

Condensed Transcript of Q&A Session at MGC's FY2023 2Q Results Briefing

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(Note about this transcript)

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Q1: The presentation material states that demand for optical materials was on a recovery trend in 2Q, while earnings declined compared to 1H of the previous fiscal year. Has the inventory adjustment ended or are new applications expanding? Also, you mentioned that demand for BT materials is recovering, although it remains very severe in the semiconductor-related area. Please tell us about the situation from 1Q to 2Q and your view for 2H. POM has seen market price declines, as you described, but the performance of the competitors appears to be relatively stable. What is your outlook with the recovery in automotive-related demand? Furthermore, do you see any difference in direction between EL chemicals and BT materials, both of which are semiconductor-related products, and what are your prospects for them?

A1: We recognize that earnings from optical materials are about the same level as in the previous fiscal year. Sales of high-end smartphones are expected to be favorable with a strong turnout. In BT materials, semiconductor-related demand has temporarily stagnated after bottoming out and has not reached its former momentum, but we are seeing a certain degree of recovery in orders for smartphones and PCs, which are our strong points, and we intend to move forward aggressively until next March. POM prices are down more than 15% from July 2022, when market prices peaked. This was against a backdrop of declining global demand for automobiles, economic stagnation in China and Europe, and other factors. Despite the recovery in automobile production, including in Japan, we have not been able to take advantage of it, as we have many applications for electrical equipment, office automation, and apparel. Even in the Chinese market, where we had high expectations, consumption demand continues to decline. In the area of office automation-related products, we are in the process of shifting production from China to Southeast Asia, and this has led to a decline in demand. However, we understand that demand will surely return once the transition is complete. Lastly, the sales trend of EL chemicals is somewhat different from that of BT materials; BT materials hit bottom earlier, and EL chemicals will follow, and we expect conditions to remain severe in 2H.

Q2: Do you see some recovery in demand for BT materials in 2H, based on the fact that orders have been received? Also, is there a high degree of certainty that demand for optical materials will recover? I feared that the amount of MGC's optical materials used in smartphones would be greatly reduced because of the periscope type of lenses in the new models.

A2: Regarding BT materials, we believe that demand will recover as we expect if new high-end smartphone models are launched smoothly in sequence. The amount of our optical materials used will neither increase nor decrease, and we think that the forecast is relatively certain.

Q3: Regarding the framework of your new medium-term management plan, I think you have been working on "building a more resilient business portfolio." Is there anything you would like to change from

the current plan in terms of your approach? In addition, you clearly state "promoting sustainability management," and I believe MGC is a Japanese company that will especially benefit from "realizing carbon neutrality." Will the project on carbon neutrality advance to the stage just prior to commercialization in the three years through FY2027, or will it remain in the preparatory stage before that? It's a long way off, but we expect this to drive MGC's valuations higher. I would like to know if you have any ideas regarding "enhancing human capital management."

A3: "Building a more resilient business portfolio" is basically an extension of the current concept. While reflecting on what we were unable to accomplish under the current medium-term management plan, we would like to narrow down our investment targets and focus on investments in semiconductor-related businesses and other areas. In addition, R&D for new businesses is lagging behind and must be addressed firmly. We are considering specifics, including creating a new organization in medical/food area, especially in medical area. Regarding "promoting sustainability management," we believe that achieving carbon neutrality is a great opportunity for MGC to generate profits. Advanced CCS will be developed from now on, and we intend to work on it in accordance with the law that is expected to be enacted around next spring. As for the timing of the materialization and commercialization of Carbopath, Circular Carbon Methanol, it is still difficult to see the price of hydrogen. There is no single answer for hydrogen carriers, whether it is methylcyclohexane, ammonia, methanol, or hydrogen itself, and the price will vary accordingly. We will keep a close eye on government subsidies and work as a leader to commercialize the project. Lastly, regarding human capital management, our focus is on our employees, and we have already begun reviewing our salary system to slightly increase salaries this year. We also would like to spend money on education and training. In the age of VUCA, we hope each employee will become autonomous. We have opened a new training center called MGC Commons, which we hope will raise the level of the entire group.

Q4: Compared to the sales growth of the Information and Advanced Materials segment, the improvement in profit is very large, with an operating profit margin of 25%. Your ordinary profit margin assumption for 2H is 27%, and I am surprised to see such a level of profit at the current utilization rate. Has there been an improvement in the sales mix in BT materials? Are sales increasing for AI-related motherboards, like OPE? Please elaborate on the background of the improved sales mix and profitability.

A4: OPE is a high-margin product with expected growth in sales volume, and we anticipate that it will improve the segment's portfolio and profit margins. Although the current scale is not large yet, we are looking forward to its future growth and have factored increased sales into our assumptions. As for BT materials, the utilization rate has a significant impact on profitability, so higher rate will improve profitability.

