Condensed Transcript of Q&A Session at MGC's FY2024 1Q Results Briefing

Date/time: August 7, 2024 (Wednesday) 18:00-19:00 am (webcast)

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(Note about this transcript)
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Q1: With regard to quarterly trends in segment profit, Specialty Chemicals has reported a dramatic improvement, increasing by \4.5 billion from 4Q of last fiscal year to 1Q of this fiscal year. On the other hand, from 1Q to 2Q you are forecasting a decrease of \3.0 billion. Could you explain trends for the main products and businesses?

A1: From 4Q to 1Q, sales of optical polymer increased, and sales of electronic chemicals, polyacetal (POM), and others increased due to a general recovery in demand. BT materials were level with 4Q due to a delay in demand recovery for certain applications. From 1Q to 2Q, we expect to see a deterioration in profitability of polycarbonate (PC) and POM, as well as a difference due to regular maintenance, resulting in a decrease in operating profit. On the other hand, for BT materials and OPE, we expect an increase in profit due to a continued increase in sales.

Q2: I would like to ask about the three ICT businesses that are expected to grow under the medium-term management plan: electronic chemicals, optical materials, and electronic materials. I understand that the trend in BT materials and OPE for AI servers and demand for electronic materials have yet to fully recover. Can you provide any supplementary information about regional strength and weakness and so forth, such as the effect of the mix and the effect of the price increase of hybrid chemicals for high bandwidth memory (HBM)?

A2: We saw a recovery in BT materials from 1Q, but expectations within the industry were for a full recovery from July onward. In the end, 1Q results were about level with 4Q. There has not been a major decline from 4Q. For 2Q and 2H, we see the newly revised 1H forecast as being highly probable based on the status of orders. For electronic chemicals, in 1Q we were able to confirm a recovery undertone for the overall semiconductor market. Led by fields such as smartphones and AI servers, overall profit increased from 4Q. In South Korea, especially, we saw brisk shipments of chemicals for HBM, used in AI servers, as you pointed out. In Japan, a new fab started up in Kyushu, and shipments of super-pure hydrogen peroxide from the Company have been proceeding smoothly. On the other hand, our subsidiary in the United States continues to experience a slump, and we haven't seen many signs that customers' activity is increasing.

Q3: The profit base for electronic chemicals appears to have risen substantially. Can we take it that this level can be sustained with price revisions and product mix improvements? OPE does not seem to have changed much QoQ. Will it achieve high growth YoY?

A3: For electronic chemicals, more than price revision, the causal factors are an increase in sales of what we call hybrid chemicals for HBM and other applications in South Korea, and an improvement in the product mix compared to our previous mix based on super-pure hydrogen peroxide. For OPE, we explained last time that our initial forecast was somewhat conservative, and it has performed well in 1Q also.

Q4: In that case, can we assume that OPE has been revised upward?

A4: It was not a major forecast revision, but yes.

Q5: Regarding unprofitable businesses, particularly the xylene separators and derivatives business, which is classified as a business requiring intensive management under the medium-term management plan, I don’t think the situation had changed yet in 1Q, but at the foreign exchange rate level in 1Q, even if the market conditions for purified isophthalic acid (PIA) were that bad, xylene separators and derivatives were not performing so badly. Can we take that as the reason why the aromatic chemicals segment achieved the same level of operating profit year on year, despite the deconsolidation of JSP? Also, if this is sustainable, then I think we can expect the ordinary profit margin against net sales to exceed 10% consistently in the aromatic chemicals segment in three years’ time due to the reduction in meta-xylene used for PIA and so forth following an improvement in market conditions and diversification of its applications. What do you think?

A5: For PIA, we are taking a breather for a short while. The competitive environment is as harsh as ever, and we have to admit that in the final analysis, PIA is not sustainable. We still plan to follow the direction explained in the medium-term management plan of growing the derivatives business and downsizing the PIA business when we deem that its role has finished. We are not yet able to project the timeline for this, but we are firmly committed to evolving the aromatic chemicals into high-value-added chemicals.

