堺化学工業株式会社

Sakai Chemical Industry Co., Ltd.

Q2 Financial Results Briefing for the Fiscal Year Ending March 2023

November 29, 2022

Event Summary

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[Venue]	Webcast
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[Participants]	
[Number of Speakers]	2 Toshiyuki Yagura — President Representative Director Atsuya Nakanishi — Senior Managing Director

Presentation

Moderator: Now it is time to start Sakai Chemical Industry Co., Ltd.'s financial results briefing. This briefing will be a hybrid of on-site and live-streamed sessions.

First, I would like to introduce two speakers from the Company. Mr. Toshiyuki Yagura, President Representative Director. Mr. Atsuya Nakanishi, Senior Managing Director.

Today, President Yagura is going to give a presentation. After the presentation, there will be time for a question-and-answer session for the audience at the venue. Afterwards, we will take questions from those who are participating online for as long as time permits.

Well then, Mr. Yagura, please go ahead.

Yagura: We have acrylic panels, so I will remove my mask.

Once again, I am Yagura, President. This is my first time to speak at this type of event. Thank you.

Five months have already passed since I took office in June. Since then, we have been accelerating our efforts to address the many issues we are currently facing.

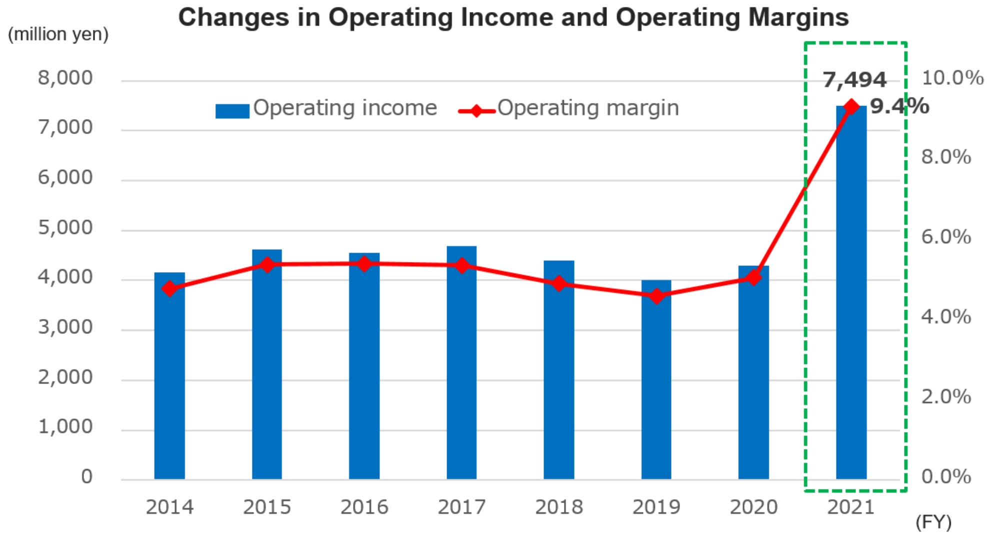
As we have already announced, H1 has not been good. Mr. Nakanishi, in charge of IR, will explain the details later.

As you can see, today's contents are as follows. I will be in charge of this topic and Nakanishi will explain topics two through five.

Now, we will begin the presentation. I would like to reiterate our business activities under the title of Review of Business Performance and Challenges.

Here we will discuss how our business is doing now, how our efforts to date are bearing fruit, what we have improved, and what issues we have.

