Condensed Transcript of Q&A Session at MGC's FY2024 Results Briefing

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Presenters:

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(Note about this transcript)

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Q1: The presentation by the new President represented a powerful statement for transformation into a company based on R&D. Actual R&D expenses in this fiscal year are projected to increase by ¥3.4 bn YoY, while depreciation costs are projected to increase by ¥4.4 bn. Given these considerations, can you say something about the status of the former Specialty Chemicals segment in the second half of last year and the outlook for this fiscal year?

For inorganic chemicals, growth in sales volumes for advanced materials use should have a positive effect on earnings, even if non-AI-related demand for chemicals for semiconductors enters an adjustment phase.
By how much do you forecast depreciation costs to increase, leading to lower earnings? Are overseas engineering plastics plants recording higher profits on a local currency basis? Are optical materials merely benefiting from the increasingly advanced functionality of smartphones? For electronics materials, BT materials appear to have undergone certain adjustments in the second half of last year. Do you consider these adjustments to be temporary? Tell us about trends in the main product lines of the former Specialty Chemicals segment, including shipments.

A1: I'd like to describe the results for 4Q of last year and the outlook for this fiscal year. Electronic chemicals fell short of previous forecasts for various reasons, including the higher costs associated with a new plant and recording of revaluation losses on the lower of cost or market basis at a subsidiary in Taiwan. While demand remained strong for chemicals for advanced semiconductors at the South Korean plant, demand lacked strength overall in non-AI-related fields. The outlook for this fiscal year calls for higher marginal profit, based on overall sales growth, but lower profit overall due to increased depreciation cost associated with growth investments and selling, general, and administrative expenses at various plants, including domestic plants. Another factor underlying lower profits will be the absence of some of the profits associated with the past transfer of part of the inorganic chemicals business to the LivingTech and Hygiene Solutions Division. Results in 4Q for optical materials came in somewhat below earlier forecasts. We believe this reflects strong 3Q sales, a reaction to the Chinese New Year's holidays earlier than average spring, and early demand generated by those seeking to avoid tariff increases. But on a YoY basis, optical materials showed very strong performance. As for the outlook for this fiscal year, we expect sales volume to grow alongside growth in smartphones. We also expect the high share of sales accounted for by high-refractive materials to drive profit growth. In polycarbonate (PC) and polyacetal (POM), the performance for PC was down somewhat as the Thai plant fell short of earlier forecasts. The China plant, which had been performing well, experienced something of a pullback from the overheated performance seen through 3Q. Performance for POM was slightly higher than earlier forecasts. For this fiscal year, although we expect a challenging spread in general-purpose PC products, we project results to remain largely unchanged YoY thanks to our policy of expanding sales of high value added products. We expect performance for POM to be down somewhat YoY due to increased costs and foreign exchange effects, including appreciation of the baht and yen.

Q2: It looks like growth in marginal profit was reflected in increased operating profit in the former Information & Advanced Materials segment. Do you expect the pressure on profits for electronic chemicals and other products that involve significant initial investment to continue in the former Specialty Chemicals segment? Can we expect sales growth beyond this pressure and gradual improvements in production efficiency in the next fiscal year and beyond? That is, would it be correct to say that there has been no change in the view that these businesses contribute significantly to growth in U&P business operating profit?

A2: Yes. That's accurate. Ultimately, electronic chemicals involve significant forward-looking investment. While assuming increasing depreciation expense and other expenses, which is unavoidable before sufficient profit growth emerges, we plan to prepare during this fiscal year for demand recovery and for the launch of new customer plants. As you note, we expect increases in fixed costs in the former Information & Advanced Materials segment, including costs associated with the expansion of the BT materials production plant in Thailand. We project higher profits as these increases in sales drive growth in marginal profit.

Q3: Is the difference in profit and loss between the first and second halves in the former Specialty Chemicals segment due to a decrease equivalent to the increase in fixed costs as demand for electronic chemicals and other products remains weak to the end of the fiscal year—for example, the cost of regular maintenance in the second half?

