Zeon Corporation

Second Quarter of FY2023

Q&A from Results Briefing for Analysts

Date and time: October 28, 2024 (Monday) 15:30-16:45

Participant: President and CEO / Tetsuya TOYOSHIMA

Director & Senior Corporate Officer

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[Overview]

Q: As a result of raising the dividend forecast this time, the dividend payout ratio for this fiscal year will exceed 70%, and the total payout ratio will exceed 100%. Although leverage will increase slightly in the short term, is it assumed that dividends will be sustainable considering medium to long term cash inflows?

A: With respect to dividends and share buybacks, we conduct a wide range of cash allocation simulations based on the business forecast for the medium-term business plan period, and set amounts within the range that we believe is optimal through dialog with investors and shareholders. Although this will increase borrowings in the short term, we do not believe this is a negative in the sense that it will increase leverage.

[Specialty Materials business]

Q: With respect to specialty plastics (Cyclo Olefin Polymer(hereinafter COP) and optical films), please explain why Zeon expects ROIC to be in the mid-20% range for the fiscal year 2035. New investment in COP has been announced, and will ROIC improve as invested capital decreases through declining balance depreciation toward the fiscal year 2035? Or will there be other growth investments planned that will contribute to operating income expansion in the fiscal year 2035?

A: We mainly adopts the declining balance method for depreciation of tangible fixed assets. As the new investment in COP is scheduled to start operation in the fiscal year 2028, it is expected that invested capital will decrease through depreciation toward the fiscal year 2035. On the other hand, particularly in the specialty materials business, we believe there are further growth investments that can be made toward the fiscal year 2035. We are preparing to make appropriate investments at the right time while keeping an eye on the business environment, and we would like to disclose specific investment details, etc., as soon as we are able to do so.

Q: Are other growth investments for downstream areas such as processed products made from COP resin?

A: Looking at it over a long span of 10 years, there may be expansions that are not limited to downstream. The land to be newly acquired in the Shunan area is large, and the investment in COP is designed with a margin in mind, anticipating future expansion of monomers. For example, it will be possible to install the framework and equipment next to the COP plant in which we are investing this time, and we believe this will enable us to increase capacity while keeping investment costs down. If demand rises, we would like to make investments flexibly.

Q: With respect to the specialty materials business, please explain the reasons why financial results exceeded the performance forecast for the first half of the fiscal year.
A: The main factor was optical films, whose shipments exceeded the performance forecast.

Q: Please explain why the performance forecast for the second half of the fiscal year is expected to be down from the performance for the first half of the year for the specialty materials business.
A: The first factor is a suspension of operation in one of the production lines at the Mizushima Plant, which is expected to incur expenses of approximately 1.9 billion yen due to fixed costs during the suspension and equipment restoration costs. The second factor is that, as shipments of smartphones, tablets, etc. tend to be concentrated in the first half of the fiscal year as part of the production cycle, adjustments are expected in the second half as a reaction to the shipments in the first half. The third factor is the revision of the exchange rate to an appreciation yen. (Assumed exchange rates for the second half as of July 29, 2024: US$=155 yen, €=165 yen; assumed exchange rates for the second half as of October 28, 2024: US$=145 yen, €=155 yen)

Q: When are the approximately 1.9 billion yen in fixed costs and equipment restoration costs incurred during the suspension of one production line at the Mizushima Plant expected to occur?
A: These costs are expected to be distributed in the third and fourth quarters. They will be resolved once the plant is back in operation.

Q: With respect to the growth of specialty plastics (COP and optical films) in the medium to long term, how will retardation films and optical lenses applications be expected to grow in the future, while the final demand market for large sized TVs and smartphones is maturing?
A: We expect CAGR of 6% for retardation films for large sized TVs and 7% for optical lens applications. The general market forecast for retardation films is that the growth rate of TVs production volume will slow down and plateau, and we support this view. However, market forecasts by screen size predict that the production volume of large sized TVs will increase, and we expect that the production volume of large sized TVs of 55 inches or more, for which our retardation films are the de facto standard, will increase in the future.
As for optical lens applications, the general market forecast for smartphones is that the growth rate of production volume will slow down and plateau, and we also support this view. However, with regard to smartphones, the performance requirements from customers are increasing as they move towards higher resolution, and we plan to grow while also developing new products.

