Investors' Meeting for Current Priority Management Issues and Business Strategy Q&A Summary

Date and Time: Thursday, June 3, 2021, 13:30-14:45
Presenter: Keiichi Iwata, President

<General>

Q. I would like to ask about improving your portfolio. As you are trying to improve your results to achieve a core operating income of 200 billion yen for fiscal 2021, while petrochemicals and methionine are seeing some recovery from the previous fiscal year, volatility in your performance results remains extremely high. How will you be reducing volatility going forward?

A. For commodity products, where it is difficult to differentiate our products from those of competitors in terms of functionality, as with methionine, volatility will always be high. Because we cannot control market conditions, we feel that what is important is raising cost competitiveness. Because we are currently working to focus on cost rationalization, cost competitiveness will increase steadily year over year.
For petrochemicals, this is a more difficult issue, but Singapore has been steadily producing profits for the last ten to fifteen years. This is largely due to the fact that we were able to build a network of numerous outstanding customers across Asia. While these are largely commodity products, we are working to differentiate ourselves based on markets and customers. For Petro Rabigh, because it has an overwhelming cost advantage, even though there is some volatility, we feel that the chances of falling into an extremely bad situation are quite low. We are working to improve the competitiveness of its products and to bring it up to an acceptable level.

<Petrochemicals & Plastics>

Q. In the briefing six months ago, you stated that you were thinking of expanding your production capacity for polypropylene, but I got the impression that there was a low possibility of you investing in propylene, which is used to make polypropylene. In recent press reports, however, it seemed to me that you were thinking more positively about investing in propylene. What is your current thinking about investing in a propane dehydrogenation (PDH) to produce propylene? In conjunction with PDH, if you do chemical recycling, such as methanol derived from carbon dioxide, because that would be an investment in reducing the burden on the environment, would that make it easier to justify as an environmental investment? In addition, even before the development of chemical recycling technology is fully complete, is there a possibility that you would invest in PDH?

A. For the purpose of a volume expansion, we have no intention of making a large-scale investment in general-purpose products, and our thinking on that has not changed at all. Regarding PDH, we currently are not thinking of investing in it prior to developing chemical cycling technology. By pairing PDH with chemical recycling, a variety of different ways of making it a business emerge, including where it would be located. We could produce it ourselves, we could combine the technologies as a set package and license them, or we could do small-scale production ourselves as a validation plant to facilitate licensing. So we first have to work on developing the technology, and at the stage that it is nearly complete, we can start to think about how it will be deployed. What we introduced today is an example of carbon-neutral contribution efforts, and we are still in the midst of developing the technology, so I would like you to take a longer-term perspective.

Q. I would again like to confirm your thinking about the positioning of Petro Rabigh. If current market conditions persist, from the standpoint of profits, it will contribute to your performance, but when you release company-wide indicators, will Petro Rabigh just figure into the calculations as an equity-method affiliate? In addition, the Phase 1 project financing is expected to be repaid in December of 2021, after which I think there is the possibility of cash being freed up from Phase 1. If the present business environment continues, is there a possibility of a large return of funds in the form a dividend to the two parent companies?

A. The way we position Petro Rabigh has not changed from what we said before. We are not thinking of further investments or providing funds for a capacity expansion at this time. In addition, even if market conditions further improve and profitability improves, we will not change our stance. In terms of profits, we want the company to contribute to our performance, and returns in the form of dividends would be extremely welcome news for us, as we want Petro Rabigh to be a cash cow. However, dividends is a determination the company's management, and I think that is an issue that will be discussed in the future.

In terms of our management indicators, Petro Rabigh figures into the calculations as an equity-method affiliate.

<IT-related Chemicals>

Q. I would like to ask about the status of the IT-related Chemicals Sector, including your progress with EUV resists and trends in your market share for polarizers for OLEDs, as well as coating-type phase contrast polarizers for liquid crystal displays.

