

FY2016 - FY2018 Three-Year Corporate Business Plan Presentation Meeting
Q&A Summary

Date and time: Tuesday, March 8, 1:30 to 2:45 p.m.
Presenter: Masakazu Tokura, President

Petrochemicals & Plastics Sector

Q. In the next Corporate Business Plan, you expect a modest increase in equity in earnings of affiliates. How do you see Petro Rabigh's contribution to profit?

A. As for Petro Rabigh's earnings, we estimate the refinery margin very conservatively. Also, for Petrochemical Corporation of Singapore (PCS), we cannot expect margins on ethylene to be as high as they were in fiscal 2015. Therefore, we expect a smaller increase in equity in earnings of affiliates in fiscal 2018 compared with fiscal 2015.

Q. What do you think about the risk of a further rise in the price of ethane?

A. At the end of last year, the Saudi Arabian government announced a hike in the price of ethane to \$1.75/MMBtu. We think the future direction of the ethane price is affected by crude oil prices. Oil prices are expected to gradually recover, and based on this assumption, we believe the risk of a large increase in the ethane price is small. At present, major international oil companies and other oil prospecting firms are refraining from new investments in oil field development, and production of shale oil is expected to level off at five million barrels a day. Under these circumstances, it is said that crude oil supply and demand will be balanced at below 100 million barrels a day in 2017. The price of Brent crude oil is slightly more than 40 dollars per barrel at present, and I think the price of Brent crude may recover to around 50 dollars or 60 dollars per barrel in fiscal 2018, and to around 70 dollars or 80 dollars per barrel in 2019 and beyond.

Energy & Functional Materials Sector

Q. After the reorganization, the Energy & Functional Materials Sector's operating income in fiscal 2018 is expected to increase by 12 billion yen from the projected level of operating income in fiscal 2015. Which business do you think will contribute?

A. Slide 73 in the presentation shows the business strategy of the Energy & Functional Materials Sector. One of the three priority measures in the sector's action plan is to promptly make the major investment projects profitable. The major investment projects here mean investments in solution styrene-butadiene rubber (S-SBR), diesel particulate filters (DPF), and high-purity alumina. These businesses are all struggling with low operating rates, but we can expect a steady increase in demand for these products. We will strengthen marketing activities, such as building closer ties with customers, to promptly improve capacity utilization.

The second priority measure in the action plan is to shift to high value-added products. We aim to launch new high value-added products mainly for automotive use, as there will be synergy between super engineering plastics, which will be transferred to the Energy & Functional Materials Sector from the IT-related Chemicals Sector in April this year, and advanced polymers, which was transferred to the Energy & Functional Materials Sector from the Petrochemicals & Plastics Sector in April last year. We also intend to increase profits in our business in resorcinol, a main product of fine chemicals.

The third priority measure in the action plan is to accelerate the launch of new products and promptly make them profitable. We will work to develop S-DPF (a filter that removes nitrogen oxides as well as soot by using a catalyst for selective catalytic reduction), CO₂ separation membranes, and next-generation heat-resistant separators. Despite concern about the effect of the diesel emissions scandal on the market, sales of diesel cars have shown a steady increase in Europe. Given this situation, we will work on the development of S-DPF for diesel cars.

IT-related Chemicals Sector

Q. Comparing the business performance of the IT-related Chemicals Sector for fiscal 2018 with that for fiscal 2015, sales are expected to increase sharply, while the increase in operating income is anticipated to be small. What is behind this?

A. Slide 75 shows operating income of the IT-related Chemicals Sector. In the reorganization that will take place in April this year, some businesses of the IT-related Chemicals Sector, which collectively generate operating income of about 6 billion yen a year, will be transferred to the Energy & Functional Materials Sector. Taking into account this reorganization, the IT-related Chemicals Sector's operating income for fiscal 2018 is forecast to be 34 billion yen. Without the reorganization, the sector's projected operating income would be 40 billion yen.

We expect profit margins will decline by about 107 billion yen over three years as the market environment is generally severe for materials for flat-panel displays. We aim to secure profit by offsetting the margin erosion with streamlining effects and higher sales volumes.

We have the largest share of the market for touchscreen panels for OLED displays. Our customer is expected to lead the OLED display market for the time being. We intend to maintain good relationships with this customer and expand the OLED-related materials business.

As for semiconductor materials, the life cycle of ArF resists will be extended until around 2019 or 2020, and we aim to expand sales of this product. The growth market for color resists is shifting from South Korea to China. We will increase sales in China by taking advantage of the strength of dye-containing resists.

The challenge for the IT-related Chemicals Sector is to develop a new core business in addition to the polarizer and touchscreen panels businesses. When the current Corporate Business Plan was launched, we did not expect touchscreen panels to grow into a core business as it is now. At this point, it is difficult to predict what will grow to become a core business. In this industry, where technological innovation is fast-paced, we will make every effort to develop new core businesses during the period of the new Corporate Business Plan by utilizing our technological capabilities.