Operating income for FY2021 exceeded the 4 billion yen mark



Operating income 4 billion yen range -> 7 billion yen range

Operating margin of about 5% jumped to the 9% range

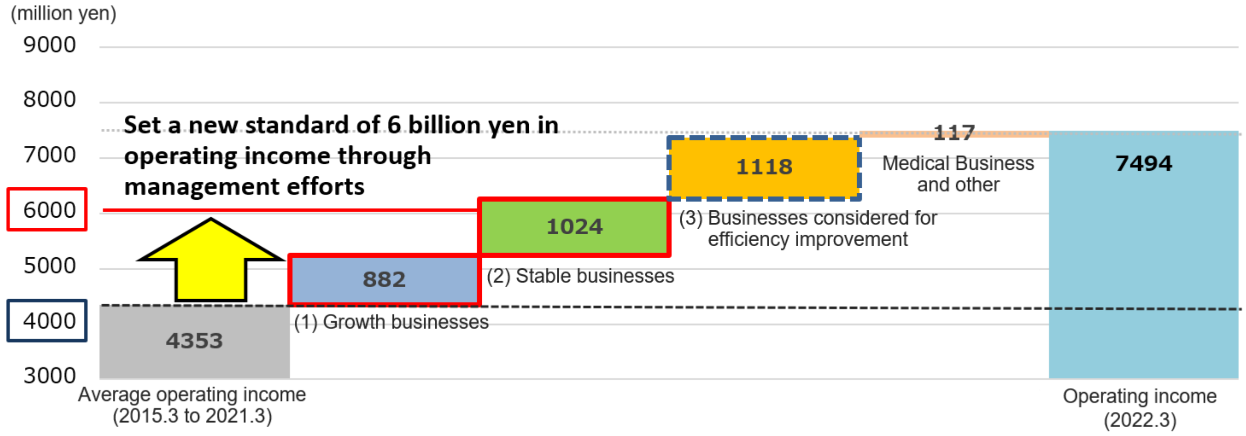
4

Now, please see the slide. Operating income for FY2021 crossed the JPY4 billion barrier. Here is a graph showing this.

The blue bars show operating income by fiscal year. From FY2014 to FY2020, the blue bars have remained almost flat.

But look at FY2021, which is circled by the dotted line. Operating income was roughly JPY7.5 billion, and the operating margin, shown in the red line graph, exceeded 9%. I will now explain how this happened.

Breakdown of Growth in Operating Income for FY2021



* (1) Electronic materials and cosmetics materials (2) Organic chemicals, contract processing, hygienic products
(3) Titanium dioxide and zinc products, plastic additives, catalysts

<u>(1) Growth businesses getting back on track + (2) Stable businesses raising their bottom line resulted in an increase of about 2 billion yen</u>

Toward Further Growth

- **(3) Businesses considered for efficiency improvement are susceptible to market conditions. Proceed with review to ensure stable earnings**
- **Further expand growth businesses**
- **Support businesses considered for efficiency improvement**

5

Here is a breakdown of the growth in operating income for FY2021.

First, on the far left, JPY4.3 billion in gray. This is the average operating income for the seven-year period from FY2014 to FY2020. With this as a launching pad, we have achieved JPY7.5 billion, with growth in the growth businesses, the stable businesses, and the efficiency study businesses.

Let’s take a look at the breakdown. First, the JPY880 million in blue represents the increase in the growth business. This corresponds to electronic materials/cosmetics materials as shown in item one with an asterisk.

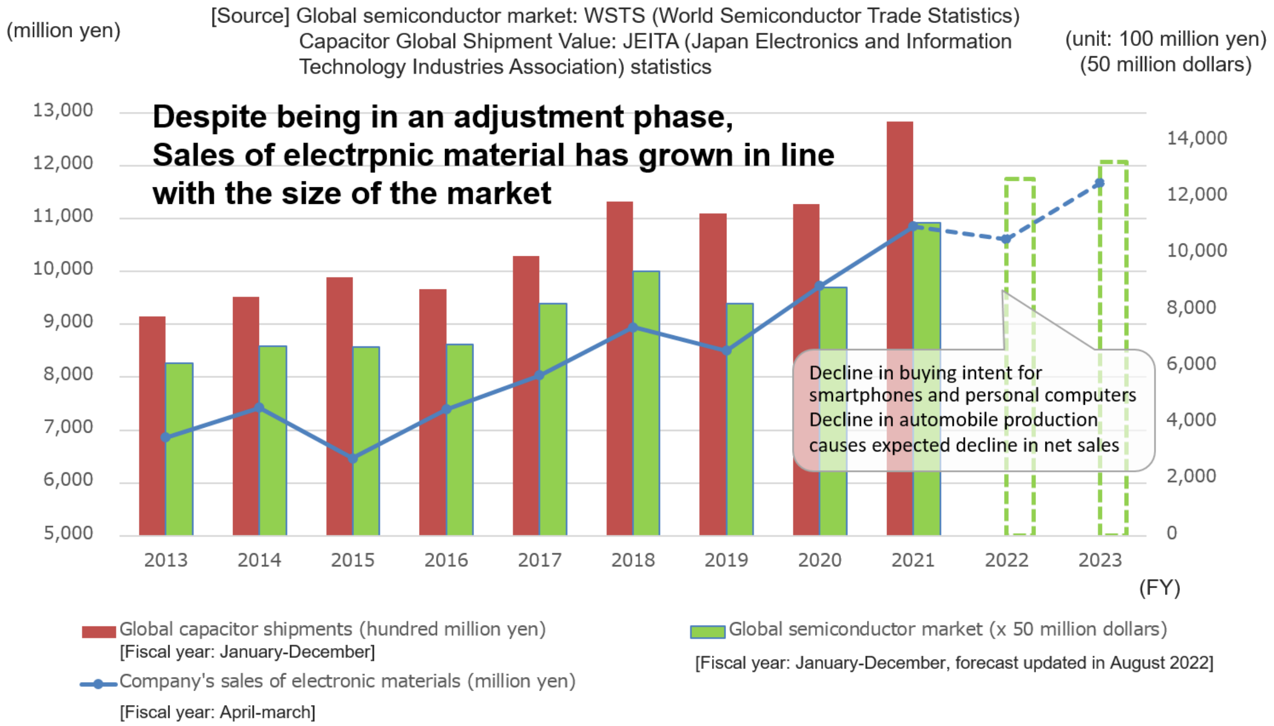
The green portion to the right of this amount, JPY1.02 billion, is the increase in the stable business. Organic chemicals/contract processing/hygienic products fall under this category.