Q6: I am sure you are staying firmly in line with your policy. But is it correct to understand that at the foreign exchange rate level seen in 1Q PIA is not performing so badly? We are also expecting to see expansion of derivative products and expansion of external sales of meta-xylene, and so forth.
A6: Unfortunately, that is not the case, and even with the exchange rate levels seen in 1Q, PIA was not able to eliminate its losses. Although the losses have narrowed to the verge of profitability, they are expected to remain for the whole year when we consider the burden of periodic maintenance costs and other factors.

Q7: Could you please provide some details on the background to the sharp increase in 1Q profit for the former Specialty Chemicals segment, and the 2Q forecast for a QoQ decrease in profit?

A7: 1Q results were an increase of \4.2 billion from 4Q of the previous fiscal year, mainly reflecting the effect of an increase in profit of about the same amount in optical polymer and POM in Thailand. In other businesses, there was virtually no deterioration. For example, our PC subsidiary in China continued to be firmly profitable. On the other hand, one of the factors for the decrease in profits from 1Q to 2Q is a difference due to regular maintenance. Also, for the optical polymer, we received an extremely large amount of orders in 1Q, but this is expected to subside in 2Q. For POM in Thailand, we also expect a decrease in profits due to increases in fixed costs and high transport costs, coupled with a fall in prices and other factors. In addition, Our PC subsidiary, Mitsubishi Engineering-Plastics Corporation, is also expected to see a decrease as profits are weighed down by several factors.

Q8: Are shipments of optical polymer already beginning to soften?

A8: For the time being, we believe they can maintain their briskness. It is a product that has comparatively high variance in monthly volume, and while we think that 2Q will probably not reach the level of 1Q, we would want you to understand that our forecast is made amid stable orders with none of the massive inventory stockpiling activities of the kind that we have seen in the past.

Q9: 2Q profit for inorganic chemicals is also forecast to decrease from 1Q. Is this due to increase in fixed costs and so forth?

A9: Part of the reason for the forecast decrease is the overlap of regular maintenance at our three plants in Japan associated with inorganic chemicals (Kashima, Yamakita, Yokkaichi). However, on the sale front we are actually expecting a recovery in 2Q and 2H, so we are not overly concerned.

Q10. With regard to electronic chemicals, you mentioned that hybrid chemicals have performed well in 1Q, and that regular maintenance will be concentrated in 2Q, but could you please provide an outlook for 2H? With regard to the timing of regular maintenance at large plants in the United States and South Korea, and the improvement in the sales mix, is this only due to hybrid chemicals, or are there other products that are expected to have a beneficial effect? Please explain in more detail about your forecast for 2H.

A10: Compared to our previous forecast, we expect an increase in profit for electronic chemicals in 2H. There is some regional variation in demand, with weak demand expected in the United States, but strong demand in South Korea. With regard to regular maintenance, at plants that manufacture only super-pure hydrogen peroxide, super-pure ammonium hydroxide, and hybrid chemicals, the cost burden is not large. But at Kashima and Yokkaichi, there is a certain cost burden for regular maintenance as they also manufacture other products. For the improvement in the product mix, the change in weighting for hybrid chemicals and super-pure hydrogen peroxide is significant.

Q11: Could you please explain about the growth in optical polymer in 1Q?

A11: Optical polymer increased both YoY and QoQ. With the YoY result in particular, due to a sharp drop in the previous fiscal year, the growth on a volume basis has been almost double. The factors behind this brisk sales performance were increasing functionality of cameras with higher resolution and increased size of CMOS sensors, which led to an increase in orders for grades with higher functionality.

Q12: Can we understand that optical polymer made a substantial contribution to the increase in profits for the Specialty Chemicals segment in 1Q?