A. As for OLED polarizers, currently we have an extremely high market share. Competition is quite intense, with various companies repeatedly winning and losing on a model-by-model basis, so we do not think it will be easy to constantly maintain a similar market share going forward, but we are working hard to be able to secure at least a somewhat high market share.

For resists, because prices fall even as volume increases, the global market was around 100 to 120 billion yen, but we are aware that it is currently reaching a scale of around 200 billion yen, and we expect that in ten years, by 2030, it will have grown even larger. Resists are one of our core businesses where we have extremely high expectations. Of all the various types of resists, we forecast that the ones where we can expect the largest increases are ArF resists, which include immersion resists, where we have an advantage, and we are expecting to expand earnings there. For EUV resists, we are right now in the midst of a development race, and the number of applicable layers is expected to more or less double from 2021 to 2024. From a market scale perspective, however, we expect the market scale to be similar to that of g-line and i-line resists by about the mid-2020s, and we are aware that a development race is currently ongoing between various companies with a focus on 2030.

Q. Because you expect shipments of film-type touch-screen sensors to significantly fall in fiscal 2021, you stated that you are shifting resources into new products, such as 5G antennas that use the production technology of film-type sensors, but how will this be applied? I assume that it will be difficult to launch new products this year, but a few years in the future, will new products be able to sufficiently cover for the decline in shipments of your existing products?

A. In the touch-screen sensor business, we expected a generational shift from glass-type to film-type sensors, but because of its cost competitiveness, demand for glass-type sensors has continued. On top of that, for film-type sensors, display manufacturers in Korea and China switched to bring production in-house much faster than we anticipated, so it has been a struggle. Our film-type touch-screen sensor technology has its own unique superior attributes, and we are working on developing new applications, mainly at Dongwoo Fine-Chem, our subsidiary in Korea. I cannot disclose the details, but because the sales opportunity for a new application we had expected this year has now gone away, we are projecting that the weak business performance for film-type sensors will continue for the time being, and to recover we are working to develop the technology for other areas in which it can be used.

Q. For the application whose use went away this year, is there a possible that it will be used next year? Or is that something that you do not expect to happen?

A. Even if the timing is delayed a bit, we hope we can arrange the use of the same application.

Q. Since the summer of 2019, because the Japanese government has strengthened export controls toward Korea, a move to shift production of semiconductor material to within Korea has been actively promoted. Are we correct to assume that it serves as a tail wind to you? In addition, are we correct in thinking that your market share in Korea, including in high-purity chemicals used for semiconductors, is steadily increasing?

A. We have a local company in Korea called Dongwoo Fine-Chem, and we think it will be treated as a Korean manufacturer. That is because it is actively engaged in development and sales activities for its Korean customers. Regarding semiconductor materials, we understand there is a movement by Korean companies to make them in Korea, but because for example advanced resists is a product with a high degree of technical difficulty, at the present time we see no concrete moves toward mass production. In terms of stable supply, we think we are viewed as being very reliable by our Korean customers, and we will continue to work to expand our business in Korea.

Q. In the market for resists, you stated that you would expand production, primarily of ArFs, but in terms of your strategy going forward, are we correct in thinking that your market share in ArFs will continue to increase?

A. We have a major share of the ArF immersion market. It may be difficult for us to further increase our share, but we will maintain our current share as we work to expand market volume.

<Health & Crop Sciences>

Q. For the Health & Crop Sciences Sector, I would like to ask about the reasons you could not achieve the initial target of 75 billion yen, and how you intend to retrieve the situation going forward. In addition, I would also like to ask about the current profitability of biorational products, and about their earnings potential in the next few years.

