Condensed Transcript of Q&A Session at MGC's FY2024 2Q Results Briefing

Date/time: November 8, 2024 (Friday) 5:00-6:00 pm (webcast)

Presenter:
Masashi Fujii, President and Representative Director
Motoyasu Kitagawa, Director, Managing Executive Officer, responsible for Corporate Planning and in charge of CSR & IR Division
Kosei Kondo, General Manager of Finance and Accounting Division

(Note about this transcript)

This document has been translated from the Japanese original for reference purpose only. In the event of any discrepancy between this translated document and the Japanese original, the original shall prevail. This transcript was edited for clarity and brevity at the Company's discretion. Additionally, forward-looking statements, including plans and targets, contained herein, like those in the briefing's presentation materials, are judgments based on information in the Company's possession as of the briefing's date and certain assumptions deemed reasonable by the Company. Forward-looking statements involve uncertainty. Actual outcomes may differ substantially from such forward-looking statements as a result of various factors.

Q1: Regarding your outlook for full-year forecasts, we conjecture factors such as the concentration of regular maintenance in the second half. How much of the differences in negative impacts on the 2H results compared to 1H do these factors account for?

Additionally, in the engineering plastics business, you explained that there would likely be various negative impacts in 2H. Does this mean, nevertheless, you will be able to secure an operating profit? Aren't conditions likely to further deteriorate from this segment? I understand that structural reforms related to the polycarbonates business is an important issue, but with structural reforms continuing, is it not correct to say we may see a recovery starting in the next term? Please explain your outlook for 2H and your thinking for a slightly longer span.

A1: First, regarding the regular maintenance in 2H compared to 1H, there are major differences in regular maintenance primarily at the Niigata Plant and Mizushima Plant and particularly, assuming the former segments, in Natural Gas Chemicals and Aromatic Chemicals segments. The largest differences will be for the former Natural Gas Chemicals segment; compared to 1H, costs will increase by more than 4.0 billion yen. In the former Aromatic Chemicals segment, there will be a difference in regular maintenance of close to 1.0 billion yen between 1H and 2H. In the polycarbonate business, differences in routine repairs will arise at the Thai Plant. These factors account for the profit difference between 1H and 2H.

In the engineering plastics business, I'll explain the results for each of polycarbonates and polyacetals, our main products, in chronological order. First, QoQ, from 1Q to 2Q, profits for polycarbonates increased. The cost of bisphenol A, an ingredient, rose with yen depreciation, but sales were better than expected, and cost improvements at Chinese plants were also positive. The results for polyacetals declined somewhat QoQ, but compared to the previous forecast, both polycarbonates and polyacetals are in a very good position as of 2Q, and profits are up. Regarding polycarbonates, costs not recorded in 1H, on the scale of several hundreds of millions to less than 1.0 billion yen, will be pushed back to 2H. This is another factor in the upswing in 1H results. This is a key reason for the major difference in profit and loss between 1H and 2H.

For 2H, this time lag in recording costs should result in differences in 1H and 2H profits and losses, combined with the higher cost of regular maintenance at the site in Thailand and other costs, amounting to a total of around 2.0 billion yen. Although performance at the Chinese plants remains firm, 1H and 2H differences will turn negative based on the lower of cost or market accounting method. Seen together, these various factors will result in a major decline in profit for polycarbonates between 1H and 2H. But despite a large 1H-2H profit difference, we're making structural improvements. Looking at the full year, compared to the previous forecasts, profits in polycarbonates are expected to increase by more than 1.0 billion yen and in polyacetals by more than 2.0 billion yen. Things are proceeding steadily: that's the main point.

Q2: Do you mean that regular maintenance in Thailand, etc., will be around 2.0 billion yen?

A2: The regular maintenance itself does not cost that much, but including other additional costs, we estimate overall a little less than 2.0 billion yen.

Q3: Regular maintenance is around 6.0 billion yen, other cost increases are around 2.0 billon yen, and the time lag in recording between 1H and 2H accounts for around 1.0–2.0 billion yen. These specific factors you have explained are mainly pushing down profit by 10.0 billion yen. Despite the difficulties, are we to understand that the fundamentals are good; that there is relatively little cause to worry; that engineering plastics will not verge on the red; and that things become better than before?

A3: That's correct. You can frame the situation in such a way.

Q4: I want to ask about your three ICT businesses. Why are EL chemicals and BT materials being revised down from the previous forecast? Moving from 1H into 2H, electronic materials (BT materials and OPE) are expected to recover, but optical polymers are flat. You expect lower profits for EL chemicals (chemicals for use in semiconductor manufacturing). Can you explain each business environment for these three businesses?

