantage of this opportunity to expand our business while contributing to society by utilizing the technologies we have developed since our founding and by implementing new technologies into society.

Q-2-1-2

For food business, your efforts on sustainable cacao are very understandable. I think that the new health value, for example, is certainly a phase in which your company has been able to achieve profitable growth. Can you comment on enhancing the internal structure to create such a product?

A-2-1-2

Kawamura: As Matsuda mentioned, we are working on various initiatives through trial and error, but I think the most important element is social contribution. In other words, how much business potential we can find in this field. We have been working on the integration of business and sustainability as one of our major themes, even as we have set a new goal of Meiji ROESG. Therefore, I would like to incorporate sustainability into our business in this next mid-term plan.

The most obvious example is nutrition. I think that until now, most of the evaluation of food products has focused on taste and enjoyment, and the emphasis has been on proposing new such products.

However, I think that what society needs most now is nutrition.

The consumers are not clearly informed about what the nutritional value of products is. This is a field that global food companies are putting the most effort into, and we have also begun working to properly communicate nutritional evaluations in our products.

Specifically, we are in the process of building a nutritional profiling system. The government is also beginning to address such matters as a new labeling system. We would like to participate and work on the government's policies. At the same time, I would like to propose concretely how Meiji should be involved in nutrition and how we should disseminate information about it.

In the sense that this will fundamentally shift the focus of the evaluation of our products as a whole, I believe that this nutritional profiling system will become a very important axis in the future.

That is a very big part of the integration of sustainability in the food business. We are now in the process of preparing our proposal for a nutritional profiling system during this fiscal year. In the next medium-term plan, I would like to show how we will proceed with the specific products, from the perspective of nutrition in terms of labeling, evaluation, and product improvement.

That is, I believe, the new market creation in the future. We will work to create new value in individual products and categories, but more than that, I think it is even more important to work on how to improve the overall evaluation of the entire product line.

Q-3-1-1

I would like to know your approach to the drinking milk business and what the situation is with respect to your company's goal of becoming profitable. I think the fixed costs will decrease in fiscal 2023, and the initial image was that the Company would return to profitability, but the deficit will increase again this year, so I would like to start by asking for some background here.

I also believe that turning this drinking milk business around is a structural issue for the dairy industry as a whole, and that your company has led the industry in this effort. If your company is having a tough time, I am sure that other companies are probably having a tough time as well. I would like to know your thoughts on whether there has been any change from your original assumptions or whether you are talking about a clear prospect of achieving profitability in the

drinking milk business.

A-3-1-1

Matsuda: Regarding the profitability of the drinking milk business, we worked hard the year before last and last year, and we were almost there. However, there is a slight setback because of the price increase due to the revision of raw milk prices, and also because of the large depreciation cost of our new plant in Eniwa.

However, sales of Meiji's drinking milk business did not fall significantly compared to the industry, and on a volume basis, it was settled at around 99% or 98% compared to the previous year.

The *Meiji Oishii Gyunyu* 900 ml is about the same, but on the other hand, the *Meiji Oishii Gyunyu* 450 ml and 200 ml sales have grown by more than two digits. I believe that consumers are changing the way they buy, and they prefer a lower unit price for buying at a time. It means that they choose 450 ml or even 200 ml rather than 900 ml.

Then, of course, the smaller volume is more positive in terms of product mix and profits. We have improved considerably compared to the previous composition of SKUs, but unfortunately, I think we have regressed somewhat due to the significant increase in depreciation cost load of a new plant.

Raw milk price will be increased again in the fall. However, we would like to increase demand for drinking milk by working together with the Japan Dairy Industry Association and J Milk to emphasize the value and importance of milk as a food throughout the supply chain. In this context, I would like to make a profit while promoting sales centered on the *Meiji Oishii Gyunyu* and providing a solid sales space and sales method.

Q-3-1-2

On such as the SKU changes, and other such extensions, do you see a turnaround in this business in your company? Or perhaps there is a view that this industry as a whole needs to go through another round of structural reforms here. What do you think about that?