A. Compared with the initial target of 75 billion yen, our forecast for the Health & Crop Sciences Sector for FY2021 is about half that level of profit. There are two reasons, the first of which is the fact that methionine is not producing as much profit as initially assumed, and the second is that the impact of the unseasonable weather in North America in 2019 are still lingering. It is not fair, however, to say that the unseasonable weather by itself is a reason, as we consider the need to secure a resilient earnings capability, even in the face of that sort of difficult environment, to be an issue we are facing in the North America region. Compared with that, our South American crop protection business has become a strength that we had not incorporated into our initial forecasts, and India is also growing more than expected, so we view the growth potential of Brazil and India as positive factors, while in North America, which has been a negative factor, we want to rebuild our structure. For methionine, even if we cannot secure the high profits we initially envisioned, we would like to secure profitability even on the basis of when the market was at its lowest by improving cost competitiveness. Through these sorts of initiatives, we feel that 75 or even 80 billion yen is within the realm of possibility.

As for biorationals, rather we view them as a long-term initiative, with an eye on 2030, or even 2040. For this reason, we are not expecting significant earnings contributions from biorationals in our results for 2024 or 2025.

Q. In terms of methionine prices, is it possible for you to continue at current levels?

A. While there is a possibility that our results for April through June were higher than our baseline capabilities due to scheduled refurbishment at competing plants or to some minor disturbance in the distribution network, we feel that there will probably be no sudden, massive fall to a much lower price level. Although we cannot control market conditions, we ourselves are not expecting prices to continue an unchanging rise forever, and even if they fall to a somewhat lower level than they are currently at, so long as they remain stable there, we feel that would be fine.

Q. On slide 25, where you show your sales revenue targets for your crop protection business for FY2025, to what extent do you expect your A2020 and B2020 products to contribute in both North America and South America? In addition, I would also like to ask about what sort of initiatives you are considering for the Japan market. At the same time, could you tell us about other initiatives to achieve your targets for FY20205, such as whether we should expect an increase in profit margin due to improvements in overall efficiency, such as those brought about by having your facilities in India supply precursors to various Group companies?

A. For our sales revenue targets for FY2025, A2020 products are included to some degree. With respect to B2020 products as well, we have arrived at these numbers by incorporating products that are already beginning to receive registration now, such as INDIFLIN.

As for India, it is naturally extremely interesting as a market, and our subsidiary in India have the capability to manufacture both crop protection chemical precursors and the chemicals themselves, so because they can manufacture things in a cost competitive way, we are beginning an initiative to more effectively utilize India as a production base for crop protection products. As you pointed out, we think it could become a factor in strengthening the earnings capability of our crop protection business, or in increasing profits.

As for sales of crop protection products in Japan, we have three other B2020 products besides INDIFLIN, two antimicrobials and one pesticide, which will be receiving registration one by one, and we expect sales of those products to contribute in 2025.

Q. I personally think that INDIFLIN may account for twenty to thirty billion yen in sales, so my impression is that your sales forecasts for South America are fairly firm numbers, but what are your thoughts?

A. With respect to future results from South America, local management has an extremely ambitious plan, with numbers around 30% higher than the numbers we have incorporated into our forecasts. We understand that they are steadily working to achieve those goals, which we find extremely heartening.

<Finance / Others>

Q. Looking at the horizontal axis of the graph on slide 31, capital invested, it seems that you have made a number of large-scale investments in a row. While I understand that most of those investments were necessary for Roivant and the South American facilities, among others, from the perspective of limiting capital investments, it seems like under the current Corporate Business Plan, things have been trending toward expansion. I would like to ask, in the next Corporate Business Plan and beyond, whether you plan to prioritize limiting capital investment or improving NOPAT more.

A. Under the current Corporate Business Plan, there were relatively more acquisitions and investments, but we feel that these were necessary investments in order to resolve the issues we were facing in 2019. Increasing the results of those investments will be an issue in the next three years, but as for our investment plans for 2022 and beyond, including whether you plan to prioritize limiting capital investment or improving NOPAT more, we will consider it while formulating the plan. M&A, however, is something that requires another party, so I do not think many opportunities will come around. The next Corporate Business Plan will be a period of prioritizing the recovery of our financial structure and limiting capital investment, but if there is an opportunity for growth or to expand our business fundamentals, we feel that it would be worth it to take advantage of the opportunity, even if it delays the recovery of our financial structure by one or two years.