Q: Please explain a forecast for the shipment volume of optical film for large sized TVs from the first half to the second half of the fiscal year. Also, during the suspension of one production line at the Mizushima Plant, is it assumed that shipments will be possible from inventory and that there will be no major impact to a performance in the second half?

A: For optical film for large sized TVs, we don't expect significant adjustments from the first half to the second half of the fiscal year. In addition, we will ship existing inventories to customers during the suspension of operations.

Q: With respect to battery materials, what are Zeon's prospects for the second half of the fiscal year while shipments for EVs are sluggish?
A: Although the situation regarding battery for EVs remains pessimistic view, EV production in China has not fallen. In addition, ESS production is steady and shipments to China are increasing, so one key point is whether ESS will remain steady. On the other hand, shipments to Europe are sluggish, and the second key point for the second half of the fiscal year will be how this will develop. At the moment, we have a pessimistic view of shipments to Europe.

[Elastomer business]
Q: Please explain a forecast for shipment volumes of general-purpose rubbers (for tires)?
A: Demand for S-SBR is steady, and shipments from the Singapore Plant have increased by about 30% YoY in the first six months of this year. Although demand for products in China is lackluster, demand is recovering in the United States, South America, and Europe, primarily due to replacement demand, and this situation is expected to continue in the second half of the fiscal year. As for other general-purpose rubbers, the Tokuyama Plant is undergoing regular repairs from September to November, and the amount that can be put on the market in the second half of the fiscal year will be limited, so shipments are unlikely to exceed expectations largely.

Q: Please explain a demand trend of HNBR.
A: In the second quarter, some shipments were sluggish due to various circumstances at OEMs. In the second half of the fiscal year, shipments for rigs will be affected by the price of crude oil, but we expect shipments for automobiles to remain relatively steady. We consider that shipments will be influenced in part by the U.S. economy, but we don't expect a large decline.

Q: The soaring ocean freight charges are cited as a factor in the QoQ operating income decline, but they have stabilized compared to three months ago. May this lead to an increase in operating income in the second half of the fiscal year?
A: Although the ocean freight charges have temporarily risen, they are expected to ease from the second half of the fiscal year onwards, and they are expected to decline QoQ going forward.

Q: With respect to chemicals, shipments increased QoQ while consolidated sales declined. What is the reason for this? Also, what are Zeon's expectations for the second half of the fiscal year?
A: Shipment volume and consolidated sales did not move in tandem due to differences in the composition of sales items. On the other hand, we expect that distribution inventory has run its course, especially for SIS, and shipments have started to move forward as demand has returned in North America and Europe. We expect shipments to remain stable in the second half of the fiscal year.

Q: Please explain the factor why Zeon expects 3 billion yen decrease in operating income from the first to the second half of the fiscal year.

A: Main factors are increases in sales expenses, R&D expenses, and indirect department expenses, etc. and the revision of the exchange rate to 10 appreciation yen. In addition, the Asian Butadiene was revised upward for the second half, but naphtha was revised downward. In order to adjust sales prices in accordance with raw material prices, the difference between production and sales has been factored in, as inventory produced in the first half using expensive naphtha as a raw material will be sold in the second half.

Q: Is there room for upside to current performance forecast?

A: As of October 28, 2024, the US dollar is fluctuating between 153 and 154 yen. Our second half performance forecast assumes an exchange rate of 145 yen per US dollar, and if the exchange rate lands at 155 yen per US dollar, this is expected to have a positive on performance. Also, depending on the market price trend of raw materials, there is a possibility of upside if Asian Butadiene remains high.

Q: What will be the scale of the partial production discontinue at the Tokuyama Plant planned for fiscal 2026?

A: We are planning to discontinue 60% of the elastomer manufacturing facilities at the Tokuyama Plant. The shutdown will be phased in from the fiscal year 2026 onwards. There is currently no change to the plan to shut down the E-SBR line first for synthetic rubber.

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