Summary of the Question and Answer Session

Asahi Kasei Corporation Financial Results Briefing for Q3 Fiscal 2022, held on February 8, 2023

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Questioner 1: Profitability is declining in FY 2022, and operating income for Q4 is expected to be less than 10 billion yen, although there may be some special factors. You have explained that you will pursue fundamental business structure transformation for Material. What kind of performance improvement do you aim to achieve in FY 2023 and beyond?

Horie: We are considering fundamental business structure transformation in petrochemicals and related areas. Although we cannot give specifics, we intend to steadily proceed with the study.

As for FY 2023, we expect Material to start the year under a difficult business environment. We aim to generate a certain level of earnings even in such an environment by reviewing our production plan, fixed costs, pricing strategy, and other factors. We expect Homes to remain firm and Health Care to improve its performance.

Questioner 1: Are there any signs of impairment in the separator business, etc.?

Horie: With regard to the separator business, we check for signs of impairment every year and plan to continue to do so in FY 2022 as in the past.

Questioner 2: I would like to ask you about Health Care. Regarding Critical Care, the graph on page 26 of the presentation material shows that the operating income forecast for H2 2022 is below the level before the positive impact of the increased demand for ventilators due to COVID-19. I believe that the impact of temporary factors is significant, but to what extent was this factored into H2 2022? Also, I believe that synergies from acquired businesses will emerge in the future, but what is your view on the timing of the recovery exceeding the level prior to COVID-19? May I assume that it will return in H1 2023, or will it take a little longer?

Regarding the Health Care business category, your mainstay products appear to be performing well, but if there are any other major developments, please let us know.

Otsubo: With regard to Critical Care, in FY 2022, there was the impact of the temporary positive factors occurring in the previous year such as the effect from surge in demand for ventilators and the accounting treatment on the acquisition of Respicardia, as well as the impact of the consolidation of Itamar. We expect Respicardia and Itamar to grow in the future, but it will take some time for them to contribute to profits, including amortization of goodwill.

As previously reported, the existing business has been significantly affected by difficulties in parts procurement, mainly semiconductors, for defibrillators since Q4 2021, resulting in a decline in shipments and an increase in procurement costs. However, this situation bottomed out in Q4 2021 and has been improving every quarter, and is expected to continue to improve in FY 2023.

Orders for defibrillators saw a decline in Q3 2022 as medical institutions, mainly in North America, refrained from purchasing defibrillators and other equipment against the backdrop of the economic slowdown. However, orders are expected to improve in Q4 and are expected to continue to improve into FY 2023. Based on these factors, we expect operating income growth in FY 2023 for Critical Care.

Sato: I will now explain our pharmaceuticals business. As described on page 34 of the presentation material, sales of mainstay formulations have been firm. Sales of Teribone increased by 1.8 billion yen year-on-year in the cumulative period for Q1–Q3 2022, and Kevzara and Plaquenil also grew steadily. Although a generic of Teribone was launched in September 2022, we believe that its impact on overall Teribone sales is limited and within our initial expectations. The shipments of autoinjectors also grew steadily, and overall sales of Teribone increased. We expect a similar development in Q4.

Otsubo: I would like to explain Veloxis' Envarsus XR. Sales are steadily increasing, with a 31% year-on-year increase in the cumulative period for Q1–Q3 2022. As we have said in the past, they have been acquiring new patients steadily, and we expect this trend to continue into FY 2023.

In the medical devices business, sales of the mainstay product Planova temporarily declined year-on-year due to a drop in demand related to COVID-19, but from Q2 to Q3 and from Q3 to Q4, demand for conventional biopharmaceuticals and plasma derivatives grew, leading to an increase in sales. As for Bionova, the biologics CDMO acquired in FY 2022, although it will take some more time before it contributes to profits, we have recently decided to quadruple its production capacity in response to steady inquiries from customers, and we expect it to grow over the long term.

Questioner 2: What about the timing of the recovery of operating income of Critical Care to the level of FY 2019, before COVID-19? Although there is a significant impact by amortization, etc. from the acquisitions, but I believe that these were assumed to be covered by synergies and other factors. Is it correct to assume that it will recover in FY 2023?

Also, the amount of intangible assets generated by the acquisition of Bionova is nearly 40 billion yen, and I expect there will be a negative factor in operating income of about 4 billion yen per year, at the beginning, related to Bionova due to amortization, etc. Is it correct to assume that it will be profitable from around 2025?

Otsubo: As for Critical Care, we do not yet have established plans for FY 2023 and beyond, but we believe there is a possibility as you mentioned.

Regarding Bionova, despite the impact of amortization as you pointed out, the CDMO market is growing at a CAGR of about 12%, and we expect further growth, especially for next-generation antibody drugs, in which it has strengths. We believe that the company can steadily grow and turn profitable in a few years.