A-3-1-2

Kawamura: I am not aware that structural reforms are necessary for our company. I think it is necessary for the industry as a whole. Since we have taken various measures ahead of others, I believe we are in the best position in terms of such competitive conditions.

As Matsuda explained earlier, the improvement in profitability appears to have stalled a bit in the face of various transitional measures, such as the temporary operation of two plants. However, in the medium term, I believe that we will be able to overcome this.

As for the issues faced by the industry as a whole, producers are facing an increasing number of problems such as high feed prices, labor shortages, and other issues that are causing farmers to leave farming.

On the other hand, the dairy manufacturer was originally troubled by the extremely high cost of raw milk, and now the cost has risen even higher. We have raised the price by a total of JPY20 twice within the past year. This is becoming a very difficult situation on a profitable basis. Since there are companies of various sizes in the dairy industry, I think it will lead to a very big problem for the industry, how to withstand this much cost increase.

Q-4-1-1

What I wanted to ask was about the structural reform of the food business. With the high cost of raw materials significantly changing the profitability of each product, I believe that you have said that you are going to step in again to carry out structural reforms without the sanctuary. What exactly do you envision doing, and could you share an image with us?

A-4-1-1

Matsuda: Meiji's original foundation for growth was in Japan, but we have been investing overseas for several years now with the expectation of growth.

And although the Chinese milk business has been a little sluggish during the past two years in the pandemic, we will open a drinking milk and yogurt factory in Tianjin early this year, a chocolate factory and a drinking milk and yogurt factory in Guangzhou at the beginning of next year, then an

ice cream factory in Shanghai in about a year. In Europe, we have been strengthening sales of cube-type baby formula with Danone. Sales in the US and Southeast Asia have also been favorable. Thus, we are shifting overseas while transforming our business structure, now you may wonder what about Japan. Of course, we will strive to make efforts to achieve significant growth. If we cannot do so, as I mentioned earlier, structural reforms and SKU reviews will be necessary. We are planning to deal with it, even if it means the loss of some marginal profit, by analyzing the growth potential, profitability, and factory utilization rates, and by taking a scalpel to these areas. From FY2024 onward, by strengthening our domestic business base, we will be able to add extra capacity overseas and further promote growth overseas.

Q-4-1-2

For example, in the domestic category in the food business, what areas of profitability are declining significantly, and what kind of leverage is needed in those categories?

It is also true that your company has been selling or liquidating its operating subsidiaries for the past several years, but I don't think it is impactful on overall results. Even in this context, I would like to know if the structural reforms without the sanctuary that your company is about to undertake could have a significant impact on overall business performance.

A-4-1-2

Matsuda: Indeed, our group companies were not that large sales scale, so I think the impact of liquidating them was small.

As for the first question about the image of the reorganization of the domestic business and SKUs, of course, we are analyzing this with views from the growth potential of the market, our share of the market, and how our technology can be used in the market. As I mentioned earlier, we will reach a firm conclusion by the end of this year and then take concrete action. Also, we intend to reduce the amount of manufacturing overhead costs, which have been rising for some time now, by disposing of manufacturing lines.

Q-4-1-3

I think you explained that you would separate segments firmly, separating non-core and core, and that you would proceed with selections by looking specifically at the ROIC of each business.

Do you recognize if there are additional businesses that need to be restructured when raw materials are proceeding at such unprecedentedly high prices? Or have you become aware that you need to act more proactively and speedily with regard to the non-core areas that were originally an issue for you? What are your thoughts on these areas?

A-4-1-3

Matsuda: It is the latter. As for our price hike and the increase in raw material or energy costs, this has been shifted by about six months, but at the end of FY2023, all the cost increases to date will be absorbed. However, the volume of goods may drop or rise somewhat, and apart from this fluctuation, it can be absorbed. So I don't think the former possibility applies.