We believe that the possibility of a large downward swing in the future is small for this blue and green JPY2 billion increase.

Lastly, approximately JPY1.1 billion in orange is for the efficiency study business. Titanium dioxide, zinc oxide/plastic additives, etc. fall under this category. What makes this business unique is its deep penetration into a wide range of industries. Therefore, growth will be linked to the domestic economy. On the other hand, there is a weakness in that it is not expected to grow independently of the economy. Therefore, securing profit is an issue and it is positioned as an efficiency study business.

Sales of electronic materials grew in line with the growth of the semiconductor and capacitor markets

Growth businesses



The following is an introduction to each of our major businesses.

First is the electronic materials business. This is one of our growth businesses and consists mainly of dielectrics and dielectric materials for monolithic ceramic capacitors. Our sales of electronic materials have grown along with the growth of the semiconductor and capacitor markets.

Let's take a closer look at the graph. The blue bars on the left side show the global shipment value of capacitors. To the right of it, the green bars show the size of the global semiconductor market. The red line shows our electronic materials sales.

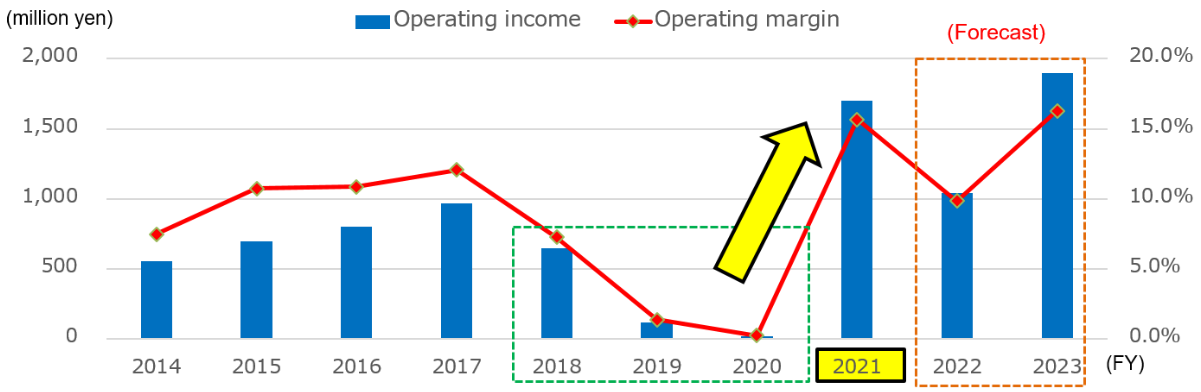
Compare the blue and green bar graphs. The movement is almost the same. Our electronic materials are generally growing steadily in line with the size of the market. However, we are forecasting sluggish growth in FY2022.

This time, it is particularly noticeable in consumer applications. Uncertainty about inflation and the economic outlook has reduced the desire to purchase smartphones and computers. Also, the Chinese market is cooling down due to the Chinese lockdown. These factors have led to a slowdown in orders for capacitors.

However, we see growth potential for the future. This is because the market is expected to grow further in the future as more capacitors are used in the spread of electric vehicles, the evolution of automated driving technology, and the advancement of metaverse and DX with faster communication speeds.

