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

Date/time: May 10, 2024 (Friday) 5:00-6:00 pm (webcast)

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(Note about this transcript)
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Q1: With regard to the impairment loss in the Republic of Trinidad and Tobago, is it correct to say that the impact of the loss in your company's equity in earnings of affiliates is 7.4 billion yen? Also, what is the background behind this impairment loss? Will there not be a similar impairment loss at the other three methanol production sites?

A1: As you say, the 7.4 billion yen is the amount of impact in the Company's equity in earnings of affiliates on a yen basis. Regarding the cause of the impairment loss, Trinidad does have some special factors compared with other sites. The first is an issue with the sales portfolio. I cannot go into detail, but the market conditions in the main sales target area were extremely bad last year, and export logistics expenses have also increased dramatically. The second is an issue concerning gas contracts, the content of which prevented us from obtaining a sufficient spread between gas cost and methanol selling prices under recent methanol market conditions. At other sites, these factors are not present, and we plan to generate solid profits during this medium-term management plan. The third factor is that the book value of non-current assets was extremely high as we have just started operations in Trinidad.

Q2: What impact will the withdrawal of the MGC Filsheet Osaka Plant have on the sheets and films business? Also, the structural reform of the PC business was mentioned in the recently announced medium-term management plan. Could you provide some details of that?

A2: The withdrawal of the MGC Filsheet Osaka Plant has already been decided, and we are now in preparations for it. The current fiscal year is still early, but in the lead up to FY2026 we believe we need to make an improvement in the billions of yen. The structural reform of the PC business will be explained at the presentation meeting for the medium-term management plan on May 17.

Q3: In electronic materials, sales have recovered since the last fiscal year. The current fiscal year, sales have increased even further, and inorganic chemicals have also delivered further growth. Wafer sales volumes have not really recovered, but it appears that you plan to steadily expand BT materials, OPE, and chemicals for use in semiconductor manufacturing in light of their increasing use in cutting-edge processes and the emergence of OPE demand related to AI. Is this understanding correct? Also, are there any risk factors?

A3: In BT materials, sales have steadily recovered each quarter in the last fiscal year. We expect sales to continue increasing for all applications in the current fiscal year also; with significant year-on-year growth expected for the first half compared with lackluster performance in the first half of the last fiscal year. In the industry, full-scale recovery in demand is expected from July onward, and for 1Q there is a possibility of a partial recovery. In 2Q, we expect a full-scale recovery, with a possible peak during 3Q. Replacement demand for smartphones equipped with AI and so on is also likely to have a positive impact for stimulating demand for BT materials. OPE, which is also growing, is expected to continue to see solid demand for use in AI servers.

EL chemicals (chemicals for use in semiconductor manufacturing), which are inorganic chemicals, continued to see weak general demand in the last fiscal year, but profits exceeded the forecast as a result of various cost improvements undertaken at overseas subsidiaries. In addition, for users in South Korea, demand for hybrid chemicals for new fields such as HBM increased. Currently, demand is weak; however, the adoption of EL chemicals in new product lines in Japan, South Korea, Taiwan, and the United States is making steady progress, and we expect to see growth in demand for super-pure hydrogen peroxide and others. With the miniaturization of wiring and increased complexity of manufacturing processes, the amount of chemicals used by one advanced fab is increasing, and from this fiscal year onward, we expect EL chemicals to become a key profit driver alongside BT materials

Q4: In chemicals for use in semiconductor manufacturing, the recovery of weak demand for preprocessing has been slow, with chip inventories remaining, while for cutting-edge applications, demand for electronic materials BT and OPE is emerging ahead of others, mainly for AI services and the like. Is that picture of the situation correct? And if so, if wafer launches increase from around July, I suppose we should see further expansion of chemicals for use in semiconductor manufacturing, mainly for HBM. Is that thinking along the right lines?

A4: I think that assessment is right. To add to that, in the background, demand for chemicals for use in semiconductor manufacturing is still weak among our North American customers, who are the biggest users. I think that as a result of that, in the last fiscal year, demand for chemicals used in front-end processes was somewhat weaker than BT materials used in back-end processes.

Q5: How fast are you expecting BT materials and OPE to grow from the last fiscal year to the current fiscal year? Can we understand that smartphones will be the main driver of growth in BT materials? Do you also see an increase in factors driven by the emergence of AI smartphones? With regard to OPE, how have you factored in the fluctuation in share of PCB customers to earnings forecasts?

A5: We are expecting BT materials to show strong growth in sales from the last fiscal year to the current fiscal year. These figures are not at all surprising considering the poor performance in 1Q and 2Q of the last fiscal year. We are expecting demand to grow in general, for general materials, low thermal-expansion materials, materials for high-frequency applications, and materials for BGA, where we have promoted sales expansion. In terms of volume, the main growth is in low thermal expansion materials for smartphones and so forth, which we expect to drive growth from the current fiscal year and onward. With regard to OPE, the AI server market is said to be growing 200% per annum, and our customers' forecasts also show strong demand projections. Given concerns of supply chain bottlenecks and inventory formation, we have taken a somewhat more conservative approach to the current fiscal year compared to the market view; however, we still expect year-on-year increases in sales and profits.

Q6: For OPE, can we take it that you are able to maintain an extremely high market share? Also, in terms of low-thermal expansion BT materials, is there any other positive factor in play other than simply growth in smartphones? For example, is there any benefit from increased functionality?

