

AGC Inc. Minutes of Briefings on Operating Results for 3Q FY2018

Corporate Communications & Investor Relations Div.

[Overall company]

Q1

How can the 15.0 billion JPY downward revision of the operating profit be roughly divided between the third quarter and the fourth quarter?

A1

It is about half each for the third quarter and the fourth quarter. I think that it is around 7.5 billion JPY for each.

Q2

Due to this latest downward revision of financial results, I have a feeling that the profit target for next fiscal year may decline from the previous level. Could you give us a qualitative image of what will happen to the target for profit next fiscal year?

A2

We consider the target for profit under the framework of our three-year (2018 – 2020) Mid-Term Plan. This year, we initially expected operating profit of 130.0 billion JPY, so there is a decrease of about 10.0 billion JPY compared with this. However, raw materials and fuel prices obviously had a big effect, so we believe that we were not wrong strategically, excluding the impact of raw materials and fuel prices. Strategic businesses are also expanding steadily, so we plan to discuss what the concrete figures will be in the full-year financial results next year. We believe there may be no need to make major changes in our direction.

Q3

You gave us a broad explanation of the individual factors involved in the downward revision of full-year operating profit, but about how much has been decreased in each segment?

A3

Each segment fell short of expectations by around the same amount.

Q4

The increase in profit from the third quarter through the fourth quarter is 6.3 billion JPY. Is the Chemicals segment significant?

A4

The Chemicals segment is significant, but we believe that the Glass segment will record similar profit growth.

Q5

Can you explain the trends you see for profit in each segment from the third quarter through the fourth quarter following the recent revision to financial results forecasts?

A5

In the Glass segment, profit for both flat glass and automotive glass usually increases in the fourth quarter more than the third quarter due to seasonal factors and we believe this will be the same for the current fiscal year. In the Electronics segment, profit for electronic materials is usually the highest in the fourth quarter in terms of seasonality. For displays, the third quarter will be slightly stronger than the fourth quarter this year. Therefore, we expect the Electronics segment overall to be slightly weaker in the fourth quarter than in the third quarter. The Chemicals segment has a structure in which the most profit is produced in the fourth quarter. Although we do not expect such a big increase in profit for Chlor-Alkali this year, profit in Fluorochemicals & Specialty Chemicals and particularly in Life Science is forecasted to increase dramatically in the fourth quarter, so profit will rise in the Chemicals segment as well. Accordingly, we believe that the Chemicals segment and the Glass segment will experience modest profit growth in the fourth quarter, and the Electronics segment should be flat or slightly weak.

Q6

Please tell us which issues are due to temporary factors and will recover next fiscal year and which issues you need to monitor the current trends when you look at each segment for the next fiscal year going forward. For example, I think that there are some areas in the Glass segment where you could not really keep up as raw material and fuel prices increased significantly. On the other hand, when are issues such as the changes in the sales mix in the United States and the impact of European exhaust gas standards likely to be resolved and leveled out? Or are they likely to last a bit longer? In the Chemicals segment, are you thinking about increasing profit by increasing volume for Chlor-Alkali and other products? What are the grounds for concern for each segment?

A6

I cannot give you a very quantitative explanation at present, and I may leave the discussion regarding FY2019 until the next conference. However, with regard to temporary factors, European exhaust gas regulations are a temporary issue at the moment for the Glass segment, and we believe that this factor should resolve within the year. Also a considerable

portion of cost increases have occurred due to the rise in European natural gas prices, which rose sharply by about 2 EUR (TTF) in the summer. The impact of this has appeared to a considerable degree, and we think that it will level off eventually because of the abnormal circumstances. It is a temporary problem for the Glass segment.

It should be noted that European natural gas prices were not included in the sensitivity, which we have usually described as an effect of 300 million JPY per 1 USD/BBL(Dubai). As European natural gas has moved without being linked to Dubai crude oil in the past, it has not been necessary to explain sensitivity, but I explained it this time due to the soaring price.

In the Electronics segment, the biggest factor is inventory clearance of advanced function glass as I said earlier. This factor will be gone next year, and conversely will be a factor that boosts profits going into next year.