Questioner 3: Looking at page 39 of the presentation material, operating income for Material decreased from Q2 to Q3 and Q4, and is expected to be a loss of 7.5 billion yen in Q4. Please explain these quarterly changes. I would also like to know the operating rate and price spread of acrylonitrile (AN).

Takahashi: I will explain about Environmental Solutions. Although operating income decreased from Q2 to Q3 and Q4, the general trend has not changed, with demand falling more than expected due to the economic slowdown. In addition, feedstock prices have been falling in H2, continuing from H1, which results in an inventory valuation loss. On the other hand, some products, including AN, are experiencing worsening terms of trade due to higher feedstock prices and lower sales prices. Some products are experiencing lower capacity utilization due to lower sales volumes and inventory adjustments, and the combination of various such factors has resulted in decline in operating income.

The operating rate of AN was in the 70% range, and we continue to adjust the rate while monitoring demand. The market prices in Q3 were $1,513/ton for AN and $873/ton for propylene, for a spread of $640/ton, which was slightly lower than the previous forecast assumption of $700/ton. For Q4, although we need to closely monitor the situation after the Chinese New Year, we are assuming $1,500/ton for AN, $900/ton for propylene, and a spread of $600/ton.

Onodera: Let me explain the separator business. The shipments of LIB separators have been recovering from Q2 through Q4 as customers' semiconductor and component shortages have been resolved mainly for automotive applications. However, for consumer electronics applications, mainly smartphones, shipments improved from Q2 to Q3, but are expected to decline in Q4 due to the slowdown caused by the spread of COVID-19 infections in China since December.

Operating income was negatively affected by production adjustments due to high inventory levels since H2 2021, as well as an increase in amortization of goodwill from the acquisition of Polypore from Q2 to Q3 due to the depreciation of the yen. In addition, the separator for lead-acid batteries continued to be affected by the high feedstock prices from Q2 through Q4.

Yamaguchi: In Mobility & Industrial, from Q2 to Q3, we have been affected by the decline in shipments due to the economic slowdown in China, Europe, and other regions, as well as by customers' moves to reduce inventories for home appliance applications, etc., mainly in China. In addition, our own efforts to reduce inventories have also led to a deterioration in capacity utilization. The situation will not change significantly in Q4, but we expect a slight increase in operating income from Q3 due to progress in price pass-through of costs, a slight increase in shipments due to a gradual improvement in the semiconductor shortages, efforts to reduce fixed costs, and other factors.

Igarashi: In Life Innovation, demand for our company has been declining from Q2 to Q3 and Q4, especially in Digital Solutions, as customers' operating rates have dropped due to the globally sluggish demand for devices such as smartphones and PCs, and for industrial equipment. There are still no signs of recovery in Q4, and we expect operating income to decline from Q3 due to the Chinese New Year and other factors. Comfort Life is also expected to see a decline in operating income centered on consumables, where shipments are declining due to seasonality.

Questioner 3: Operating income in Basic Materials declined by 5.4 billion yen from Q2 to Q3, but you said the operating rate of AN did not changed much. What is the reason for the decline?

Takahashi: As for AN, there was a maintenance turnaround at our production site in Korea in Q3, and the shutdown period was slightly longer than usual, including as a means of inventory adjustment. While the sites are operating, the utilization rates were at about 70%, but we adjusted the operation in such a way. In addition, terms of trade have deteriorated in some areas in response to market prices. Due to the decline in feedstock prices, the inventory valuation loss also has a larger-than-expected impact on operating income.

Questioner 3: In the current medium-term management plan (MTP), you have a policy for Material of prioritizing profit stabilization centered on petrochemical-related businesses and increasing the composition of high-value-added businesses, but its performance appears to be deteriorating considerably in response to sluggish business conditions. It appears that you are adjusting operations more than the decline in demand for many products, but even so, the decline in operating income has been significant, and Material as a whole is expected to be in the red in Q4. What are your thoughts on this situation? What are your prospects for improvement?

Takahashi: Basic Materials is expected to remain in the red in Q3 and Q4, and as you have pointed out, this is partly due to the impact of efforts to reduce inventories accumulated in H1 through capacity utilization adjustments. In addition, we expect many factors that will worsen operating income in H2, including an increase in fixed costs and inventory valuation, etc. FY 2023 is expected to start in a difficult environment due to the uncertain outlook for demand. We are currently formulating a plan on how to increase profits under such circumstances. We will continue our efforts to improve profitability.

Questioner 4: On page 24 of the presentation material, I see the factors behind the downward revision of operating income forecasts for Health Care. What is the order of magnitude of the impact with respect to these? In addition, please elaborate on the expected timing of the customers' inventory adjustments settling down for Planova, the reason for the delay in Bionova sales, and the status of declining demand for defibrillators against the backdrop of the economic slowdown.