Q5: Regarding OPE, how much did sales grow in 1H and how much do you expect it to grow for the full year? Is OPE the de facto standard material for motherboards for NVIDIA's GPUs? Since GPU motherboards are large and multi-layered substrates, I am very excited about the growth of OPE and would like to hear more about it.

A5: We expect that OPE's characteristics will match the high-frequency and high-speed communications that are expanding worldwide. However, the production volume of AI servers and GPUs used for AI servers has not reached a scale that could increase overall semiconductor demand. We are building a structure to increase sales in anticipation of future growth in demand for OPE. We expect that regular servers will continue to evolve, driven by AI servers, and we are working to expand sales so that our products will be adopted in such fields as well. In addition, we expect that peripheral materials for servers, such as memories and other semiconductors, will become more sophisticated, and that the number of units used will increase.

Q6: Does this mean that OPE is growing for motherboards?

A6: That is correct.

Q7: I think it was a wise decision to exclude JSP from the scope of consolidation. While you had been pursuing synergies in various ways, what led you to this decision? Please also tell us about the direction you are taking in reforming low-profit or loss-making businesses such as engineering plastics (polycarbonate produced in Shanghai and MEP, and polycarbonate sheet film), commodity products in the xylene chain, and MMA products.

A7: Although we had pursued synergies with JSP, we decided to make JSP a non-consolidated subsidiary because the business fields of both companies are somewhat different and we thought it would be better to give each other more flexibility. Since JSP is also a publicly traded company, we would prefer not to make specific statements about the future here. We believe that this decision will lead to portfolio reform and that the economic indicators, ROE and ROIC, will improve. We would like to discuss this issue, taking into considerations the opinions about JSP that you give us and the judgment of the stock market. We are also taking steps for polycarbonate produced in Shanghai and polycarbonate sheets film, and we have high expectations for global sales activities through the consolidation of MEP. Regarding purified isophthalic acid, an aromatic chemical, we intend to focus on sales of MXDA and aldehydes in the chain. Since we think MMA products are not necessarily a loss-making business, but rather one of the pillars of our organic chemical business, we will take time to find an answer to how we should handle them.

Q8: Do you plan to present your vision for structural reforms in the next medium-term management plan?

A8: We cannot assure that we will have all the answers when we announce our next medium-term management plan next May, but we do not imagine that the current business structure will remain in place over the next 10 or 20 years, and intend to change it significantly.

Q9: The BT sales forecast looks pretty strong. What is factored into the 2H forecast? Is it a recovery in demand for memories, an increase in sales value due to growth in copper-clad laminates, or a positive effect of larger substrates?

A9: We have strength in products for smartphones and expect new models of Android and other OS to be launched one after another. Although we have reflected a slight delay in the recovery of memory demand in our forecast, we have factored in the expectation of a certain degree of recovery at the beginning of next year, given information that inventory adjustments are progressing. The larger substrate size has not affected the 2H forecast.

Q10: I understand that MGC sells OPE to other companies for their motherboards, but is it possible for you to develop business using OPE for your board materials in the future?

A10: We cannot give you the details of our product design strategy, but in general, it is common to work on new projects when opportunities arise, and we would like to proceed with material development without ruling out any and all possibilities.

Q11: Regarding the exchange rate impact, I think there will be exchange rate benefits in Japan, but are the costs incurred in Thailand based on baht or dollar?

A11: Costs in Thailand are not only based on baht or dollar, but also on yen, and we are working to create a scheme that is less susceptible to exchange rate fluctuations, for better or worse.

Q12: I would like you to summarize the current situation and the 2H outlook for polycarbonate resin at each of your bases.

A12: We are working on business structure reforms. In terms of cost reduction, the current low and stable level of bisphenol A, the raw material for polycarbonate, and thorough sales and inventory management have produced positive results, including improvements in the impact of lower cost or market. As for high value-added products, demand for specific grades for automotive applications has been growing strongly, especially in the Chinese market.

Q13: Regarding investment for growth, you mentioned that you will concentrate investment in semiconductor-related businesses. With so many investments already made and a heavy fixed cost burden, in what areas will you invest further, BT materials or OPE, which are performing well?

A13: We intend to make appropriate investment decisions for our businesses, including those you just indicated, in line with our clients' plans. We have already decided to invest in many projects, and we believe it is important to reap the results of these investments first.

Q14: I am concerned that if you invest in Taiwan JV of BT materials, the returns will flow outward.

A14: We believe it is important how well we conduct market research before worrying about the outflow of returns.

Q15: Will Intel's glass substrates have a negative or positive impact on BT materials?

A15: We believe that glass substrates will enter the market in the late 2020s. We see the possibility of some impact and are analyzing the benefits as well.