Q. Please tell us about the development of flexible display materials and the competitive environment.

A. OLED displays are selling very well. A major OLED display manufacturer uses its OLED displays for its smartphones, and also started selling to other smartphone manufacturers. We were asked to increase production of glass-type touchscreen panels, and are investing about 20 billion yen to raise output capacity in South Korea. We are advancing the development of film-type flexible touchscreen panels, and we are ready for mass production, expecting sales to increase significantly in fiscal 2016. In competition with other manufacturers, we aim for the top position in the market for flexible touchscreen panels, with a large market share. The development of window film and barrier film is also proceeding to reach the stage of receiving customer evaluation.

Q. I hear Chinese liquid crystal display (LCD) manufacturers want LCD materials makers to set up production plants in China. I fear that the business environment for polarizing film will be very tough. What do you think of this?

A. As you pointed out, a major Chinese LCD manufacturer plans to use materials produced in China. But if we significantly increase production capacity for polarizing film in China, this may result in an oversupply. Accordingly, we will gradually raise our production capacity for polarizing film for specific fields in China, while increasing production of high-value-added products for displays in mobile devices in Japan, South Korea and Taiwan.

We are a comprehensive materials maker, producing polarizing film, color resists, high-purity wet chemicals, color filters, and aluminum targets. We therefore believe building a good relationship with the major Chinese LCD manufacturer will be highly beneficial for our business. We will continue to promote our LCD materials business in China.

Health & Crop Sciences Sector

Q. With the announcements of the merger between Dow Chemical and DuPont and ChemChina's acquisition of Syngenta, as well as media reports that BASF is considering a counterbid to acquire DuPont, there has been a global reorganization in the crop protection chemical field. What is the medium- and long-term position of your crop protection business? How will you compete in the global marketplace, and how will you position your relationship with Nufarm?

A. As you pointed out, reorganization of the crop protection industry is accelerating. It seems that one of the aims of the merger between Dow Chemical and DuPont is to offer a combination of genetically modified organisms (GMOs) and agricultural chemicals. There is a very large market for GMOs, but investments of over 1 trillion yen will be needed to enter the GMO field of row crops*. We therefore think it is unwise for us to enter the GMO market for the row crop business in the near future. Our strength lies in our lineup of superior agricultural chemicals created by superior R&D capabilities and also having good products in the biorational and crop stress management areas. We will expand our business as a manufacturer of specialty agricultural chemicals by offering a combination of these products.

As we cannot survive only by possessing superior R&D capabilities, we plan to expand our global footprint to promote development, production and sales of agricultural chemicals worldwide. Strengthening our ties with Nufarm is one of the possible ways to expand our global footprint, but our expansion is not limited to Nufarm.

We want to survive as a manufacturer of specialty agricultural chemicals, with R&D capabilities being our core competency, while working to expand our global footprint.

*Crops that can be planted in rows, such as corn and cotton.

Q. In the Health & Crop Sciences Sector, operating income is expected to increase to 86 billion yen in fiscal 2018 from 75 billion yen in fiscal 2015. What is the reason for the increase in income? The global agricultural chemicals market seems to be experiencing a downturn. How would you handle this situation?

A. While an expected decline in selling prices of the feed additive methionine will likely reduce operating income by 13 billion yen, streamlining effects are anticipated to raise operating income by 6 billion yen, and higher sales volumes are anticipated to raise operating income by an additional 24 billion yen. The considerable increase in income due to higher sales volumes is mainly because sales of agricultural chemicals, biorational crop protection products and methionine are expected to rise.

Major agrochemicals manufacturers with global operations are currently having a tough time, with increases in inventory due to unseasonable weather. We are similarly affected, too, but we think it is only a temporary impact. As I explained earlier, we plan to more than double sales of biorational crop protection products over the next five years. We have conservative outlooks about selling prices of methionine, while we expect lower prices of propylene as a raw material and benefits from utilities cost reduction. Sales volume of methionine is expected to increase due to a small expansion of production capacity by about 10 percent in 2017.

Pharmaceuticals Sector

Q. Under the next Corporate Business Plan, the Pharmaceuticals Sector will contribute most to the company's profit growth. Is our understanding correct that you predict an increase in profit of 20 billion yen after factoring in the patent expiration of LATUDA®?

A. As the patent on LATUDA® expires in 2019, it will affect our performance for the fourth quarter of fiscal 2018. In the U.S. pharmaceuticals market, after the patent on an original drug expires, we should expect generic drugs to have about 90 percent of the market share. Our projected profit increase of 20 billion yen takes into account the effect of the patent expiration.

Others

Q. Slide 44 indicates investment cash flow is projected to be 540 billion yen under the new Corporate Business Plan, while slide 36 shows investments of 400 billion yen. What is the difference?

A. The main difference is investment in the Rabigh Phase II Project. Cash outflow of about 1 billion dollars is factored into the cash flow statement.

Q. How do you plan to use up to 300 billion yen in investments in strategic M&A?

A. It was recently reported that Sumitomo Dainippon Pharma plans to invest about 150 billion yen in M&A. We want to use about half of the investments in strategic M&A for the Pharmaceuticals Sector. There are several M&A possibilities, and we have not yet made any decision.

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