AGC Inc. Minutes of Briefings on Operating Results for 2Q FY2021

Corporate Communications & Investor Relations Div.

[Overall company]

Q: The operating income plan was raised to ¥180 billion from ¥160 billion. What has changed?

A: We revised our operating income forecast upward to ¥160 billion on April 12, but even after that, the price of PVC in Southeast Asia has remained at a higher than we expected. A major reason for the upward revision is that we expect 2H to also be higher than our initial forecast.

Q: What is the background to the increase in the capex forecast to ¥220 billion from ¥200 billion?

A: We are increasing capital investment in the Chemicals business, mainly in Life Sciences, including the recently announced biotechnology-related M&A in Colorado, USA.

Q: What is the background to the rise in sales in 2H versus 1H in this upward revision?

A: Each segment has its own seasonality, and the market situation is revealing their individual characteristics. In the Glass segment, automotive glass is typically tilted to 1H. Electronics is overwhelmingly tilted toward 2H, so the gap is showing here. Chemicals is slightly 2H-heavy, but there is minor variance between 1H and 2H. Considering this seasonality, the sales growth in 2H is close to what would be expected in a typical year.

Q: What is your outlook for the next fiscal year and beyond, and how do you plan to implement a revision to the mid-term management plan?

A: At the time of the mid-term management plan announcement in February this year, it was still difficult to tell how long the effects of the coronavirus disaster would last. After that, we revised the forecast partly because we have come to understand the situation in the world. We would like to set a new forecast for next year and beyond based on the current situation and the status of the coronavirus disaster. I believe we will be able to present new targets when we announce our full-year results for 2021.

Q: The strategic businesses are expanding steadily, but don't you need a new strategic business field? What areas are under consideration?

A: We always feel the need for new strategic businesses. There are two directions. One is to further explore the existing strategic business areas. In the Life Science field, for example, we entered the gene and cell therapy CDMO market last year. We are also searching for new pillars within the Electronics field. Another direction is to set up a new business domain itself. The mid-term management plan explains that AGC is exploring the environment and energy fields. The world's expectations for these fields are rising, and while in some respects it is considered a risk, in other respects it is a business opportunity. We would like to set up a new business domain as soon as possible and to incorporate it into the next mid-term management plan at the latest.

Q: Regarding shareholder returns, you announced a special dividend, but will you continue to prioritize a payout ratio of 40% over share buybacks when profits become higher?

A: We changed our shareholder return policy when the current mid-term management plan was announced. The policy is to pay a stable dividend with a target payout ratio of 40% and to flexibly implement share buybacks. We have revised up our basic dividend to ¥160 per share to reflect the portion of our overall profit growth this time. In addition, we intend to adhere to our return policy of a dividend payout ratio at the 40% level, and have decided to return the portion of profits temporarily boosted by the extraordinary gain on the sale of the architectural glass business in North America as a special dividend. It is not our policy to pay a special dividend in the event of a similar overshoot in profits in the future. Another option is to buy back shares, considering overall trends in business performance, financial position, and share price. Considering the overall situation, we have decided that a special dividend is appropriate this time.

[Glass]

Q: You believe that the price of architectural glass is on an uptrend, but what is the sustainability of this trend and the forecast for demand by region?

A: Our architectural glass business is doing well in Europe, South America, and North America. The overall sense is that Asia is not doing well and that Japan's recovery is weak. The biggest impact is in Europe due to its large business scale, and demand and price trends there are pushing up earnings. The current price of float glass is neither very high nor very low. It is better not expect prices to rise unabated, but the risk of price decline is getting smaller as manufacturers that have competed with low prices are being driven out of the market. This is because the structure of the industry itself is changing due to changes in management and other factors. Also, the market is not as oversupplied as it used to be, given the status of each company's furnace. We believe that the range of fluctuation in earnings due to market conditions has become much smaller than before. There was a recession after the peak in 2007, and since then we have been implementing structural reforms, and the business environment seems to have calmed down a bit.

Q: In the Glass segment, both sales and profits are projected to decrease in 2H versus 1H. What is behind this?

A: The Glass segment is tilted toward 1H, centered on the automotive glass business, although it is not clear whether it will drop to the projected level in 2H due to the current strong performance. Around March is the demand period for the automotive glass business in Japan and Asia, and shipments increase causing the weighting toward 1H. That is the balance we normally see. On the other hand, the decline in both sales and operating income due to the exclusion of the robust North American construction glass business from consolidated earnings is also a factor in the projected decrease in sales and profit.

[Electronics]

Q: Regarding display glass, competitors seem to be raising their prices, but what are the price trends and future prospects?

A: As explained on the Electronics segment slide, prices increased by a low single-digit percentage QoQ and were flat YoY. Supply/demand has been tight recently and we expect the same to continue with no change in the current situation.

