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Q & A's of Analyst Briefing Session for Medium-Term Management Plan

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Presentation Material:

https://www.ube-ind.co.jp/ube/en/ir/ir_library/presentation/pdf/keiei_change_challenge_2016_en_17111521.pdf

Questions:

Corporate management

Q1. I have a question about your approach to investment. If you are not able to generate the profits you expect in your plan, your operating cash flow will shrink. In this case, can you still reach your objective of ¥150 billion? Would you reduce your investments in order to secure free cash flow?

A1. We will prioritize cash flow, so if we don't meet our operating cash flow objective, we will need to consider delaying investments. I envision investments in Active Growth Businesses being implemented as planned, but we may need to adjust investment for maintenance and upgrades in the Platform Businesses.

Q2. Since cash flow will be preserved, do we not need to consider a possible reduction in the dividend?

A2. Even if profits are low, we will prioritize a consistent dividend payment, as we have done in the past.

Q3. You are aiming for return on sales (ROS) of 6.5% or higher in fiscal 2018, but you already reached 6.5% in fiscal 2015. Going forward, what key indicators will you use as you seek to improve performance? Please let me know if you have quantitative indicators.

A3. Return on equity (ROE) is fundamental. ROE was 7.2% in fiscal 2015, and we are aiming for 9% or higher in fiscal 2018. However, ROE can be difficult to assess on a daily basis, so we decided to shift our focus to ROS. In fiscal 2018, routine maintenance will have a ¥5 billion negative impact on our performance. This was not the case in fiscal 2015, so even if the ROS figure is the same, the actual situation is very different. In addition, regarding profitability, we are focused not only on overall improvement but also on improvement in each business.

Chemicals business

Q4. I have a question about the management strategy on slide 9 regarding keeping a strong focus on profitability. I believe the strength of UBE Group's Chemicals segment is hydrocarbon compounds based on the carbon-hydrogen framework which is the basis of organic compounds. In addition, the Group has strengths in creating chemical compounds that could be called organic-inorganic hybrids. These are achieved by introducing elements like sulfur,

instead of carbon, into the structure, to create more options for structural expansion through chemical reaction, and then bonding the hydrocarbon compound with sulfur, silicon, etc.

The market for this field is small, so this is like a collection of trinkets. Therefore, customers don't know which product is making money for UBE, so we can sell them at a high price. If you highlight the function, profitability should increase. But this has not happened so far. How will you increase profits? To achieve ¥20 billion in operating income, you will have to increase sales of these kinds of products in addition to bulk products.

A4. We will focus research and development and capital investment on areas where we can increase profits. We offer a wide variety of products, and to date we have made investments in various areas with a focus on the bottom line. However, with an eye on efficiency, we are changing our investment style to focus on carefully selected themes, without changing the total amount of our investment. But it will take time to see results. The strategy of keeping a strong focus on profitability must be implemented on a group-wide basis, including research and development, not just businesses that manufacture and sell things.

Q5 With so many technologies, how do you decide which ones to focus on?

A5 Last year we integrated our chemicals segments into a single segment. By moving forward with strong communication between the Chemicals segments and our research and development division, our approach of transitioning from "business unit optimization" to "chemicals optimization" is beginning to take root. Also, starting this fiscal year, we are moving toward ensuring that all employees are aware of the profit and profitability of each product as they perform their jobs.

Q6 I have a question about the Chemicals segment. Regarding the goal of expanding operating income from ¥9 billion in fiscal 2016 to ¥20 billion in fiscal 2018, I think each sub-segment will need to grow. Can you provide more quantitative details on how each will grow, including sales price fluctuations and cost reduction efforts?

A6 Looking at operating income growth from fiscal 2016 to fiscal 2018 by business portfolio category, 50% will be from Active Growth Business. Along with the streamlining of caprolactam, we'll also grow, to a certain extent, other businesses such as ceramics and separation membranes (which I didn't cover today). Also, polyimides and electrolytes will start contributing to profits. We've accounted for some decline in sales prices for battery materials.

Nylon and caprolactam chain

Q7 I have a question about caprolactam. You didn't cover it much in the explanation today and I would like to hear more about where you're heading in terms of spread, cost reduction measures, results over three years, and measures for increasing the internal consumption ratio.

A7 First, on a benzene Asia Contract Price (ACP) basis, the spread is assumed to be $750. To improve profitability we will change the manufacturing process for cyclohexanone and manufacture large-crystal ammonium sulfate. We are renovating facilities in Thailand to

achieve cost reductions and will see steady results in fiscal 2018. We will also expand capacity in Spain by 40,000 tonnes during the New Medium-Term Management Plan, which will increase our internal consumption ratio from the current 50% up into the 60% range. When capacity is expanded in Thailand, that rate will reach 80%. There is no change in this stance.