Sato: With regard to the pharmaceuticals business, in addition to the delay of the planned licensing income into FY 2023, the shipments of Teribone are not expected to reach the previously forecasted level. As explained earlier, the decline in the conventional formulation of Teribone was offset by the autoinjector, but was affected by the competing drug, as well as COVID-19.

Otsubo: As for the medical devices business, shipments of Planova are expected to fall short of the previous forecast due to temporary inventory adjustments by customers, etc. As for Bionova, orders are strong, but sales are lagging due to the current economic slowdown in North America, which has caused some customers to push back their projects.

As for Critical Care, the main reason is that orders for defibrillators for professional use have fallen sharply due to the economic downturn. In terms of the impact on operating income, in addition to the decline in sales, there are also lower capacity utilization and a deteriorated product mix, with defibrillators for professional use decreasing and AEDs increasing.

Questioner 4: Regarding the downward revision of ¥3.3 billion in the Health Care business category, is the delay of licensing income a significant factor? Also, is it correct to assume that the customers' inventory adjustments will be settled down and shipments will recover in Q4 for Planova? Regarding defibrillators, although Q3 was temporarily sluggish, is the situation improving currently?

Otsubo: As for the Health Care business category, the downward revision in the medical devices business is more significant, with Bionova having a particularly large impact. As for defibrillators, we believe that the decline in orders bottomed out in Q3, and we expect an improvement in Q4. However, the situation should be closely monitored as it depends on economic trends in North America.

Questioner 5: You have explained the temporary factors regarding the deterioration of operating income in Basic Materials, but I'm not optimistic about the situation in FY 2023 either. From your company's previous explanations, I had the impression that the fundamental business structure transformation of petrochemicals-related would target a relatively small businesses within Material, but are we shifting your policy toward a more drastic measures than that? Also, what is the time frame for the effects to be seen? Please tell us to the extent possible whether your aim is to improve the deficit or ROA.

Horie: We have not changed our policy of the fundamental business structure transformation envisioned in MTP. The initiatives for the strategic restructuring businesses that we have been pursuing since the previous MTP were focused on relatively small businesses, but in the current MTP, we believe the fundamental business structure transformation is necessary, and we have started working on it.

It is difficult to say what the time frame will be, and it will take some time from agreement to implementation, but we would like to start by drawing up a basic design. One of our major aims is to reduce our exposure to fluctuations in the Chinese economy, and we will consider a fairly broad range of target businesses. Although we cannot provide information on the status of individual negotiations, we would like you to understand that there are no major changes in our approach.

Questioner 5: Could there be a significant impact on the balance sheets?

Horie: That is correct. Our management has traditionally been rather flow-focused, but we believe that strengthening the balance sheets is also a major issue, and we will work to improve it.

Questioner 6: Regarding the Homes business category, you didn't change the operating income forecast for FY 2022 this time, but the orders in order-built homes in Q3 showed a lower year-on-year change rate than the previous forecast for H2, and although January saw a 10% increase year-on-year, I do not think the situation in February and March is very optimistic either. Under such circumstances, what measures are you considering for FY 2023? Regarding materials, lumber prices are falling, but steel prices remain high. Also, as for overseas operations, you have explained that there is no major concern about the North American business because you are operating in areas where the population is growing, but today you mentioned that the construction starts in North America are decreasing. Is the situation more difficult than you had expected?

Kume: As shown on page 32 of the presentation material, orders received were −7.3% year-on-year in H1 and −10.8% year-on-year in Q3. In the previous forecast, we had expected a year-on-year increase of +2% for H2, but we revised it downward to −3.8% based on the Q3 results. As noted, January saw a 10% increase due to strong orders for high unit-price properties, but the forecast for Q4 is +2%, resulting in a full-year forecast of −5.7%.

For FY 2023, these declines in orders will have a negative impact. However, we hope to improve operating income by continuing the marketing strategy of focusing on larger and higher value-added properties and reducing fixed costs, etc. The plan for FY 2023 is currently being formulated. As for materials, steel prices remain high, but we are continuing to reduce costs to offset the impact of material prices as much as possible.

In the overseas business, due to inflation and rising interest rates, the number of construction starts in the U.S. as a whole is down approximately 20% from the previous year, and even in our operating areas with a growing population, our client builders are adjusting their construction starts, which is having an impact on us. However, the interest rates for a 30-year mortgage fell to 5.9% in January 2023 after reaching 7.2% in November 2022. We are keeping a close eye on various situations for the U.S. market.

Questioner 6: For FY 2023, even if the order situation in order-built homes does not improve, do you think that the business performance will not deteriorate that much taking the real estate business into consideration?

Kume: In FY 2023, although the construction volume is expected to decrease in order-built homes, the Homes business category as a whole aims to contribute to earnings, as real estate plans the sales of large condominiums and the overseas business expects a recovery in Australia.