A3: Overall, that’s correct. Projections are based on information available at this time. We do expect to incur some fixed costs. Demand conditions for electronic chemicals vary from plant to plant. For example, conversion to profits has lagged at the Taiwan plant, but we expect a sharp increase in FY2026, the final year of the Medium-term Management Plan, as we make steady progress on user evaluations.

Q4: Where can I find temporary factors on page 11 of the materials—for example, temporary issues with BT materials last year and the factors associated with revaluation on the lower of cost or market basis mentioned earlier? Can you go over the temporary extraordinary factors for last year's results and this year's forecasts? You noted that the effects of recent US tariff policies haven’t been fully incorporated. Have any specific effects been incorporated? Fixed costs rise significantly this fiscal year; how much room is there to cut costs that are neither necessary nor urgent?

A4: First, on the question of where temporary costs are incorporated, they’re included in costs and other factors. For that reason, I regret that I can’t break them down for you today.

Regarding the impact of President Trump's tariff policies, the direct impact would be insignificant because sales to the US account for only about 5% of Group overall sales. But we haven’t incorporated all indirect impacts, since they involve considerable uncertainty. Certain negative factors have been incorporated in the overall consolidated earnings. These include the assumption of an exchange rate of ¥140 to the dollar over the whole year and conservative projections of terms of trade in the petroleum, methanol, and other markets. The projected impacts also reflect the impacts on individual businesses, which will be discussed under each of those businesses.

Q5: I believe costs increased in Information & Advanced Materials last year due to enhancements of the inspection structures for sales to certain customers. How is this reflected in forecasts for this year? Do you expect no particular fluctuations in market share? You noted that you don’t expect a very large increase in products for smartphones. Can you tell us about the assumptions for semiconductors, centered on BT products?

A5: First, I’d like to apologize for the concerns prompted by the increase in costs associated with BT product quality measures. We expect costs in 1H of this year to remain at the same level as that after the increases in 2H last year, and then to move toward resolution in 2H of this year. Fortunately, this hasn’t affected orders received at all, and shipments and deliveries to the customers in question continue even after this incident.

Regarding our assumptions concerning semiconductors, we have a high exposure to the smartphone market in multiple businesses. Forecasts are based on a projected growth rate of about 2.5% in smartphone demand. Forecasts for BT and other products are based on the rate of growth in the general semiconductors market (WSTS global semiconductor market growth rate), and we project growth at about the same level as market growth forecasts or better. We project an even higher rate of growth for OPE® products.

Q6: I'd like to return to the topic of the impact of US tariffs. You noted that exports to the US account for about 5% of sales overall. I believe this would amount to about ¥40 bn. While I suppose that in fact you export products from countries other than Japan, too, wouldn't the estimated impact based on the reciprocal tariff rate of 24% for Japan be more than insignificant?

A6: Basically, we will transfer the additional costs of tariffs to sales prices. For certain customers, transaction conditions originally require customers to assume the cost of the tariffs, which means our costs would remain unaffected. And polyacetal (POM), for example, is on the list of materials excluded from reciprocal tariffs. While we expect no direct tariff effects on POM materials, the POM materials we sell are used as raw materials in various parts, some of which are exported to the US. Since it's hard to estimate the indirect impact in such transactions, we're applying conservative assumptions overall, including exchange rates that reflect appreciation of the yen. Regarding sales of methanol from our Venezuela plant to the US, since we can leverage our global sales network to increase sales to markets other than the US, our forecasts of business results don't incorporate any direct impact. For products like chemicals for use in semiconductor manufacturing and MX Nylon, we operate manufacturing plants in the US. And we plan to make the most of those plants.

Q7: What factors explain why your FY2024 operating profit in the Specialty Chemicals segment is around ¥4.5 bn lower than the previous forecast?

A7: The approximately ¥4.5 bn shortfall consists of a little more than ¥3 bn in the former Specialty Chemicals segment and a little more than ¥1 bn in the former Information & Advanced Materials segment. Businesses that contributed significantly to the shortfall in the former Specialty Chemicals segment include EL chemicals and optical materials. BT materials contributed significantly to the shortfall in the former Information & Advanced Materials segment. Although low thermal expansion BT materials were trending toward recovery, sales of other types fell short of earlier forecasts, contributing to the shortfall.