Weak elements in electronic materials will be eliminated in FY2021

Growth businesses



FY2018: In dielectrics, past high-end products have become obsolete, and competitiveness declined due to delays in the development of new products

FY2019: In dielectric materials, upfront investment in anticipation of increased demand caused an increase in the depreciation burden and a decrease in profit margin

FY2020: Due to the spread of remote work, the shipment ratio of general-purpose products increased, and the product mix worsened (became less profitable)

FY2021: (1) Mass-production and sales of high-end dielectric products began
(2) Dielectric materials, for which we expanded facilities, received user certification and the utilization rate increased
(3) Improved product mix through price corrections and increased the sales volume of high-margin products

From FY2022 onward: A decline in demand will cause a temporary drop, but growth is expected in the mid- to long-term

7

This slide shows the operating income of electronic materials in chronological order. This graph shows that the uncertainty in electronic materials was dispelled in FY2021.

The blue bar graph shows the amount of operating income and the red line graph shows the operating margin. I told you that the sales shown on the previous slide were generally favorable, but the operating income here is clearly not moving in the right direction. Let me explain why this happened.

Please see the graph from left to right. From FY2014 to FY2017, the Company made relatively steady progress. However, we can see a significant downturn in the three-year period from 2018 to 2020, circled by the green dotted line. Why is that? The reasons for this vary from year to year.

First, in 2018, there were delays in the development of dielectric high-end products. Profitability deteriorated due to the inability to create new products amid the intense turnover in the pursuit of performance.

Next is 2019. Amortization of the capital investment made to grow dielectric materials begun. This further worsened profit margins. However, this was factored in from the beginning.

In FY2020, it was even worse. Telework became widespread due to COVID-19. I am sure it was the same at your companies. So the sales volume of PCs and WiFi devices for general household use increased rapidly, and sales of our own materials increased as well. However, the profit margin conversely deteriorated due to an increase in shipments, mainly of general-purpose grade products with low profit margins.

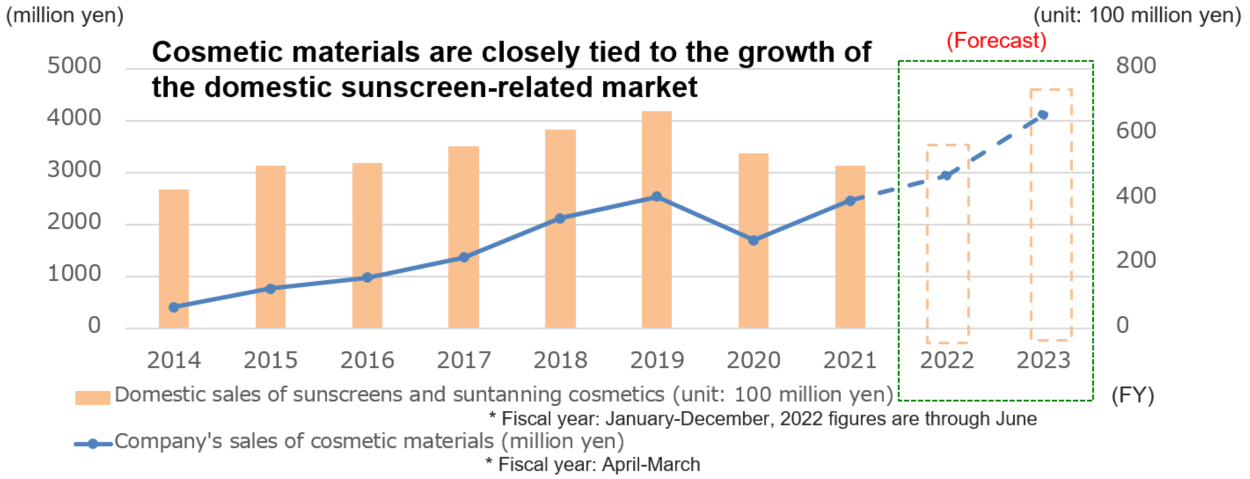
Thus, during the past three years, sales of low-margin graded products have only increased and high-profit products have not been nurtured. Depreciation associated with capital expenditures increased. All of these factors combined to cause a significant decline in profit margins.