In the Chemicals segment, market conditions of Chlor-Alkali products remain strong, so we do not consider there will be that much of a deterioration. Likewise, there are no major grounds for concern in Fluorochemicals & Specialty Chemicals, and we consider that there will be a dramatic expansion for Life Science.

It should be noted that we have not planned a major capacity expansion in the Chlor-Alkali business next year, so we do not anticipate an effect from increased capacity.

Q7

Could you explain the current situation regarding the degree of profit contribution by strategic businesses?

A7

Strategic businesses are relatively favorable. The percentage of profit they account for recently increased to 15%. I would like to explain this again at the time of the full-year financial results. Electronics business generates the biggest operating profit, but life science has also demonstrated extremely dramatic growth recently. Mobility business is steady too, but its contribution is still to come in the future in terms of the absolute amount.

Q8

It is calculated that depreciation will increase by 7.2 billion JPY from the third quarter through the fourth quarter. Is this the impact of the Chinese 11th generation facility?

A8

The main reasons for the increase include the power plant in Indonesia and other factors in addition to the investment in the 11th generation facility.

Q9

Depreciation & Amortization has been reduced 5.0 billion JPY for the full year. Is there any connection between this and the 15.0 billion JPY downward revision?

A9

The accuracy of full-year depreciation has increased recently, so we have declined the forecast. It is not directly connected to the downward revision.

[Glass]**Q10**

I'd like to confirm the situation where the operating profit margin in the Glass segment deteriorated in the third quarter compared with the same period in the previous fiscal year (down 5.0 billion JPY). Did you manage to secure profit in line with the previous year or slightly up for flat glass due to price increases? You explained earlier that the sales mix in North America deteriorated, but do you mean that the automotive glass sales deteriorated? The deterioration in the North America sales mix is included in the 4.0 billion JPY deterioration in sales under the factors for the downward revision of the full year results, but how much of this occurred in the third quarter and will it continue in the future?

A10

There was not that much change for flat glass. There are regional differences, and while there were somewhat difficult circumstances in Japan & Asia given the impact of raw material price increases, there was no major impact seen overall. On the other hand, there was a significant decline in profit for automotive glass. As explained earlier, order volumes and shipment volumes were robust in Japan & Asia, but additional costs were incurred to ensure shipment volumes. Thus the increase in shipment volumes did not lead to an increase in operating profit. In North America, there has recently been a sudden shift from sedans to pickup trucks and SUVs, and as our sales portion to sedans in this region is high, we have been quite impacted by this shift. A decline in shipments in Europe has occurred since August due to the problem of compliance with new exhaust gas regulations. Allocation of corporate expenses also increased. We increased R&D investment in order to develop new business, and advertising expenses also rose. As revenues from Glass segment are large, a large share of costs was allocated to the segment.

As to whether this will continue in the future, we believe that the issue of Europe's exhaust gas regulations is a temporary problem. Cost improvements will make full-scale progress in

Europe from the second half of 2019 or 2020 after the Morocco plant starts up. In Japan & Asia, particularly Japan, we were unable to keep up with a sudden increase in orders, and we are dealing with it. It is taking some time, but we believe that things will level out from around the second half of 2019.

Q11

You mentioned the rapid increase in raw material and fuel prices. Are you making effort to pass this increase onto product prices going forward?

A11

We are doing it now, and product prices have increased considerably in Japan as well, but we have not caught up with the increase in raw material and fuel prices yet, so we will have to work as hard as possible going forward. Also in Europe, the hike in the price of natural gas due to the unseasonable weather in the summer has let up, and we believe that the price will level out going forward. However, energy costs are high, partly due to political instability, so we will have to work as hard as possible if this continues. We are still working to raise prices for non-commodity, high value-added products, so I believe that we will be continually reviewing the prices of such products.

Q12

There is an atmosphere in Europe that the economy of the entire region could deteriorate due to factors such as poor car sales and the impact of Brexit. I think that AGC has high exposure in Europe. Could you tell me whether we should be concerned about the impact on the Glass segment?