Meanwhile, for our overall caprolactam profit/loss profile, we are aiming to break even across all plants by fiscal 2018. We recognize this will be a challenge, since we have routine maintenance at our ammonia plant in fiscal 2018.

Q8 Other companies are also employing strategies that involve a shift to nylon production. Do you see this creating a situation similar to what exists with caprolactam?

A8 First, more than 60% of nylon is for textile applications. We produce engineering plastics which deliver higher quality. Extrusion applications such as food packages require gas barrier performance. As for injection applications for automotive and other industries, there are always various product development demands. In these areas it is necessary to have the technological and overall capacity to meet customers' needs. The market will not see explosive growth, but since products will be taken up on a consistent basis, I don't see it as very comparable with the caprolactam situation.

Q9 Regarding increasing the profitability of the caprolactam chain, which has the stronger effect: the change in the production process for cyclohexanone, or downstream developments?

A9 They are about the same.

Synthetic Rubber

Q10 My question is about synthetic rubber. As tires are developed to be more fuel efficient and last longer, I believe that optimization of the sidewall portion, which is a specialized application of butadiene rubber, will be important. How many (or what percent of) major tire manufacturers are you collaborating with on research? What is your timeline for expanding supply capacity and increasing the added-value? Please also explain how you will secure supplies of butadiene.

A10 A large share of our joint research is with Japanese manufacturers, and it's relatively small for overseas manufacturers. Since we are delivering our products to all major manufacturers, we will keep working with any company that has a need or request. How to secure butadiene at a reasonable price is the most critical issue for this product, and we are constantly reviewing this. It is not possible to achieve profitability if synthetic rubber is used. However, the production of petrochemical products is expanding around the world, so I believe opportunities exist to secure supplies.

Q11 According to my calculations, butadiene derived from naphtha cracking stands at about 11 million tonnes, and supplies will be insufficient around 2018–2020. Is your company not concerned by this situation because you think naphtha cracking will provide a sufficient supply?

A11 Looking at the situation worldwide, I don't think production will fall that much.

Q12 I think demand for butadiene rubber is at the bottom of a cycle. If the demand and supply situation improves, do you think your profitability will recover to previous levels? In the past, butadiene rubber was not produced in China, but now local Chinese manufacturers are producing it in large volume.

A12 It won't recover to previous levels in terms of profitability. Other than the demand-and-supply balance, there are several reasons for this.

First, previously sales price was determined by a mix of the market for raw materials and costs, but this is quickly moving toward being based on the market for raw materials alone.

Second, the problem of overcapacity in China has not been resolved. Since the butadiene rubber we produce is mainly for specialized products, they cannot be substituted for by generic Chinese products. That does not mean there is no market impact, however. The market for generic products is extremely volatile, and our market position definitely insulates us from those effects.

Q13 You operate the Chiba Plant at full capacity even when demand is weak. Does this mean that, going forward, you can maintain production with limited impact on spreads?

A13 That is correct.

Separator

Q14 Your separator business has not been able to contribute to profits to date even as production increased. How much will separators contribute to profits in fiscal 2018?

A14 The separator business was driven by capital investment. Companies expanded capacity based on consumer demand, but demand has stopped growing and it's no longer profitable. In 2015, demand for automotive applications increased rapidly in China due partly to government policy, and production in Japan, the U.S., and Europe has finally expanded. I believe it will continue to grow. The reasons for poor profitability to date include oversupply that drove down prices and a low operating rate at our plants. We will resolve these issues. In addition, we believe we can improve profitability by expanding growth with a focus on high value-added coated separator films.

Q15 Regarding the plan to expand sales focused on coated separator films, how well are those being adopted by customers? Also, what direction will sales prices go in the future?

A15 Currently we are having difficulty meeting customer demand. The chart on the PowerPoint shows how much we can produce, but there is more demand than that.

Q16 Therefore, as you monitor prices, will you adjust your order volume based on production capacity?

A16 That's how we view it.

Q17 When coated separator films make up half of your sales, what do you expect your profitability and profit to be in this business? Also, does your ¥20 billion forecast for chemicals include that contribution to profits?

A17 Coated separator films are more profitable than basic films. Separators are an Active Growth Business, and we expect they will make substantial contributions to profits.

Q18 My question is about separators for automotive applications. In automotive applications the first generation was mainly dry process, however in the second generation, wet process is increasing except for production in China. For hybrid applications, your company appears to have a high market share, but how is your share among Western manufacturers? Also, from a technical perspective, when coatings are placed on three layers, the separator would seem to become thick. How do you address the need for thinness?

A18 U.S. and European manufacturers don't manufacture their own batteries, but instead use Japanese and Korean made ones. We are also developing materials to target Japanese and Korean battery manufacturers to respond to global market demands. Further, all types of separators will become available: wet, dry, coated, etc. Which will be adopted comes down to a design decision by vehicle and battery manufacturers. We are not planning to obtain market share for separators in every market around the world. We will generate a profit by obtaining a share in certain markets that demand extremely high safety and output.