But look at FY2021. As the yellow arrow indicates, operating income improved significantly and quickly. There are three reasons for this, which are described here. The recovery of the world economy has increased demand, and the factory utilization rate of dielectric materials has improved. Sales of high-margin products increased, and price adjustments also bore fruit, resulting in an improved product mix. Also, mass production and sales of new high-end products began. Those three factors are the reasons.

So what will happen in the future? The red dotted line is the forecast for the current FY2022. As explained in the sales trend, we expect sales to decline this fiscal year due to an adjustment phase, but we expect the related market to grow in the medium to long term. We have already made the necessary capital investments that we made during the difficult times, and we have the capacity to increase production. We believe that both sales and profit will grow significantly in the future.

Cosmetics materials sales grew along with the domestic sunscreen market

Growth businesses



Source: Ministry of Economy, Trade and Industry Chronology of Production Dynamics (domestic sales of sunscreens and suntanning cosmetics)

- Sales were growing steadily, driven by inbound demand
  -> Significant delay in growth due to the disappearance of inbound demand caused by COVID-19

Toward Further Growth

From FY2022 onward, the following trends are considered opportunities to boost business performance

(1) Further easing of restrictions on going out

(2) Recovery of inbound demand

(3) Expansion of replacement of organic UV absorbers with inorganic UV absorbers (growing environmental awareness)

8

Next is cosmetics materials. This slide shows that sales of cosmetic materials have grown along with the domestic sunscreen market.

First, the orange bar graph shows the overall sales of sunscreen cosmetics in the domestic market. The blue line graph shows sales of our products. You can see that the bar and line graphs show similar movements. Thus, sales of our products have been closely tied to domestic market conditions for sunscreen cosmetics.

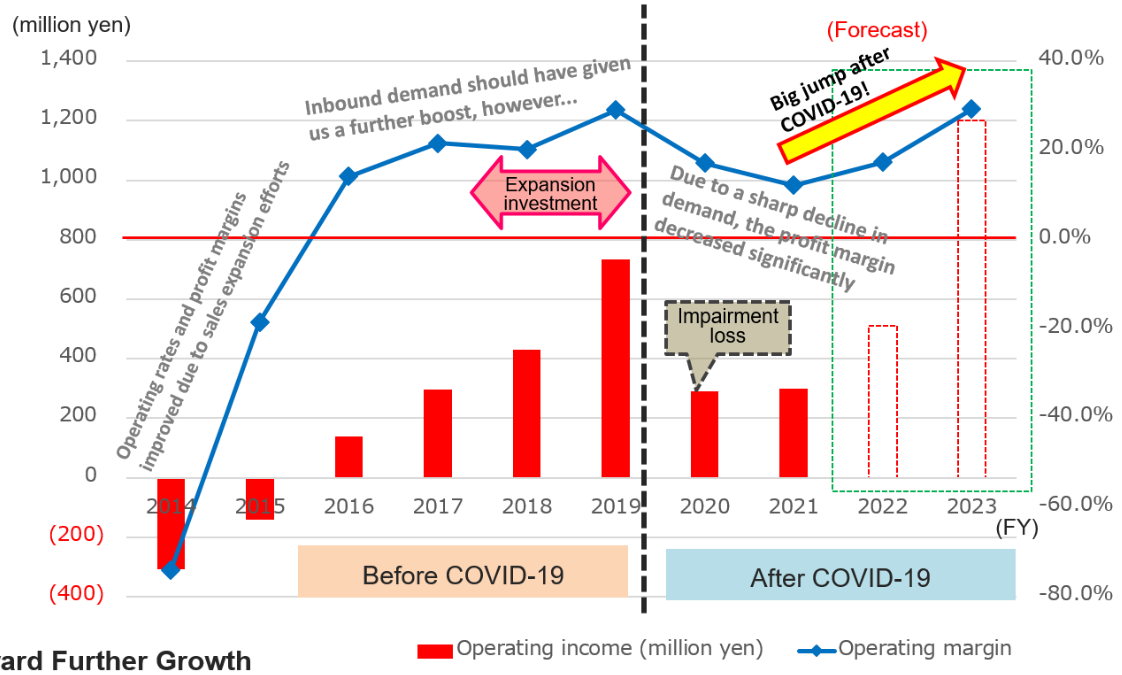
We plan to grow significantly after COVID-19 on the back of the following three factors as written here. The first is the easing of restrictions on going out, the second is the recovery of inbound demand, and the third is the expansion of the replacement of organic sunscreens with inorganic sunscreens. I am sure that the first two will make sense to you, but the third may be difficult to understand, so I will explain it a little.