A12

Sales of automotive glass in Europe are comparatively high, so any deterioration will have a comparatively big impact, but current sales are extremely strong. There are no concerns about shipments. On the other hand, we are aware that manufacturing costs need to be improved as soon as possible. Obviously, were anything to occur due to the political situation in Europe or other factors, it may be impossible to say that there will be no impact, but there has been no impact due to such factors at present. We have been affected by exhaust gas regulations recently, but we believe this is a temporary problem, so we have no specific concerns at the moment.

Q13

In other words, you consider that the slump in automotive glass is temporary and that it will

gradually come back in the future. Is that correct?

A13

That is correct. Costs are a particular problem in Japan and Europe, so this is a problem that we will solve through our own efforts, and we believe that we can solve it. Although we consider that it will take about a year to resolve, we believe that profit will come back once the problem is resolved. In the United States, there has been a significant change in vehicle model types, and we have been forced to consider how to accommodate these vehicle model types. However, sales in the United States are not that high, so we believe we will be able to maintain profit growth if we recover sales in Japan & Asia and Europe properly.

[Electronics]

Q14

You said that the inventory clearance of specialty glass for display applications in the Electronics segment appears in both the results for the third quarter and the forecasts for the fourth quarter, but what is the specific product? What is the impact on profit and loss? Is it reasonable to expect that it will resolve in the second half of 2018?

A14

It is a product called a glass light guiding panel (LGP) used in LCD televisions. It attracted a great deal of attention, and it seemed that it would be widely adopted. However, this did not happen contrary to expectations, so we decided on inventory clearance. I will reserve comment on the amount, but it is a fairly large sum. Recognition of expenses will be completed in the second half of 2018 and will not be carried forward to 2019.

Q15

You said that for displays, you were unable to offset the price decline with improvement in manufacturing cost. Can you give details?

A15

Manufacturing cost is decreasing steadily, however, volume fell slightly. We cannot offset the price decline without a certain volume.

Q16

Will the Chinese facility for 11th generation TFT-LCD glass substrates start operation in the fourth quarter of this year? Or will it be next fiscal year?

A16

We plan to commence shipments at the end of this year.

Q17

Could you explain the year-on-year trends for profit in the Electronics segment separately for displays and electronic components?

A17

Comparing the third quarter with the second quarter, operating profit increased 1.9 billion JPY. The margin of profit growth was greater for electronic components, but there was profit growth for displays too.

Q18

Shipments of electronic components for smartphones declined, but the trend of profit growth will continue into the fourth quarter. Is that correct?

A18

Of course, there is seasonality. Semi-conductor related and smartphone optical materials will continue to remain strong. They will not achieve growth as initially expected, but we think they will remain firm.

[Chemicals]**Q19**

Could you tell us your view on the Chlor-Alkali business? The news release on the revision of the financial forecast mentioned the narrowing of spread among chlor-alkali products as a factor for the downward revision. The forecast for fourth quarter sales prices is said to be virtually flat in comparison with the third quarter. The spot price for caustic soda fell quite a bit in the third quarter. Do you see the worsened spread in caustic soda will recover in the fourth quarter?

A19

The total spread for caustic soda, PVC, and ethylene is important for the Chlor-Alkali business, and we consider this spread should be virtually flat in the third quarter and the fourth quarter. We named as a factor for the downward revision because we believed that the spread would recover a bit earlier, but it was not in line with our expectations. The supply and demand balance remains tight.

Q20

I believe that the decline in the spot price of caustic soda was around June, and there were concerns that it might be reflected in long-term contracts after about six months. Judging from the content of this conference call, there is no need for concern about deterioration in

the spread going forward. Is that correct?

A20

The impact from the decline in the price of caustic soda already appeared in the third quarter, but caustic soda prices are currently stabilizing, so we believe there will be no further deterioration, and this is the assumption for our expected price.

Q21

Looking at the changes in quarterly net sales, sales in Life Science were highest in the first quarter and have fallen in the second and third quarters, but will recover in the fourth quarter. Is that correct?

A21

We forecasted high sales in the fourth quarter, so it is correct that Life Science will record quite large growth in sales.

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