A4: First, regarding BT materials, the results for 1H were weak in both 1Q and 2Q. That's the reason for the modest downward revision for 2H. The major factor is that the recovery in the general purpose sphere where BT materials are used was weaker than expected. This is likely to be true in 2H as well, but we believe it won’t be worse than 1Q and 2Q. The recovery appears gradual. Regarding the mainstay of low thermal expansion materials, we recognize that smartphone applications weren’t so bad, but our analysis shows memory applications for servers and related applications were down. We believe memory applications, which were bad, are likely to recover in 2H. For FC-BGA applications as well, which are increasingly being adopted, there were slight inventory adjustments at end users in 1H. So they were a bit below forecasts. In 3Q, we’re expecting positive returns. Demand for high frequency materials for antenna-in-package applications is declining this term.

The 2Q results for OPE were very good, driven by the AI server market. In addition to AI-related motherboards, the scope of customers and applications expanded. Sales are up QoQ and YoY. In 2H as well, we’re expecting the continuation of solid results. With seasonality factored in, our forecasts for 2H are somewhat conservative.

Regarding EL chemicals, there was regular maintenance in 2Q at three plants in Japan which increased fixed costs and reduced profits compared to 1Q. Overseas, results varied from region to region. Although North American users remained in a major slump, chemicals for HBM increased in Korea, and profits were up even compared to 1Q. If chip layering continues due to the spread of interposers and other factors, this will act as a tailwind for our chemicals. We see that as a positive. At the same time, 2H forecasts are below our previous forecasts, because a new overseas plant is starting operations, which will result in a large increase in related depreciation, and fixed costs are expected to increase in Korea and in other countries. The high-end market remains strong. Other areas are recovering, albeit gradually, but we believe the recovery will be slow. Given these factors, even in a 1H-2H comparison, we expect profits from EL chemicals to be down.

Optical products are performing well as demand continues to surge. 2Q results exceeded the previous forecast. Even though smartphone demand itself isn’t growing significantly, demand for our materials is increasing significantly, driven by demand for better performance. In emerging countries like Africa and India, use of smartphones is expanding, while demand for higher performance is trending up. Our products are used here, too, and this trend is expected to continue in 2H.

Q5: 1H operating profits were approximately 34.0 billion yen. Of this, the U&P business accounted for 31.0 billion yen in profits, while areas other than the U&P business accounted for approximately 3.0 billion yen in profits. Up to the last term, the JSP factors appeared to be significant. This year, the other businesses appear to be improving. What areas improved? Will this situation continue in 2H?

A5: In areas other than the U&P business, polycarbonates made a big contribution to profits in 1H. For polycarbonates, we’re expecting lower profits due in part to technical factors in accounting. Profits from MMA-related products were very good in 1H.

Q6: Regarding the impact of lower profits due to regular maintenance factors in 2H, which will be more affected, the U&P business or the other businesses?

A6: Regular repairs are done for the plant as a whole, so the impact on each business depends on allocation of the cost. It's hard to tell details of the breakdown. Generally speaking, businesses other than the U&P business have higher regular maintenance costs. For example, regular maintenance costs are high for MMA-related products, xylene separators and derivatives including meta-xylene and purified isophthalic acid (PIA), and polycarbonates.

Q7: In 2H forecasts for EL chemicals, you estimate depreciation expense for new plant operations. But is it correct that these forecasts exclude corresponding sales estimates? Please explain if there is a reason why you can't expect sales. Are you waiting for approval by the customer, for example?

A7: We aren't expecting a major time lag. Rather, the plant will launch, then we'll finally launch sales. Our expectations for sales are dominant.

Q8: 2Q results for EL chemicals appear to have been less than stellar. In the current medium-term plan, your focus is to secure return on past investments and current launched operations in EL chemical on a cashflow basis. What stance will you take to proceed with these efforts? In addition, I think you will be launching a new plant in Oregon going forward. But will capacity utilization go up?

A8: As you point out, under the medium-term plan, the business in which we expect to see the largest profit gain is EL chemicals, centering on super-pure hydrogen peroxide. In that sense, it's unfortunate we were forced to revise the figure down a bit in the initial fiscal year of the plan. The factors are the overall slow recovery in semiconductor demand and the impact of the poor performance at one end-user company in the U.S. But other Taiwanese and Korean end users are performing relatively well, so the capital investment additionally made to our plants will be recovered to some extent. At this point in time, I've heard there will be subsidies from the U.S. government for the end user performing poorly, and we expect a recovery going forward. But with the political events in the U.S. and other factors, the outlook for the economic environment for the next fiscal year remains unclear. We need to keep a close eye on the situation. If revisions become necessary, we will present and explain them going forward.

