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Q & A's of Analyst Briefing Session for "Change & Challenge 2018" Management Overview Briefing

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Presentation Material:

https://www.ube-ind.co.jp/ube/en/ir/ir_library/presentation/pdf/keiei_change_challenge_2017_en_17101017.pdf

Investment Plan and Cash Flow Plan

Q1 Could you clarify the company's approach to mergers and acquisitions? Will the company also pursue mergers and acquisitions for platform businesses and other businesses if there are synergies, or is the company only targeting active growth businesses? Or does it mean that the company will pursue mergers and acquisitions for businesses that are relatively smaller in scale but have a high chance of success?

A1 Our mergers and acquisitions will center on active growth businesses. However, these businesses are sustained by our platform businesses, making it problematic if our platform businesses were to decline. We will certainly pursue mergers and acquisitions if they prevent our platform businesses from declining and enable us to secure stable profits.

Q2 You said that investments are slightly behind schedule, which has increased the free cash flow above projections. Although this is a good thing, if it stays that way, the net debt-to-earnings ratio will be about 0.5 times by the end of fiscal 2018. What is the company's position on its financial position and shareholder dividends?

A2 We are satisfied with our current financial position and are not focused on further improving it. However, we want to fully emphasize the efficiency of our investments. The timing of our investments has changed because the business conditions are different from our original projections, but we will still make necessary investments.

The projection in the medium-term management plan was for ¥26 billion in free cash flow, which is actually quite low compared with our past earnings. We set it to a low figure so that we can execute major investments in order to maintain our platform businesses in the Chemicals and Cement & Construction Materials segments for the long term. For example, we have invested in facilities to change the manufacturing process for caprolactam and to deploy an exhaust heat recovery system at the Isa Factory. Neither of these investments is profitable in any way, yet they are necessary for advancing the businesses, so we decided to move forward with them based on the return on investment. That is why we set the free cash flow to such a low figure.

Having said that, our actual free cash flow is slightly higher than we projected, and it will increase even more if we are unable to find any good investments yet are generating profits. In that case, we would also consider acquiring treasury stock as a way to reward shareholders.

Q3 So is it your first priority to invest in growth while maintaining the current financial position and invest in platform businesses as much as possible, and secondarily to consider acquiring treasury stock if there is enough cash flow?

A3 We think we can view the financial position with greater flexibility. We have no baseline for improving our financial position and it also depends on our approach to future investments. We will consider the overall numbers and make decisions.

Chemicals Company

<Engineering Plastics, Caprolactam and Industrial Chemicals>

Q4 The Chemicals Company is projected to increase its operating income in fiscal 2017 by ¥8.4 billion. At first glance, this seems like a large increase. However, the Chemicals Company will save ¥4 billion from regular maintenance not being scheduled for the ammonia plant in fiscal 2017. Furthermore, spreads are expected to improve for synthetic rubber and nylon, and the company is projecting significant growth in battery materials and fine chemicals. The increase in operating income seems small when you consider these factors.

A4 Although there will be savings from not conducting maintenance at the ammonia plant, there are also a number of cost-increasing factors. These include increases in energy cost such as higher coal prices, and price increases for petro cokes used as a raw material for ammonia. The ammonia market in Japan is also poor. We expect that the price increases combined with poor market conditions in Japan for ammonia will cancel out the maintenance savings.

Q5 Caprolactam prices have recently declined significantly. Under the medium-term management plan, the company projected that spreads would be under \$800. Is that level sustainable?

A5 To be honest, we don't know. In fiscal 2016, manufacturers around the world took steps to correct the oversupply of caprolactam. The oversupply was particularly pronounced in the United States and Europe. However, we don't know what kind of pricing strategies are being used by the major caprolactam suppliers in China. We recognize that the Chinese market continues to be a destabilizing factor. If spreads increase due to production increases by Chinese manufacturers, then there will definitely be an oversupply. In that case, the market will worsen rather than normalize. We expect caprolactam spreads to average at just under \$800.

Q6 What are the conditions for the caprolactam market in China, and what are the latest trends among Chinese manufacturers?

A6 We don't know. China's heavy and chemical industry is dominated by large state-run companies that manufacture a lot of other products in addition to caprolactam. We just do not know what criteria the Chinese manufacturers are using to set their prices. However, we expect that environmental issues in China will have a big impact on the market. For example, it is said that environmental regulations in China have been one of the factors that have caused a sharp increase in prices for coal, which is a raw material for caprolactam. The market is also affected by the trends among downstream nylon plants, which we need to closely monitor.