Q. Should we understand that those sorts of M&A or growth investments will take place in the Health & Crop Sciences, Energy & Functional Materials, or IT-related Chemicals sectors, where differentiation based on functionality is possible?

A. That is the case. We are not considering investments to expand volume or investments in fields where we cannot compete with technology at all.

Q. In terms of strict selection of investments, on slide 35 you state that investments "may increase if decisions or projects are pulled forward from FY22," but can we assume that any increase would be related to PDH in Singapore? In addition, in terms of reducing your assets, have there been discussions about carve-outs?

A. With regards to the strict selection of investments, we have now reduced our planned investments by about 100 billion yen, with the aim of about a total of 850 billion yen on a decision-making basis. Depending on the extent of the progress in considering M&A deals or the kind of deals you cited as an example, however, there is a possibility that there could be a slight divergence in the timing, such as whether a decision is reached in the fourth quarter of fiscal 2021 or the first quarter of fiscal 2022. Therefore, the reason why we made that statement is that we cannot commit that investments will be reduced by 100 billion yen, to 850 billion yen. Even if investments increase beyond that level in fiscal 2021, however, please understand that they will be reduced by that amount in fiscal 2022 and beyond. Also, at the present time, none of our businesses are considering carve-outs.

Q. In recent years, many companies have started initiatives in new businesses to address environmental issues or have increased upfront spending on investments or R&D to address environmental issues, but how much of the amounts on slide 35 for capital expenditures and investments are expenditures to address environmental issues?

A. First, on slide 46, we show an illustration of the Sumitomo Chemical Group's reduction in greenhouse gas emissions. From 2013 to 2019, most of the reduction in greenhouse gas emissions was from rebuilding plants and changes in our business portfolio rather than from environmental investments. Going forward, there will be some emblematic environmental investments, such as the Sumitomo Joint Electric Power LNG power plant in Ehime and the Chiba gas turbine, but because these decisions were made in the previous Corporate Business Plan, they are not included in the amounts for capital expenditures and investments (on a decision-making basis) on slide 35. Regarding the Chiba gas turbines, that spending was included in the current Corporate Business Plan, and the amounts are fairly significant. Regarding other investments in energy conservation, every year we spend about the same amount, but because we are reaching the point at which we have exhausted everything that we can do in terms of in energy conservation of existing plants, our investments in energy conservation will not increase by very much, simply because we have run out of ideas right now. On the other hand, we will invest in developing new technologies, such as chemical recycling, CCU, and CCS, but these investments are at the stage of building pilot plants for validating proof of concept, and the amounts are not yet very large.

Q. Regarding the issue of having a subsidiary and the parent both be publicly listed, would you consider doing away with that structure if there were a case in which it would make a large contribution to improving earnings per share, or if there were synergies with your existing businesses, in which, for example, you could invest in strengthening your product portfolio? Please tell us your current thoughts, including about equity-method affiliates that are listed.

A. Our thinking about having a subsidiary and the parent both be publicly listed fundamentally has not changed from the stance we explained at the prior briefing. So long as the autonomy of the subsidiary and the rights of the minority shareholders are protected, and, for both sides, the relationship improves corporate value, having a subsidiary and the parent both be publicly listed is one option.

Regarding Sumitomo Dainippon Pharma, from the perspective of Sumitomo Chemical's financial condition and our investment priorities, at the present time we have no intention of changing the capital structure. We believe that there are enormous synergies in the healthcare field between Sumitomo Chemical as a diversified chemical company and a pharmaceutical company. As one example, we have launched a joint venture for the CDMO business in regenerative medicine and cell therapy, and by demonstrating its performance, we think you will get a solid sense of the synergies between a diversified chemical company and a pharmaceutical company.

Regarding three other companies, as to whether the holdings are appropriate in light of the Sumitomo Chemical Group's management strategy or possible changes in the business environment, it is an issue that we are continually monitoring very closely.

(END)