Medium-Term Management Plan 2025 Tokuyama Corporation Investor Meeting

Q&A (Excerpts)

Date and time: Feb. 26, 2021 (Friday) 11:00 – 12:30

Participants:

Hiroshi Yokota, President and Representative Director

Hideo Sugimura, Director, Managing Executive Officer, General Manager, Corporate Planning Div.

Mr. Nakada, Macquarie Capital Securities

Q1: As for the new mid-term business plan, frankly speaking, I feel that the profit target is not enough. If we consider FY2020 as the base, profits will increase 33% over five years, but if we consider FY2019 as the base, profits will increase only about 15% over five years. In the Chemicals and Cement businesses, I assume that you have factored in increased costs for environmental measures and so on. How much costs have you factored in respectively?

A1: In the area of CO_2 reduction, we have specific plans to introduce biomass. The fuel cost is expected to increase by more than JPY3 billion due to the conversion to biomass fuel, and the depreciation cost is expected to be more than JPY1 billion due to the associated maintenance of facilities and infrastructure. In total, we have factored in a little less than JPY5 billion for fuel conversion and depreciation of the investment associated with the introduction of the fuel.

Q2: Is it correct to say that the cost will not suddenly increase in the first half of the five-year period, but will increase in the second half?

A2: It will be introduced in stages, starting in 2023, and then in 2025.

Q3: As for a roadmap toward carbon-neutral, how far do you think you will have progressed by 2025?

A3: Reduction of CO_2 from energy will be by about 30%. Reduction by process improvement is expected to be about 10%.

Q4: You said that operating cash flow will be JPY250 billion. If you make capital investment and strategic investments of JPY230 billion combined, will JPY20 billion be left for the dividend?

A4: We are planning 20 to 30% of payout ratio. We currently have a very high level of cash on hand, partly due to COIVD-19. Once we get back to normal operations, we would like to use them to repay interest-bearing debt and to pay dividends, for financial cash flow.

Mr. Azuma, Jefferies Securities

Q5: It is a very ambitious goal to reduce CO_2 emissions in absolute terms. I think it would have been better to set a target to reduce per unit of production, such as per ton of cement.

A5: When we originally set the target two years ago, we were working on business-as-usual, but in the current review, we have changed our policy to basically indicate the target in absolute terms. One of the reasons for this is that, for example, in the Cement Business, we basically assume that there will be no expansion in scale. In addition, in the Chemicals Business, given that there is no realistic capacity for further expansion, at least in Japan, we are aware of the situation in which businesses with high CO_2 emissions will not grow. In this context, we believe that we should set clear goals and steadily implement them. One practical solution is to use biomass instead of coal. If we are going to use

biomass, one of the things we need to do is to sign a contract as early as possible to secure it. Furthermore, we are planning to produce the biomass ourselves, rather than simply procuring it. We want to be proactive in this area.

Q6: That is ambitious that you are considering making your own biomass. On page 28, it says that biomass can be introduced thorough the existing technology if you spend enough money. It also looks very ambitious that co-firing/exclusive-firing of hydrogen or ammonia will be also introduced. Are you talking about this for the future, when technological innovation is possible?

A6: That is what I mean. For ammonia, the other company has given a figure of 20% for co-firing, but I have heard that the technology is not yet up to that level when it comes to actually achieving stable operation with reasonable cost. I think it will be a long time before we can actually put these technologies to practical use.

Q7: I would like to have some additional explanation on the growth strategy of electronic materials. What kind of silica and silicon technologies have been developed, and when do you think they will be ready?

A7: As for the silicon, we would like to enhance our silane products in the future. We will accelerate our response to the ever-increasing customer's demand by offering a wider variety of products. As for the Silica Business, we are discussing the possibility of entering the organic silicone field with external parties, although this is still backdoor negotiation. This does not mean that we are going to compete with other organic silicone giants. There are various markets in the areas that they cannot reach, so we would like to expand in those niche areas.

Q8: The expansion of photochromic technology is mentioned in the Life Science Section, but I think this is where you have been working hard. I feel that your company probably needs to enhance its human resources in the marketing field, which is probably not your strong point.

A8: As you said, marketing is not our strong point. Our basic business approach has always been to supply materials to lens manufacturers. We are taking it a step further and are introducing a business model where we work together with lens manufacturers to develop their products. By doing so, we are now building a business model that can provide added value.