<Battery Materials>

Q7 The company is projecting significant growth for separators between 2016 and 2017. Does this mean that the projects that emerged in the second half of 2016 are close to being realized? Until now, it seems as if the company focused on the Chinese market with its low prices, so that the business was unprofitable. Will the business really improve?

Also, there was growth in electrolytes in fiscal 2016. Is production capacity the limiting factor in realizing overall sales growth for electrolytes?

A7 We will ship a significant volume of coated separator films in fiscal 2017. We do not have any especially large electrolyte projects that we are working on, but there is definite demand for both automotive and storage battery applications. However, the pricing situation for both separators and electrolytes is very severe. Prices will certainly fall, but our net sales projections will change depending on how far prices fall.

Q8 The company is projecting that profits from battery materials will grow significantly in fiscal 2017. Is this growth projection based on improving the product lineup and enhancing productivity?

A8 Yes, that is what we are projecting.

Q9 How are the investments in separator base films linked to the net sales projections? The company is bringing two new production lines for base films online in 2017 and 2018. Is the additional capacity based on projected demand through around 2019 to 2020? Or is it based on projected demand through 2017 and 2018?

A9 As a basic policy, we do not build major production facilities based on projected future demand. The investments in production facilities that we are currently building are based on concrete projections that call for sufficient demand to run the facilities at full capacity by around fiscal 2018 and 2019. We may need to study further production expansion in fiscal 2017, if new projects are finalized that will require us to increase production more.

Q10 This question is regarding the company's allocation of profits. Assuming that coated films command a higher unit selling price than base films, has the company significantly increased its selling price for base films to Ube Maxell Co., Ltd.? Or has Ube Industries increased its profits by shipping higher volumes while keeping the selling price the same, and using equity-method accounting to derive further profits from coated film manufacturer Ube Maxell?

A10 Ube Maxell is a consolidated subsidiary, so all profits are incorporated into our consolidated operating income. The coated films business is only two or three years old, so we will continue to integrate our business with coated film manufacturer Ube Maxwell to further streamline the business.

There is strong demand and pressure to realize cost reductions, for both base films and coated films. We will keep enhancing our cost competitiveness to address this demand, while continuing with development that recognizably adds value over our competitors.

<Polyimides>

- Q11 The company has established a joint venture with Samsung to produce polyimides for flexible displays. Since UBE only supplies the raw materials, won't the company's profits shrink even if display sales increase? If that is the case, can't the company shift to a more downstream business model?
- A11 We use equity method accounting for the joint venture with Samsung, so the profits from the joint venture are not immediately apparent. So far, Samsung has been one of the few manufacturers of flexible displays, but we expect the Chinese market to grow rapidly although it has yet to flourish.
- Q12 Would you say the company has a fivefold or tenfold gap in added value over its competitors, for polyimides for flexible displays?
- A12 It's hard to say. Other companies will enter the market and it depends on how well we can tailor the performance to match the customer requirements.
- Q13 Will it grow into quite a large business, if the company can supply varnishes?
- A13 Yes. UBE's strength is its proven track record. Once the market starts to develop, we think that UBE will be best placed to enter the market.

<Chemicals R&D>

- Q14 Which developing businesses and new businesses does the company see as rapidly developing into products or commercial businesses? Which ones have the potential to develop into major businesses once they are commercialized?
- A14 We believe that lithium titanate (LTO) will shift to mass production relatively quickly. We are slowly making headway with Tyranno Fibers. The timeline for development is quite long, partly because it involves joint development with customers. We expect the business to grow to several billion yen in revenues, although it will take another 10 years to get there. Once Tyranno Fibers are chosen to be used in aircraft engines, it will give the business longevity. That is why we want to take a long-term view of the business.
- Q15 Will the company develop the LTO business as a materials manufacturer, or will it also make batteries?
- A15 We will develop the LTO business as a materials manufacturer.