A6: For OPE, if you include a wide range of similar materials, the Company's share is small. At this stage, however, there does not appear to be any move toward acquiring our share in the fields where our strengths lie. There have not been any specifically large changes in the fields that we have protected, although this depends also on how the end users evaluate our OPE customers. For low thermal-expansion BT materials, we have factored in a recovery in demand for memory for data centers and the like.

Q7: In the broad definition of BT materials, do you expect to benefit from AI servers and so forth, for example?

A7: The spread and advance of AI-related devices are also a tailwind for BT materials in our view.

Q8: I have a question about the increase and decrease factors for operating profit on page 15 of the presentation materials. Within the minus 25.6 billion yen for "Others," JSP's deconsolidation makes up minus 6.4 billion yen, leaving a real negative factor of minus 19.2 billion yen. What kind of negative factors are included here?

A8: A significant factor in this is a sharp increase in repair expenses. From the current fiscal year, we have introduced an allowance for repairs and recorded the allowance upfront, including for the following two fiscal years. In addition, the current fiscal year is also a year for major regular repairs, making the increase in repair expenses the largest negative factor. Furthermore, depreciation expenses have also increased, excluding the JSP factor, due to continued major investments to date.

Q9: Repair expenses will increase in the current fiscal year, but will they drop in steps over the next two fiscal years?

A9: We expect repair expenses to decrease over the next two fiscal years after the current fiscal year.

Q10: Are you going to continue recording European MXDA plant opening costs in the current fiscal year?

A10: We plan to continue recording opening costs in the current fiscal year.

Q11: In the year-on-year forecast for operating profit of aromatic chemicals, the decrease in profit for the current fiscal year has been only around minus 4.0 billion yen even while there is a negative effect of minus 6.4 billion yen from the deconsolidation of JSP. Considering also that opening costs at the MXDA Europe plant and repair expenses and so forth will also weigh on profits considerably, what is the background to this forecast? Could you provide a breakdown, including positive factors?

A11: Around half of the negative factors are the absence of operating profit from JSP. Other factors putting pressure on operating profit are a year-on-year increase of around 2.0 billion yen in repair expenses, including allowance, for the Mizushima Plant, which is the main base for aromatic chemicals, the recording of opening costs for the MXDA Europe site, and an increase in depreciation expenses for aldehyde equipment, which started operating in the last fiscal year. On the other hand, demand for MXDA and aldehyde suffered in the last fiscal year, particularly in Europe and the United States, and have finally reached a situation where demand recovery is anticipated. Our expectations are based on hearing that inventory processing is now complete and that items are beginning to move. In other areas, we expect to see growth in profits from MX nylon and xylene separators and derivatives. Overall however, we are forecasting that negative factors will dominate.

Q12: In major product groups by segment, specialty chemicals' performance exceeded the forecast in the last fiscal year. Which of inorganic chemicals, engineering plastics, and optical materials contributed to this result?

A12: The largest improvement was from EL chemicals within inorganic chemicals. Overall demand is still weak, but profits increased due to progress on cost improvements at overseas subsidiaries. In engineering plastics, POM was somewhat lower than the previous forecasts, but PC was higher than the forecast, mainly due to strong performance at the subsidiary in Thailand and cost improvements. Optical materials continued to experience favorable conditions, and performed in line with the previous forecast.

Q13: My question is about the repair expenses in aromatic chemicals. Previously, regular repairs in 4Q each year tended to significantly reduce profits. From the perspectives of both expenses and sales volume, will the recording of an allowance level these out going forward?

A13: As you have said, we have large and small regular repairs in alternate years, mainly occurring in 4Q. With the repair expenses, our policy is to level them out over as wide a scope as possible; however, it is necessary to distinguish the target equipment and construction work, so overall we plan to level out around 70%. I can't say that sales volumes will be generally leveled out since we also conduct inventory management before and after regular repairs.

Q14: Including the repair allowance, how much do you expect the current fiscal year's repair expenses to increase compared to the last fiscal year?

A14: We are expecting an increase of around 5.0 to 10.0 billion yen.

Q15: Regarding OPE, about what percentage of growth have you factored in for change in net sales for the current fiscal year?

A15: For net sales, the volume factor is bigger than the unit price factor, and we are expecting double-digit growth year on year.

Q16: Regarding your dividend policy, in the recent medium-term management plan, you have introduced a progressive dividend policy. Can we interpret this as a sign of confidence that you can minimize volatility in business results through measures such as business reorganization?

A16: That is correct. It is time to harvest the gains from the investments made to date, and we expect to be able to steadily reap the rewards of these over the three years of the current medium-term management plan.

Q17: You are forecasting significant profit growth in EL chemicals for the current fiscal year. Generally one would expect large investments to result in a heavy depreciation burden, but the profit margin appears to be increasing. Is this partly attributable to an increase in added value, such as products for advanced memory? Also, breaking it down by region, is there any region in particular where you are expecting to see growth in the current fiscal year?

A17: With EL chemicals, we have customers who have unofficially signaled contracts and adoption right in front of us, and in terms of reaping investments also, we expect EL chemicals to drive the entire Group towards the final year of the medium-term management plan. In the current fiscal year, we are expecting a full-scale recovery in demand in North America from the second half. In South Korea, we anticipate a full-scale recovery from the second half at the latest, and we also expect positive effects of demand for HBM and so forth. In other areas, demand for cutting-edge semiconductors in Taiwan and increased activity in Japan are expected to bring increases in sales and profits from super-pure hydrogen peroxide and super-pure ammonium hydroxide as well as hybrid chemicals.

Q18: In the medium-term management plan, do I understand correctly that EL chemicals is positioned alongside BT materials as an earnings driver?

A18: Yes, that is correct.