There are actually two types of sunscreen: organic and inorganic. Currently, organic systems are overwhelmingly used because of their low price, transparency, and ease of handling. However, organic sunscreens have a certain weakness when considering the environment.

That is, if you wear organic sunscreen and go into the ocean, of course, the sunscreen will dissolve to some extent in the seawater. Then a theory emerged that the dissolved components were responsible for the bleaching of coral reefs. For this reason, Hawaii, the US, banned the sale of sunscreen products containing certain organic substances from January 2021. This move is a tailwind for our company, which is involved in inorganic sunscreens. We look forward to the expansion of demand for the replacement of organic systems with inorganic systems in the future.

Operating margins for cosmetic materials are high despite a drop due to COVID-19

Growth businesses



Toward Further Growth

System for increased production already established

Taking advantage of expected demand recovery after COVID-19 and other opportunities, strive to develop markets and expand sales from a medium- to long-term perspective

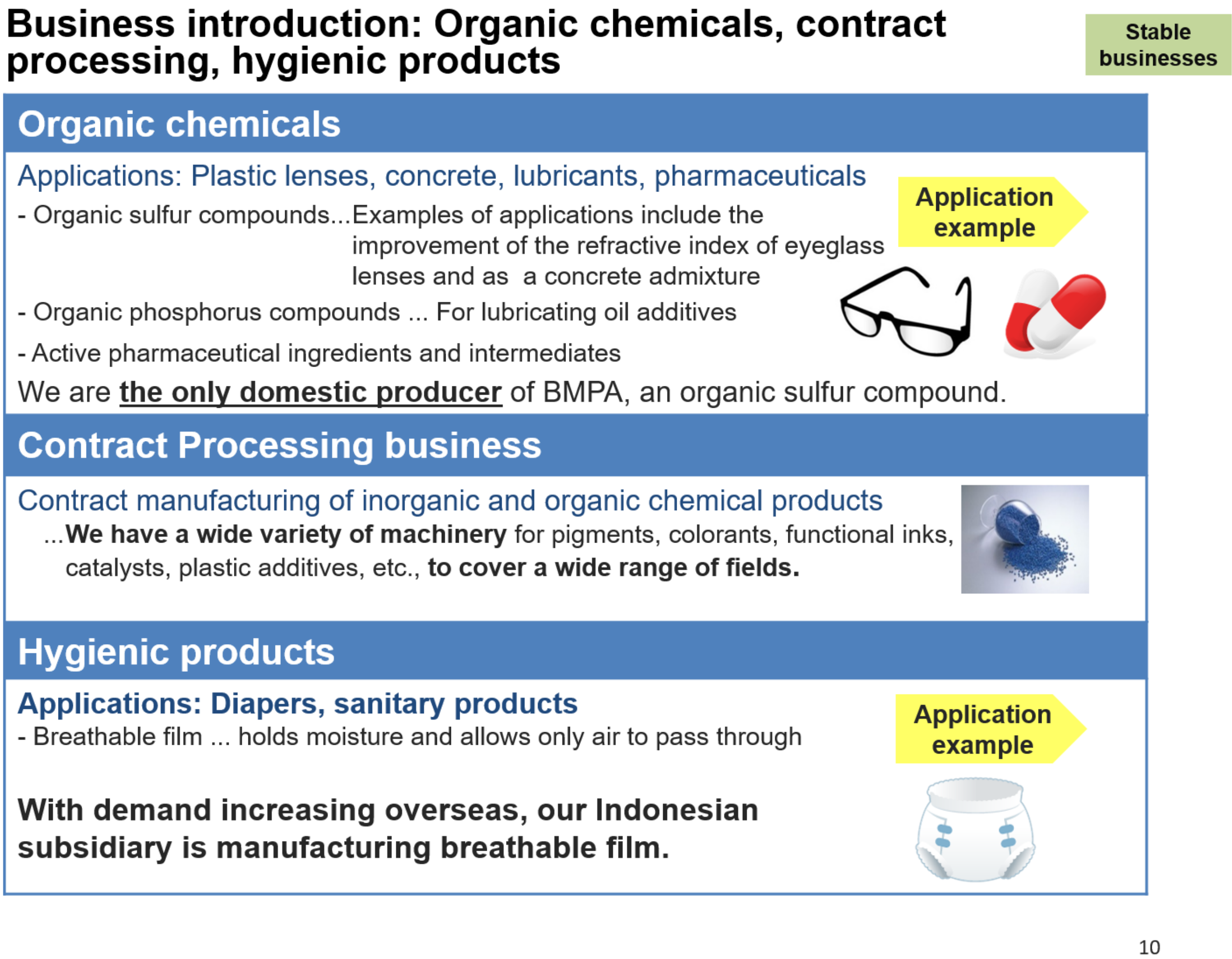
9

So what was the profit from cosmetics materials? As shown in the graph here, operating income for cosmetic materials declined due to COVID-19, but is on a recovery trend going forward.

Here, the red bar graph shows the amount of operating income. The blue line graph is the operating margin. On the left side of the screen, FY2014 and FY2015, there was a deficit. However, since then, as a result of sales expansion efforts, the utilization rate has increased and the Company has been profitable since FY2016. Subsequently, from FY2017 to FY2019, profit increased, driven by inbound demand.