Mr. Nakahara, Tokai Tokyo Research Institute

Q9: Roughly half of the investment is in growth and rationalization/energy saving/CO_2 reduction. If you have the numbers by segment, I would like to know how much you invest in which segment. Also, if you can tell us which investment corresponds to each of the key investment projects listed here.

A9: Growth business account for about one third of the total, of which the largest one is related to electronic materials. Electronic materials, including thermal management, IPA-SE, silicon nitride, and other thermal management materials, will be JPY50 billion. In addition, we are planning to spend more than JPY10 billion in healthcare-related areas and about JPY6 billion for development in the environmental field.

Then, rationalization/energy saving/CO_2 reduction accounts for about 19%. About half of this amount is related to CO_2 reduction, and the other half is for investment in equipment to burn biomass in power plants or in turning plastic into fuel. The infrastructure for growth includes investments in port facilities, storage facilities, and other facilities to receive biomass.

We expect to invest approximately JPY20 billion in R&D. This means that we need to prepare the environment for the Electronics Business, including analysis and evaluation equipment, as well as a clean room for the actual use of such equipment. In addition, we will invest in experimental facilities for scale-up, et cetera, as a result of the past five years of work.

Q10: In the Electronic Materials Business, you are planning to increase sales by JPY37 billion over the next five years, but how will it increase and what will increase?
It is difficult to read the large investment in polycrystalline silicon here. Is it correct to say that the large investment is not included, as it is under consideration for the next five years?

A10: As we plan that sales will increase mainly after 2022, the growth rate will curve after the third year. The breakdown. I will give you a rough figure. The main one is IC chemicals, which will almost double from the current situation. Thermal management materials are also expected to grow significantly in terms of value, and we are aiming for JPY20 billion. As for the silicon, we expect it to remain unchanged. As for silica, we plan around JPY20 billion. As for the investment in polycrystalline silicon, we have basically included quality investment, but not expansion investment.

Q11: The price of hydrogen has dropped considerably, because there is now a considerable surplus of electricity generated from renewable energy sources in Europe. How do you think about hydrogen?

A11: It is now competitive, however, if it is required to be green, it is very expensive. In Europe and the US, the price of renewable energy has come down, and so-called surplus electricity is used to produce hydrogen. In China, they are working on the production of hydrogen by making good use of so-called discarded electricity.
In that sense, I think that we, Japan should now consider hydrogen in two ways.
One is high purity hydrogen produced using electrolysis. Hydrogen is produced in areas where offshore wind power or PV power generation is being carried out on a large scale and use it for mobility in the hinterland. I do not think this part of the business will be competitive in the future if it is transported by ship. The government needs to focus more on renewable energy generation.
Another is the conventional products, such as those obtained by extracting natural gas or by naphtha cracking, which are with 80% to 90% purity. I think one of the main points is how to produce cheap hydrogen and use it as a substitute of coal to burn in power plants.

Q12: Carbon pricing is mentioned. Which price per ton are you considering for carbon?

A12: At present, we have not set up carbon pricing. However, at this point in time, I think that EUR40 or EUR50 is the standard in Europe, and in the future, we will have to think about USD100.

Q13: As for the Cement. As the price of coal is very low this year, the base year, I think the profit is forecasted not to increase much in FY2025. If the price of raw materials remains the same, will operating profit be a little higher?

A13: If the price of raw materials remains the same, it will be a bit higher. We are now placing coal at an international market price of USD85 for FY2021 and FY2022. For the remaining three years, we have set the price at USD75.

Q14: It is difficult to raise the price of cement, but you can raise the price of ready-mixed concrete quite a bit. Are any measures to shift to ready-mix concrete incorporated?

A14: That is not incorporated much. Based on the current market trend, it is expected that domestic demand below 40 million tons to become normal. In that sense, we have put a rather conservative view of cement in our figures.

<u>Mr. Yoshida, Mizuho Securities</u>

Q15: I would like to ask about the traditional business, Chemicals Business and the Cement Business. Those are areas that are easily affected by the external environment, so the important point will be how you can make your business structure less susceptible to external influences. The assumption for naphtha in the new medium-term plan is JPY32,500, and it is now over JPY40,000. So, please tell us how we should see the impact of the high cost of raw materials.