Q9: Regarding YoY comparisons with 1H results, on page 12 of the briefing materials, MXDA and aromatic aldehydes volume results are explained as positive factors for the operating profit increase. But on page 13, MXDA and aromatic aldehydes have an arrow for their results pointing down and to the right. Can you explain why? Additionally, while demand for Europe and the U.S. is recovering, sales volumes for China appear headed down. Can you give more information on the factors behind this regional difference?

A9: 1H sales volumes were up for MXDA and aromatic aldehydes. As shown on page 12, they helped boost operating profit. But sales volumes for 1,3-BAC, a derivative of MXDA, declined, and fixed costs increased more than the previous year. Overall, profits were lower, so the arrow on page 13 points down. Sales trends for MXDA and 1,3-BAC differ; a high proportion of sales of 1,3-BAC are to China, and due to economic stagnation in China, sales volume declined. At the same time, MXDA is seeing recovery in demand for epoxy resin curing agents for Europe and North America. Regarding aromatic aldehydes, demand for fragrances and transparent nucleating agents for polypropylene is recovering.

Q10: Is the new plant in the Netherlands for MXDA already up and running? Due to these cost increases, will profits fail to improve even if sales are positive?

A10: We plan to launch the new plant in the Netherlands next year or beyond. As I explained previously, the costs are positioned as pre-opening costs. Some of the costs have already been recorded on the P/L statement. Even though the plant hasn't been launched, the cost burdens are growing.

Q11: I want to ask about a medium- to long-term point. In the medium-term plan announced in May of this year, I understand there were the medical and food products fields, along with enhancing shareholder returns and growing the ICT business, as a new product development topic. Regarding the contract manufacturing business for antibody drugs, OXYCAPT™, and allergy test chips, has there been any progress now that a half-year has passed since the announcement of the medium-term plan? Qualification is proceeding, approval is proceeding—if there is any such talk, please let us know. I think antibody medicines and OXYCAPT™ aligned with current trends. I personally expect a takeoff during the medium-term plan period.

A11: Regarding antibody medicines, please understand that this kind of business will not bring about visible results within a couple of months. But in the midst of trends, various items we're involved in are proceeding well, including the manufacturing process. We seem to be moving to the next stage, which is something I'm happy to report. Additionally, a number of inquiries have come in. With regard to antibody medicines made in Japan, we're one of leading companies or at least we can say that we're accumulating results and are very much looking forward to the future.

OXYCAPT™'s outlook is promising, but among the number of customers expected, one company changed its policy, so major growth in sales during this period will be difficult. We may expect positive results in sales starting next year or so. We are putting a lot of resources into OXYCAPT™. Hopefully not only antibody medicines but OXYCAPT™ will be the centerpiece of our new business.

Q12: Regarding OXYCAPT™, in the case of oligonucleotide therapeutics, they are extremely sensitive to heat. At −40°C or −50°C, glass can't be used due to volumetric expansion. If we're using a gas barrier, a low-temperature gas barrier is extremely important, so I think your OXYCAPT™ products have a strong competitive advantage and will align you with the trends. Unfortunately, the items planned for sale this term have been delayed a little. Should we understand that you're working for different customers?

A12: As you say, on the performance side, we have competitive advantages against glass, and we're focused on that. But the earliest customer changed their policies, and that order was cancelled. It's not that product performance or direction are bad; the company simply changed its policies. Now we're waiting for another opportunity. Beyond that, we have two to three large orders we're waiting on, and we're currently in middle of collecting lab data. I expect we can report on good news soon.

Q13: With regard to Natural Gas Chemicals, we can surmise significant equity method profits in 2Q. But what factors led to this result? Additionally, I believe the iodine market conditions lately have been fairly positive. What is your outlook for this market trend?

A13: Regarding equity method profits in 2Q for natural gas-based chemicals, foreign exchange gain/loss improved with yen appreciation for foreign-denominated borrowings of a methanol joint venture. Iodine increased its presence significantly as part of the energy resources and environmental businesses. Market conditions have been heading upward and were rising as of September; in addition, demand has been firm, so in entering 2H our expectations remain extremely high. However, we're a little wary about whether or not the market will continue to perform at the same pace. Out forecast incorporates this concern.