With a view to further business expansion, we executed expansion investments. And just as we were about to take an even bigger leap forward, we were hit with COVID-19. Inbound demand declined sharply. See the red bar graph for FY2020 and FY2021. The business performance deteriorated significantly. Equipment that had been invested in had to be written down before depreciation could even begin.

Meanwhile, see the green box on the right. This is the outlook for the future, including the current fiscal year. Along with the mood of deregulation, the number of people going out is increasing. We expect a recovery in demand for sunscreens and a significant increase in earnings.



Next, we will introduce organic chemicals/contract processing/hygienic products, which are positioned as our stable business.

First, let met briefly explain our business activities. The top of the slide is organic chemicals. As shown in the illustration, there are two major uses for this product. First, additives for plastic lenses for eyeglasses. It functions to increase the refractive index of thin lenses, while it is also used in admixtures used to mix and make concrete. We are the only manufacturer in this field in Japan. There are only a few companies in the world that can provide high quality products.

The other is active pharmaceutical ingredients and intermediates. As a slight supplement, the active ingredients in a drug are called the active pharmaceutical ingredients, and the intermediate is the state of the drug before it becomes the active ingredient. All of these organic chemicals are subject to a business that is not easily affected by COVID-19 or the economy.

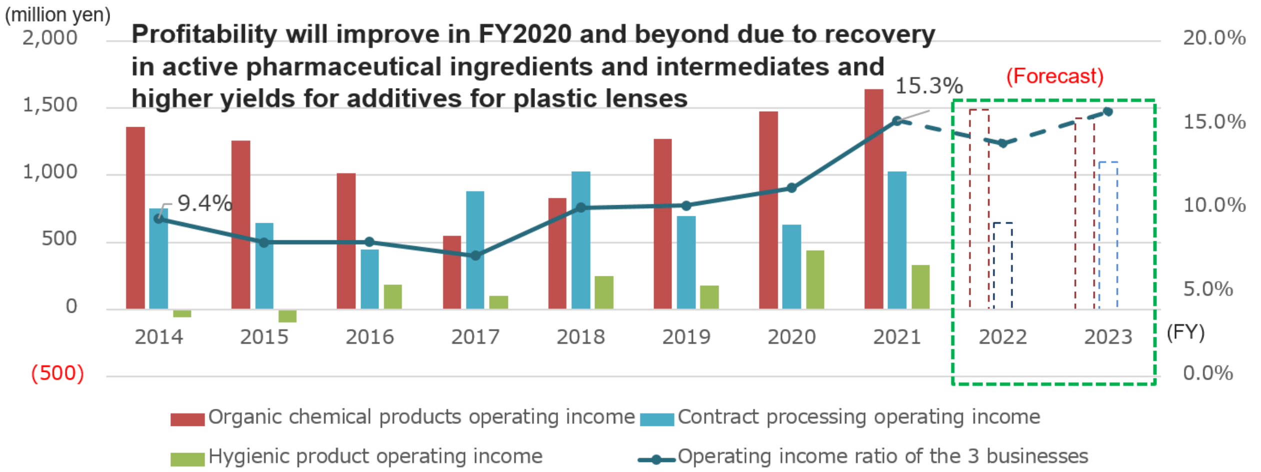
And then there is the contract processing business in the middle of the slide. This is a product that makes use of our special production technology and equipment, including firing and mixing. Due to confidentiality obligations, I cannot go into detail, but we are certainly growing into a profitable business.