Cement and Construction Materials Company

- Q16 Coal prices are rising, but declining cement demand in Japan is making it difficult to raise cement prices. Are there no simple fixes to improve the cement and ready-mix concrete business? Or will the business improve somewhat in fiscal 2018 and 2019, due to demand created by the Tokyo Olympics?
- A16 We are revising our original projection for cement demand in Japan, which we announced with the medium-term management plan. Based on the actual demand of 41.78 million tonnes in fiscal 2016, we expect a slight increase in demand to 42 million tonnes. The Japan Cement Association's official projection calls for 43 million tonnes, but we have taken a more conservative view.

The Tokyo Olympics and the various development projects that come with it are proceeding within a restricted timeline, so we are projecting that cement demand in Japan will grow through fiscal 2018. The entire industry recognizes that cement demand will peak in fiscal 2018 and then decline after that. We expect to see the same trend for ready-mix concrete.

The decline in cement demand is partly because of how buildings are being constructed today. While the amount of cement used in foundations has increased in order to meet seismic standards, the framework is shifting from steel reinforced concrete to steel construction, thus using less concrete.

As a result, cement demand in Japan has not grown as much as we expected.

Q17 The resource recycling business is the biggest factor for increasing revenues from the Cement and Construction Materials business. If rising coal prices cause a decline in operating rates for coal-fired power plants, won't this negatively impact the resource recycling business? Such as making it difficult to procure fly ash?

A17 We are approaching the limits for how much waste can be used in each tonne of cement. There is a limited amount of waste that we can use, and fly ash is just one of the wastes that we use. As such, rising coal prices have not had that much of an impact on the resource recycling business. We will continue to increase total processing revenues for our resource recycling business by switching to wastes that are difficult to process, which command higher prices for processing.

Q18 The briefing materials talk about "rapidly adapting to changing business conditions." What measures will the company take in fiscal 2017?

A18 The pace of change in the Cement & Construction Materials business is very slow. Unfortunately, there are no measures that we can take that will have an immediate impact on the business. For example, the benefits from deploying the exhaust heat recovery system at the Isa Factory won't be realized until fiscal 2019, and it will be fiscal 2018 or later until we realize the benefits from building the waste processing facility. However, the business is large enough that we can realize certain benefits by implementing cumulative and detailed streamlining and reducing costs.

Q19 What is the company's approach to increasing cement prices? Cement demand in Japan has not risen, so does it make sense for the company to refuse to increase its cement prices even though coal prices have changed, in effect letting coal prices determine the profits from the cement business? Or is the company waiting for coal prices to further increase before raising cement prices?

A19 I personally believe that it is about time to consider adjusting our cement prices. The actual manufacturing costs for cement are also an issue, but the logistics costs are also significant. Exhaust gas regulations for marine vessels will also become a major issue. We will eventually need to adjust our prices somewhere along the line.

Q20 Is it correct to say that the company is working hard to improve productivity but increased energy costs are far outweighing any of these improvements?

A20 I can't say with complete certainty, but that seems to be the direction we are heading in.

- Q21 What is the company's approach to coal procurement in the cement business? How will the company procure coal to address changing coal prices?
- A21 Our approach to coal procurement is basically unchanged. Even if coal prices are low, we can't purchase large quantities to increase our inventory, because we have nowhere to store the coal. Even if we were to buy futures, the coal futures market is quite small. UBE will systematically and flexibly procure coal based on spot prices and benchmark prices.

Machinery Company

- Q22 UBE acquired the injection molding machine business of Mitsubishi Heavy Industries (MHI). What do you perceive as being MHI's strengths, and how is their business approach different? How will the company realize synergies from the acquisition?
- A22 UBE and MHI both manufacture injection molding machines. UBE's strength is in the US market. We have a manufacturing plant and a good brand presence there. MHI has an overwhelming advantage in Southeast Asia and in the Asia region including China. These respective strengths, when added up, make the business even stronger.
- UBE also has an advantage in the servicing business. One of the key challenges for the business will be to generate revenues by strengthening the servicing business, by targeting customers that MHI has supplied with machinery.
- Beyond that, it will be critical to operate the business as efficiently as possible, since the total volume of products and servicing will increase. Even if the total costs stay the same as they are now, we think we can increase market share and expand the size of the business.
- Q23 You mentioned the company's desire to increase its market share for large machines from seven to 10%. Will the company aim to further raise the profit ratio by further increasing servicing revenues?
- A23 Yes, that is very much what we are hoping for. There are various issues with the servicing business, such as distribution, that prevent us from expanding the servicing business all at once. However, we will do what we can to expand the business.