Q: What is the impact of the accident at the display furnace?

A: There was a major accident during cold repair at a furnace in Korea in Q1, and it is now under renovation. We believe we will be able to resume operations by the end of the year, but in Q2 we were unable to provide sufficient supply amid strong demand. As cold repair was originally planned, there was little impact in Q1 due to inventory and other shipments, but shipments were affected in Q2. Supply/demand is very tight, so it is a shame that we cannot ship enough.

Q: What is the status of EUV mask blanks?

A: Demand remains brisk. We still expect our sales of EUV mask blanks to increase 50% YoY, and we expect sales to increase more in 2H than in 1H. There is no change in the plan—we continue to expand capacity. Furthermore, the market continues to expand at a faster pace than we expected when we entered it, due to the expansion of applications such as those for memory and the expansion of application layers.

Q: I understand that it is difficult to procure parts and materials due to the shortage of semiconductors and other factors. Has this had an impact on the Electronics business?

A: There is no direct concern for AGC. Shipments of not only EUV and CMP slurries, but also semiconductor-related products have been steady and have not been affected.

[Chemicals]

Q: What are the supply/demand and price trends for PVC and caustic soda in the Chlor-alkali business?

A: As shown on page 40, the PVC market was at its highest level in Q1 of this year. Spreads have contracted a bit, but are still high and demand is very strong at the moment. Market prices spiked in Q1 due to the cold snap and power outages in North America, but now the facilities that had such problems are returning to normal. However, demand remains high, and it is unlikely that prices will plummet, so we expect to enjoy relatively high spreads. In addition, supply within the Southeast Asian region has not increased and demand remains strong, thus keeping the market tight. Caustic soda prices also bottomed out in Q4 of last year and are beginning to revert, which is also expected to have a positive impact.

Q: What is the progress of capacity expansion in the Chlor-alkali business in Indonesia?

A: In Indonesia, we are constructing a 200,000-ton capacity expansion for PVC. Originally, the plant was scheduled to be on line this year, but due to the impact of the coronavirus, it is now expected to start operation next year. In addition, preparations are underway to launch a major expansion in Thailand after this expansion. We believe that this enhancement will make a significant contribution in the next mid-term management plan.

Q: How is the environmental assessment of the expansion of Thailand progressing?

A: We believe the environmental assessment is progressing well. We want to proceed with it as planned.

Q: Both sales and profits of the Life Science business decreased from Q1 to Q2. What was the cause?

A: In the Life Science business, instead of seasonality, the production method is different from that of ordinary businesses, so quarterly results may fluctuate. The Glass, Electronics, and Essential Chemicals businesses produce a certain product in continuous mass production, while the Life Science business produces a wide variety of products in small lots. Sales and profits will vary depending on what is produced at what time and when it is shipped. When viewed on a quarterly basis, the variation appears significant. In addition, the composition of profits disclosed may be rounded to the nearest 10%. Due to these two factors, the business's quarterly performance looks uneven, but viewed over a longer span, such as six months or a year, it has been growing steadily.

Q: You explained that the ROS (operating margin) of the Life Science business will improve, but what are the factors behind this improvement? Also, is this a business where you can aim for an ROS of 25% or 30% in the medium to long term?

A: The major factor driving margins is the utilization rate relative to the production capacity. In the CDMO business, investment in capacity expansion comes first, so immediately after the investment, the utilization rate is low and margins are also low. From 2019 to 2021, ROS has improved due to better utilization of previously invested facilities. Since this business involves a wide variety of products, it is difficult to explain in general which items have high margins.

Q: What is the advantage of having a leading position in the orphan drug field?

A: There are two major trends in the field of pharmaceutical CDMO. One is that the ratio of biopharmaceutical CDMOs, also known as antibody drugs, to synthetic CDMOs, which have been around since the 20th century, is increasing. The other is that the number of varieties of drugs is increasing because different drugs are needed for each rare disease. These two trends are manifested in the expectations for the CDMO business. In synthetic pharmaceuticals, which have existed for a long time, the percentage of outsourcing to CDMOs is already high, while in biopharmaceuticals, the percentage of pharmaceutical firms that in-source is high. Therefore, it is expected that the ratio of outsourcing to CDMOs will increase, and there are thus high expectations for biopharmaceutical CDMOs.

Q: Of the approximately ¥76.5 billion in intangible assets, how much of it is from the Life Science business? Also, over how many years will these intangible assets be amortized?

A: Intangible assets are booked for each business, but Life Science accounts for a significant portion of the ¥76.5 billion. At the time of acquisition, the Company recognizes items attributable to technology, items related to customer assets, etc., and amortizes them over the period corresponding to their content. Some are amortized over two years, others over as long as about 20 years.

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