Q8: The three ICT businesses you're focusing on appear to be in something of a downturn. I understand that you're incurring forward-looking costs, but can you comment on these businesses from a medium- to long-term perspective?

A8: We're confident that these three ICT businesses are aligned with medium- to long-term trends in society. While EL chemicals fell somewhat short of initial plans, we see the need to proceed alongside our customers in this business, which necessarily involves forward-looking investments and is expected to undergo rapid market growth.
In other semiconductor-related products, we sell products that meet various performance requirements, including those of generative AI. We're also making steady progress on developing next-generation materials to earn the confidence of our customers. While we expect a slight lag as we proceed with R&D alongside initial market growth, we plan to deliver products that will contribute to society while continuing to maintain steady investments in growth.

Q9: I believe keeping down costs may be a strategy chosen when the profit outlook is challenging. As a newly appointed President, do you intend to make comprehensive investments in areas where fixed costs are typically incurred, including R&D expenses?

A9: I believe R&D efforts are essential to offering new products and meeting society's needs. But just moving forward across a broad front with large-scale R&D would not be good because it would take some time to achieve return on our investments and create a new market for our products. We need to carry out research and development investment and business investment, including forward-looking investment, with a more selective eye.

Q10: Can you tell us about the rate of growth in sales, by region, under your electronics chemicals plans for this year? While some delays are apparent in the adoption in Taiwan, I believe we can expect increased sales for HBM use in South Korea and in areas such as the launching of mass production and Taiwan foundries and mass production of the next nodes by North American customers in the US. How do your current plans reflect such expectations?

A10: We expect sales growth related to AI at the Korean plant. While the Taiwan plant is behind schedule on profit generation, we expect sales to grow once we acquire certification. For the North American plant, we expect high growth in the US semiconductor market. In Singapore, we expect sales recovery for memory and other uses. We also expect sales growth in Japan. In addition, we expect demand recovery from major customers to lead to growth in sales of hybrid chemicals exported from Japan to the US. In these ways, we expect sales growth across our lines of business. But for now, we're experiencing the heavy burden of fixed costs associated with forward-looking investments. Moving forward, we plan to strive to grow sales further while resolving the challenges posed by these circumstances.

Q11: You said you expect growth for BT materials in the 10-20% range this year. Do you expect electronic chemicals to achieve higher growth than BT materials? Or do you expect somewhat restrained growth?

A11: Since the conditions of electronic chemicals vary from plant to plant, we can't project uniform growth. Future plans are based on figures adjusted for demand at each plant.

Q12: I'd like to ask about your expectations for GEC this fiscal year. You project lower operating profits, but a look at the waterfall chart in the materials shows an increase of about ¥2.1 bn in R&D expenses and other costs. What kind of R&D does this refer to? Also, regarding your withdrawal from the ortho-xylene chain business, I believe this is a joint product. Doesn't this pose a risk of higher fixed costs?

A12: GEC R&D investments mainly involve Carbopath™ Circular Carbon Methanol and CDMO in the life sciences business. The ortho-xylene chain business did generate marginal profits, and our withdrawal from this business will temporarily impact profits. But we chose to withdraw based on our judgment that staying in the business would lead to the need for large-scale investments in aging facilities in the near future alongside minimal prospects of an upturn in the business environment. For these reasons, we expected marginal profit to decline gradually. So, joint products will temporarily assume the fixed costs borne by that chain, but we decided it made more sense, all things considered, to withdraw from the business.

Q13: In the Aromatic Chemicals business this year, you project a decrease of about ¥12 bn in net sales but an increase of about ¥2.2 bn in operating profit. How should we interpret these forecasts? Also, can you tell us your thoughts on fixed costs at the new MXDA plant underway in the Netherlands?

A13: The results in the previous fiscal year were below earlier forecasts for MXDA and 1.3BAC. This year we're projecting YoY profit growth based on sales for both these products and for aromatic aldehydes. The decrease in sales is due in large part to the withdrawal from the ortho-xylene chain. We're targeting the completion of construction and start of operations at the new MXDA plant in the Netherlands in early 2026. For these reasons, forecasts for this year assume that related amortization will arise beginning in 4Q.