By firmly promoting the structural reforms that were originally listed in the 2023 medium-term business plan, and the area has not been done very well in the pandemic, we are going to further strengthen and conclude them as originally planned.

Q-5-1-1

I would like to know a little more about the acceleration of growth in the overseas business in food segment. I believe that this fiscal year will be the year finally in which you will be able to establish production bases for chilled milk and yogurt, confectionery, and ice cream in your China business. Profits may still be a bit tight this year, but since you are also aiming to expand your sales areas for FY2024 and beyond, I would like to know more about what kind of growth strategy you are envisioning.

In addition, we have heard that competition for drinking milk continues to be tough. How do you break through here? Also, you say that you have product strength in confectionery and ice cream, but even so, I think the chocolate market as a whole is stagnant in China. I would like to know how you plan to expand the market.

A-5-1-1

Matsuda: Regarding the expansion of production is proceeding as planned. Our business plan was initially progressing as planned, only the commercial milk business in China has been stagnant so far.

The reason for this is that during the past two years, we have followed the government's instructions and put the health of our employees first. As a result, although production went well, it was a fact that we were not able to do other tasks. However, the competitors were doing various tasks under those circumstances, and there was a gap in product strength.

To catch up on this, in the fall of 2022, we added screw caps to the gable tops of our drinking milk, and we have introduced healthy drinking milk this year; for example, fortified with calcium, and also yogurt, including sweet yogurt and other drinkable yogurt. I don't know if this will bring it back by the end of this year, but if we can revive well, I think we will be back on the track we were originally on.

Furthermore, the factory in Tianjin, which started operation at the beginning of the year, was also able to operate well, but we had hardly been able to conduct business negotiations for sales expansion in the past two years. Because of that, at the moment, overhead costs are going up but sales are not being made, so profitability will stagnate, but I would like to make up for that.

On the other hand, ice cream and chocolate businesses are in great shape. As for ice cream, we are good at family-packs of ice cream, and it worked well during the pandemic. We have sold so many family-packs of ice cream and we can hardly make all of them. After the opening of an ice cream factory in Shanghai at the beginning of the next year, products previously sold from Guangzhou to North China can be produced in Shanghai, so I think we will soon be on the right track.

As for the confectionery business, we were in a slump during the pandemic because we caught the demands for wedding giveaways but they were gone. At last, sales of the business are recovering. Our chocolate bars are up 150% to 200% from the previous year, and sales of chocolate snacks, including Hello Panda, are doing very well. B to B products are also doing well.

We are also strengthening our sales structure to expand the whole business in China. We have

also created a company called Meiji China, which includes corporate governance, so I would like you to have high expectations for the future, starting in FY2024.

Q-5-1-2

Have the business negotiations for the expansion of the milk products in the current situation been gradually progressing so far this year? Also, since 2021, I believe your company has been selling probiotic yogurt. Once this production system is in place, may I ask again what your strategy will be to expand sales of such value-added yogurt?

A-5-1-2

Matsuda: We have increased the number of workforces starting this spring, and we are in the process of putting together a solid sales structure to strengthen sales.

As for your second question, functional yogurt, we still try to expand its sales, but it has not been able to penetrate the market. The products are produced our factory in Suzhou. Its volume contents are more than those in Japan, and its taste or composition is changed to what Chinese people like, with a higher viscosity. This has not been successful yet, although we have made the same appeal with *R-1* and *LG21*.

In FY2023, we will concentrate on *LG21*, because many people in China have stomach discomfort. We are planning to work on this in various ways, including working with the government.

Sales promotion for functional yogurt is completely different from that in Japan. Chinese people have a negative impression of SNS for advertising purposes, and now it doesn't work well.

We would like to promote the quality of the product by firmly promoting it at mass retailers with sampling sales at the store front, where upper-class customers come to shop, as we were not able to do this during the pandemic.

Q-6-1-1

I would like to ask about the nutritional profiling model.