Q19 There are other companies with profit ratios over 30%. What is the potential for profitability for your company in three years? You can improve product mix by increasing the percent of coated separators. Should we have strong expectations for this?

A19 Yes, you should have strong expectations.

Polyimides, Electrolytes

Q20 You've classified polyimides and electrolytes as Restructuring Businesses. Having the top global market share in an advanced technology field like battery materials while being in the red is extremely rare even when looking at the situation for other companies. All companies focus on and enter growth businesses, competition increases and products cannot be sold for a decent price. I think this is the situation for electrolytes and polyimides.

UBE has unique technologies in niche markets that other companies are not focused on, like fine chemicals and high-performance coatings, and they are highly profitable for you. Regarding the effort to expand sales of coated separators, everyone is focused on battery materials, so do you not think that this will take the same course as polyimides and electrolytes?

How about targeting another niche market? Generating profits with a number of highly profitable businesses with net sales of ¥2−3 billion seems to be a better "low-risk/high-return" scenario when compared with your strategy to date. The idea of entering a market because it will grow does not seem to have worked well in the past. Please let me know your thoughts about this.

A20 Any niche market will have other companies and become competitive eventually. In the case of polyimides and electrolytes, we commercialized before other companies and enjoyed high

profits. Our failure was believing the illusion that a variety of customer needs would drive sales of the product without effort on our part. For polyimides, our expansion, based on sales forecasts, created overcapacity. We didn't operate our facilities fully and recorded an impairment loss. In summary, competition is inevitable. Moving forward, we will expand profits by creating products that leverage our strengths, by pursuing development in more specific areas based on technologies for polyimides, for example.

(1) The reason polyimides are in the red despite having a high market share are, first of all, that we have a large share of the chip-on-film market, but since the market itself is small, our shipment volumes are too small to support profitability. For UPILEX-VT film our share is small, but the market is big, so going forward we will profit through UPILEX-NVT film. Second, since the market for smart phones and mobile phones won't grow, the market for polyimide films is likewise stagnant, creating more competition. Going forward we will expand sales by leveraging our unique strengths.

(2) We recorded an impairment loss for electrolytes in China, where competition has become more intense than forecast. In this market prices won't rise, but we have capacity so we are remaining competitive through production volume.

Q21 A few years ago you entered a joint venture with Samsung to produce varnishes for flexible displays. By doing the upstream work in-house and letting the joint venture handle the high value-added downstream work, you were able to increase production volume, but the positive impact on results has been limited. Since you have the technology, do you think it may have been better to do everything in-house? Is that the optimal business model?

A21 In any business when deciding whether to keep production in-house or use a joint venture we consider future market size and the return on our investment and research and development costs. Samsung, the manufacturer with the largest share of the smart phone market, has the final product for the varnish. They asked us to jointly develop the varnish, so we moved ahead with the joint venture. Considering the significant time and investment required to ramp up production on our own, we chose the joint venture option. I sometimes look back and ask myself if that was the right choice. But reflection on past decisions becomes more valuable if you leverage it in future businesses. The joint venture is an affiliated company accounted for by the equity-method, and we are keenly aware that it is making meaningful contributions to revenues.

Q22 My question is about net sales and operating income by business portfolio. Adding together the Restructuring Businesses of polyimides and electrolytes gives a total revenue increase of ¥11 billion and a profit increase of ¥3.5 billion. In your answer to a question just now you mentioned focusing the polyimides business on areas of strength and that for electrolytes you would compete on production volume. You indicate plans to increase sales for automotive applications going forward, but that application is less profitable compared to high-end

consumer applications. Won't it be difficult to improve revenues with this approach?

A22 First, we recorded an impairment loss in both businesses in fiscal 2015, and this will have the effect of reducing amortization costs by ¥1 billion annually for a few years. Between the two businesses, the polyimides business contributes more to our profits. The reason for the impairment loss in electrolytes was a low operating rate in China. In fiscal 2016 the operating rate will increase and this business will make meaningful contributions to profits. We also booked orders during the previous medium-term management plan, so I am very certain that production and sales will increase.

Q23 Since you are expecting increased sales in both businesses, won't you need additional capital investments?

A23 We are not considering large-scale investments in either business. We previously invested a large amount in research and development for polyimides. Our approach for the New Medium-Term Management Plan is to narrow the focus.

Tyranno fiber

Q24 What is the current situation with Tyranno Fiber?

A24 We have been contracted along with other companies for a joint development project which is commissioned by the national government. We are currently working with the goal of completing a commercialized jet engine application by 2020, and we are bolstering facilities for experimental research and improving production technology. When a marketable product is fully developed, which may take around 10 years, we'll have increased capacity, so this product will contribute to profits.