A12: Looking at the YoY result, the former Specialty Chemicals segment recorded an increase in profit of \6.7 billion, and optical polymer in particular contributed substantially. QoQ, brisk performance of POM in Thailand and inorganic chemicals was a factor, but the contribution of optical polymer was also significant.

Q13: Could you explain the growth of optical polymer in the updated forecast, both for 1H and the full year?

A13: The updated 1H forecast includes the 1Q results, and has increased compared to the previous forecast. After adding the amount of this increase, we are expecting higher profits for the full year. However, the reason why the increase in profit for the Specialty Chemicals segment overall is not so large is that we expect a negative impact from the PC business. We in the management team are keenly aware of the gap between the U&P businesses and other businesses.

Q14: With regard to OPE, you had quite a conservative tone until 4Q of the previous fiscal year. With this update, I understood your comments were stronger. Is that because your assumptions were more conservative in 4Q of the previous fiscal year, or because the actual status of the business in 1Q of this fiscal year was stronger than you had anticipated? Please summarize the background to this.

A14: Looking only at the results for 1Q, we may have been a little conservative. However, there is an element of uncertainty in 2Q and 2H, so we have not revised our initial forecast. The performance will also depend on the competition between motherboard manufacturers who use our materials. OPE also has a different value chain structure to BT materials, and we are looking carefully at that as well.

Q15: Could you tell us the YoY and QoQ change in OPE’s 1Q net sales for this fiscal year?

A15: YoY, sales were up by around 30%, and QoQ there was not much change.

Q16: I understand that electronic chemicals are expected to continue a recovery trend from 4Q of the previous fiscal year, through to 1Q and 2Q of this fiscal year. Could you provide more explanation about how the sales trend appears in each region?

A16: First, in Japan we have commenced sales for a new fab of a semiconductor manufacturer, and we are also proceeding with discussions including increasing production capacity in preparation for a planned increase in new fabs going forward, so we believe we can expect further growth. In South Korea, even under the poor market conditions for semiconductors to date, we secured a certain level of demand for super-pure hydrogen peroxide. However, recently we have also had demand for hybrid chemicals for HBM, and we expect this firm demand to continue. In North America, our major customers have experienced a downturn, but we will compensate for this by diversifying our customers, as we have fielded inquiries from other companies to supply fabs that they are planning in North America.

Q17: With regard to electronic chemicals in South Korea, what is behind the emerging need for your hybrid chemicals to be used in HBM as opposed to the usual DDR5?

A17: Without going into details, development of advanced packaging materials called WLP has grown active in post processing as well, and an area is emerging that fuses post processing and pre-processing. Since we have a previous track record in supplying chemicals for both processes, we see this new development as a business opportunity.

Q18: You appear to be expecting a significant increase in profit related to inorganic chemicals this fiscal year. Can we understand that this will have a considerable impact on increasing profits in hybrid chemicals?

A18: That’s right. Actually, it is making up for a slump in sales for North America, where demand has remained weak. With a sizable numerical target in the medium-term management plan, we are grateful that new demand for South Korea and other areas is growing.

Q19: Doesn’t it see that equity in earnings of affiliates could have been a little higher given the market conditions for methanol? I think there must be some foreign exchange loss due to the yen’s depreciation with respect to the JV in Saudi Arabia. Could you tell us the amount of that loss, and describe the operating status of each plant?

A19: We do not disclose figures by site. However, there is some variation and Japan Saudi Arabia Methanol Company, Inc., which has invested in AR-RAZI, has recorded foreign exchange losses on foreign currency-denominated obligations due to the yen’s depreciation, as you have surmised, and that is the reason for recording a negative impact in equity in earnings of affiliates again this time. I cannot provide the specific amount of the loss, but for 1Q it is several hundred million yen. We recorded profits in Venezuela and Brunei, but these were cancelled out across the total for all four JVs, and the final result is not the level of profit that we have seen in the past.