I have also strongly felt for a long time that how to link the nutritional profiling model to management

is a very important topic and one with a lot of opportunities. I think that to implement this, you must eventually link this to profits, so where do you see the challenges or difficulties in linking this to profits? I would like to know about the challenges and potential when doing this nutritional profiling model management.

In addition, sales have been suffering for a long time and are suffering again this year due to price increases. Since you mentioned earlier that you are trying to get something out of the nutritional profiling model by the end of this fiscal year, which I think it is coming in the new fiscal year or next fiscal year. Can you tell me if I should be aware of the timing of the reversal of sales, marketing, etc. in this area in the next fiscal year? I would like to hear about this area more.

A-6-1-1

Kawamura: For the nutritional profiling, we hope you will first recognize that this does not immediately lead to profits or increased sales. The system is important to provide consumers with proper nutritional information in an organized manner that is relevant to the product. We are not doing this for sales promotion, but to provide accurate nutritional information to consumers.

Until now, there have been a number of nutritional ingredient labels and other such items included in Japan's labeling system. However, there is a lack of understanding among today's consumers as to how to figure it out based on individual products. I would like to develop a system to improve those areas. Overseas companies are doing this, and some Japanese companies are also working on it, so I'm not going to make it a self-indulgent project.

We have always wanted to regain sales, that's what we have been doing all along. It was the same in FY2022, but as you all know, it's that cost increase and the weak yen. I think it is admirable that a company can take a decent bite out of this and make a decent profit.

We have already started this year, but from April to June in H1 FY2023, we have implemented price revisions of many products for costs that have not yet been offset. Recently, there have been no reports of price hikes for individual products. Under such circumstances, we have been passing on prices in almost the same number of products as in the past year and in almost all categories. Although some products may be affected by lower sales volume, I believe that consumers are

becoming more accustomed to price hikes than last year. Even so, I think it will be very tough to reverse the situation in terms of sales volume.

Therefore, in H1, we implement price revision while striving to avoid a decline in sales volume. By doing so, we are envisioning a scenario in which profits will recover in H2 by improving the volume. We hope to somehow make up for the current situation in H1 in H2.

On the other hand, exchange rates and commodity market conditions were soaring tremendously in H2 last year. I think that there was a cost increase of nearly JPY 5 billion in H2 last year alone. We had expected a cost increase of about JPY1 billion, but there was an unexpected cost increase of about JPY4 billion. This has calmed down a bit, or at least it has not gone up higher than it has been for the past year. In this sense, we believe that we can expect a recovery in earnings in H2, as long as the current cost situation does not increase further in H2.

Q-6-1-2

The raw milk price for drinking milk has increased this coming August, but I believe the raw milk price for processing is still under negotiation. I think it would be realistic to reduce the number of price hikes as sales power would also be dispersed and raise them all at once, in order to take into account the cost increases that are likely to occur in the future.

A-6-1-2

Kawamura: This must be understood by consumers. Before that, we must first gain the understanding of the distributors, who are most concerned about consumers saving money and shifting away from products, as well as declining sales. We are working with distributors on a negotiation basis, but beyond that, the most important thing is how consumers will accept the price hike.

We did indeed raise the price of raw milk for drinking by JPY10 this past November, a very high level of price hike during the period. In April of this year, and this was agreed to last December, the raw milk price for dairy products has also been raised by JPY10. And in this April, it was decided to raise the raw milk price of drinking milk again by JPY10 from August.

Although there is a hypothesis why not just raise the price for drinking milk by JPY 20 from the beginning, unfortunately, we cannot do that. When discussing this with the producers, we have discussed price hike should be kept to a minimum. The producers are not just asking us to raise the price, but have a tremendous sense of urgency regarding the supply-demand situation and the extremely decreasing demand for their products. Based on the common understanding that we do not want to create a situation in which “we raise the price but consumers are not willing to pay it,” we have accepted this situation in our discussions.