A15: Regarding the impact of high raw material prices, our business is always linked with raw materials and naphtha, although there is a slight time lag. If the price of naphtha goes up, the selling price will also go up, and the spread will be maintained. On the other hand, I think you asked how we are going to ensure the profitability of this traditional business. I think we had no choice but to go with the two-pronged approach of the introduction or development of the technology and the efficiency of the operation. We need to improve our processes, so we need to develop and introduce technologies to improve the unit requirement. I think it is very important to streamline operations and minimize maintenance costs by making full use of AI and IoT. Most of the investment in traditional businesses will be spent on such things.
Basically, we would like to pass on the price increases caused by CO_2 measures as much as possible, but unfortunately, from the perspective of international market conditions, I think it depends on the competitiveness of each country and the relationship between supply and demand. Considering that it is difficult for us to pass on the price of our products to the consumers, I think it is basically important for us to streamline our operation.

Q16: Do you have any plans to downsize the business of Chemicals or Cement, or to reduce production capacity?

A16: As for the businesses of electrolysis, caustic soda, chlorine, and hydrogen, we are assuming that we will basically maintain the current scale. As for cement, although the market is mainly domestic, it is expected to decline in the medium- to long-term. Therefore, we believe that the production volume will be adjusted accordingly.

Q17: For example, you have three kilns now, but at some point, you will reduce the number of kilns to two, is that correct?

A17: It depends on the amount of demand, but we are assuming that this will be the case.

Q18: If it is possible, I would like to know if there is any analysis of the factors behind the JPY10 billion increase in operating profit in the new medium-term plan.

A18: I do not have it at hand right now.

Q19: Is it correct to say that the amount of electricity sold is going to be reduced in the future, considering the reduction of CO_2 emissions?

A19: I think it will gradually decrease.

<u>Mr. Azuma, Jefferies Securities</u>

Q20: Regarding A&T. In the growth strategy section on page 18, it says that the company aims to become the No.1 OEM supplier of open, automated bioanalytic testing system through alliances. I think you mean that you are going to change the way you sell the equipment.

A20: Basically, the fourth line of the priority measures, accelerating the development of diagnostic reagents thorough chemical integration, new alliances, and expanding testing area, is the biggest part of our policy. Strength of A&T is the ion-based blood diagnostics that analyzes electrolytes in the blood, which was developed mainly by Tokuyama in the past. We have not heard that A&T had done anything during the COVID-19 pandemic this time, which was very frustrating for us. We should expand the inspection area. The development of test reagents suitable for this purpose is the most significant for future business expansion. The bottom of this page says that we are aiming to be the No.1 OEM supplier of open automated bioanalytic testing system through alliances. Our transport system, which is not linked to reagents, has been well received and is being used in various hospitals. It is used by major companies as a link between various inspection systems. Now, the share of this is gradually expanding in China. We will change the mechanism so that the reagents can be used consistently, one after the other.

Q21: I believe that the future of A&T is promising. The other question is regarding fumed silica. On page 17, the fields you are going to expand are shown, but I would like to ask about your existing business. I think that your current main customers and main market have been sluggish, so how can you rebuild this area?

A21: The existing fumed silica business has actually stopped growing for the past one or two years. We have been particularly good at CMP, which is the process of removing oxide films, and the toner additive. In the area of CMP, the percentage of colloidal silica being used is gradually increasing at the end customers. As for the toner additives, as you know, the copier industry has become very severe, and to be honest, growth has stopped.
As an alternative to this, we need to aim to integrate silica into the field of organic silicones as an application, rather than simply selling silica on its own. Another thing is that, in addition to fumed silica, we also do so-called sol-gel colloidal products. We will increase this area. We are also receiving positive feedback in cosmetics and other fields, so we would like to gradually shift our focus to those areas.

Mr.Sawato, SBI Securities

Q22: I see the fact that CO_2 emissions are originally high as a factor pushing down your company's stock price, so I think setting the target to reduce CO_2 emission and this kind of proactive approach toward such goal are very positive. Due to the cost increase, operating profit will increase only by JPY10 billion, while net sales will increase by JPY65 billion. I would like to ask you about your thoughts on your efforts to prevent global warming as you formulate the new medium-term management plan, and I would also like to know how much the increase in depreciation and fixed costs will be.

A22: As you pointed out, the amount of emissions as a percentage of sales is one of the highest in Japan. We recognize that we need to get out of this situation as soon as possible, and that this in itself will lead to the sustainability of our business. The figures in this mid-term management plan are the result of these efforts. Investment in CO_2 countermeasures has been increasing quite aggressively. Normally, depreciation and amortization is below JPY20 billion, but over the next five years, it will increase from JPY20 billion to over JPY25 billion at one point.