The producers are struggling to control production. From H2 last year, production has been suppressed by 3% to 5% for a long time. There is a concern that at some point there might be a shortage of raw milk and dairy products. Currently, the consumption of raw milk has decreased, so the supply-demand is now balanced. However, if consumption were to reverse to the same level as the previous year, the shortage of raw milk may become a problem like the shortage of butter in the past. There are the same concerns about dairy products. I think it is conceivable that butter could face the same situation, especially if consumption increases during H2, when demand for dairy products is high.

We are also looking closely at the supply-demand outlook and the level of inventories, and since we currently have inventories of butter and nonfat dry milk, we are anticipating that such a situation will not occur. However if the supply-demand situation changes, we may need to consider such production.

Q-7-1-1

For *R-1*, in H2 last year, you aggressively invested in marketing, but as a result, Q4 stalled out considerably, and I think the sales volume was also negative.

You mentioned earlier that the anxiety index did not rise, but I think, however, that the market for lactobacillus beverages is quite exciting. I think that the effectiveness of your company's marketing has not been as high as expected, and also that this kind of intensifying competitive environment may have contributed to the struggles of *R-1*.

If the sales volume does not stop falling, there is a risk that the profit level will be further damaged

in the new fiscal year. You will raise prices further this fiscal year. Then the competitors also increase production.

Can you comment on whether you can stop lowering the sales volume? I think there may be even more headwinds in *R-1*.

A-7-1-1

Matsuda: The anxiety index we mentioned earlier is for H2, and is not relevant for H1. You mentioned that the trend seems to be a big decline, but it is not that big a decline. Since H2 last year, we have been expanding almost steadily. However, it was Q4 that did not expand as much as I had hoped. The reason is as I mentioned earlier.

Q-7-1-2

Last year's growth in Q4 was by 1%, right? Perhaps you are saying that sales are weak in the home delivery area, but if you take just the consumer market, the volume is negative. So rather than an expansion, I get the impression that it is still on the downside.

A-7-1-2

Matsuda: In terms of sales volume, it is so. In monetary terms, it is 104% compared to the previous year. Functional yogurt as a whole grew 104% in this April. For May, is trending at 108%. The sales trend of *R-1* is in line with that of functional yogurt as a whole. We have gradually hit bottom and are now recovering.

In addition, in June and August, we will launch new products that will further strengthen the concept for *R-1*. Furthermore, we will launch new products for other functional yogurt products as well. Not only *R-1* but functional yogurt as a whole will be on a growth trajectory, although it will not be the same as the big growth we saw a few years ago. We believe that we will return to the growth path after hitting the bottom.

Q-7-1-3

In recent years, other lactobacillus beverages have also been growing. Are you not concerned about a shift in demand there?

A-7-1-3

Matsuda: I think you are comparing two products from other companies. Even if demand increases, there is a problem of production capacity. The yogurt product you pointed out is quite different from our company's sense of scale, so there is no impact on the numbers. The impact is about 1%.

Another product I think is fermented milk drink, but I think it is correct to say that the bad trend over the past few years is that competitors are taking over, including dairy products, but rather that it is leaking out of the overall food industry. In the past, the number of trial users were declining. Since the beginning of this year, the number of trial users has increased compared to last year. We believe this is a growing trend, as the depth and purchase amount of those who have purchased once are also increasing.

Q-7-1-4

So you are saying that we don't have to be so pessimistic.

A-7-1-4

Matsuda: I think so. We believe that we will get back on a growth trajectory again while promoting sales by securing enough shelves at stores, or appealing to the essential value of the product.

Q-7-1-5

I understand. Is it safe to understand that your forecast for this fiscal year is roughly plus 1% for the volume compared to last year for *R-1*?



A-7-1-5

Matsuda: Functional yogurt FY23 volume is budgeted at 97% year-over-year, because we were not sure how much impact the price increase would have on everything. However, we are now seeing higher growth in April, and we are also seeing higher growth in May in a prompt report. So I think that it will be demonstrating that products with strong and differentiated features are falling less than expected. We are currently growing more than we had budgeted for at least.

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