And finally, below that, hygienic products. This is the manufacture of breathable films and sales of non-woven fabrics for diapers and sanitary products. There is a steady demand for these products along with the aging of the population and the development of emerging economies.

These three businesses are positioned as businesses that can secure stable sales and profit.

Operating income for organic chemicals, contract processing, hygienic products to stable levels

Stable businesses



- Active pharmaceutical ingredients and intermediates have high profit margins and orders are confirmed for several years to come
- Profit margins for plastic lens additives (organic chemicals) will improve due to better yields

Toward Further Growth

- **Expand active pharmaceutical ingredients and intermediates business into CDMO (contract manufacturing and development)**
- **Expand plastic lens additives production capacity**

11

Let us now look at the operating income of these three businesses. You can see that the profit of these three businesses has entered into stable territory.

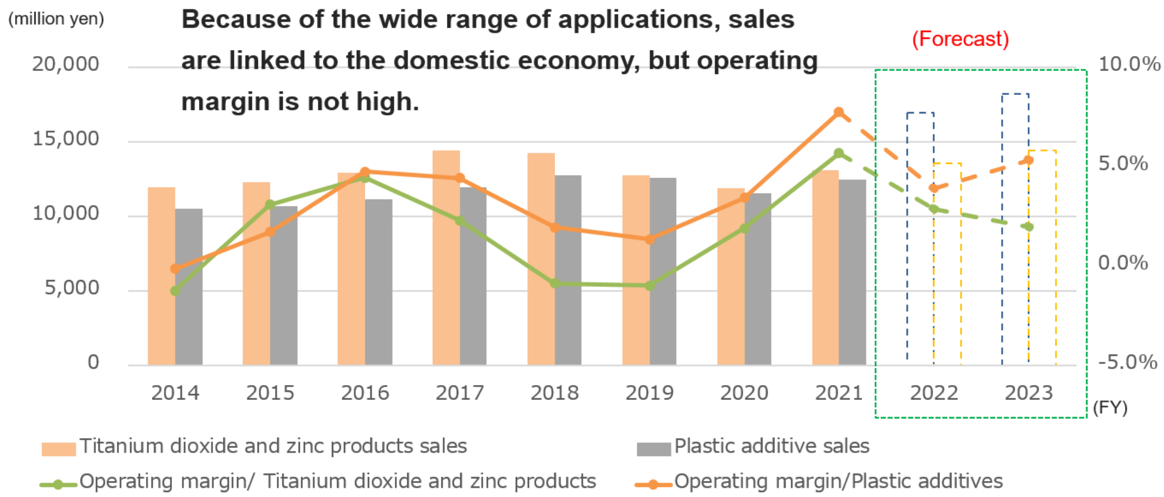
The tri-color bar graph shows the amount of operating income for each business. Red shows operating income from organic chemicals, blue shows operating income from contract processing, and green shows operating income from hygienic products. The blue line graph shows the operating margin for the three businesses.

See FY2021 slightly right of the center. The operating margin exceeds 15%. Active pharmaceutical ingredients and intermediates are highly profitable, and orders are confirmed for several years to come. In addition to this, additives for plastic lenses have succeeded in improving yield and raising profit margins.

As a result, we have been able to maintain a relatively high profit level even during COVID-19 and have grown into a strong business. For further growth, we are particularly focusing on expanding our organic chemicals. Specifically, we aim to evolve from a CMO that only accepts contracts for active pharmaceutical ingredients and intermediates to a CDMO that also handles development on behalf of clients. In addition, we will consider increasing production capacity for plastic lens additives.

Cost reduction and production efficiency are the keys for titanium dioxide, zinc products, and plastic additives

Efficiency improvement study Business



Toward Further Growth

- **Current high raw material and fuel prices will be overcome by price correction**
- **Increase high-value-added products and liquidate low-profit products**
- **To reduce the downward swing in operating income and increase profit stability even during a domestic economic downturn**

Next, we move on to the description of the efficiency study business. We believe that cost reduction and efficient production are the keys to success for titanium dioxide and zinc products/plastic additives.

Titanium dioxide is a white pigment used in a wide range of applications, including paints, inks, synthetic resins, and fibers. Zinc products are zinc oxide used to harden rubber, mostly for automotive tires. Plastic additives are additives used in the molding and processing of vinyl chloride resin, and are used in pipes and construction materials.

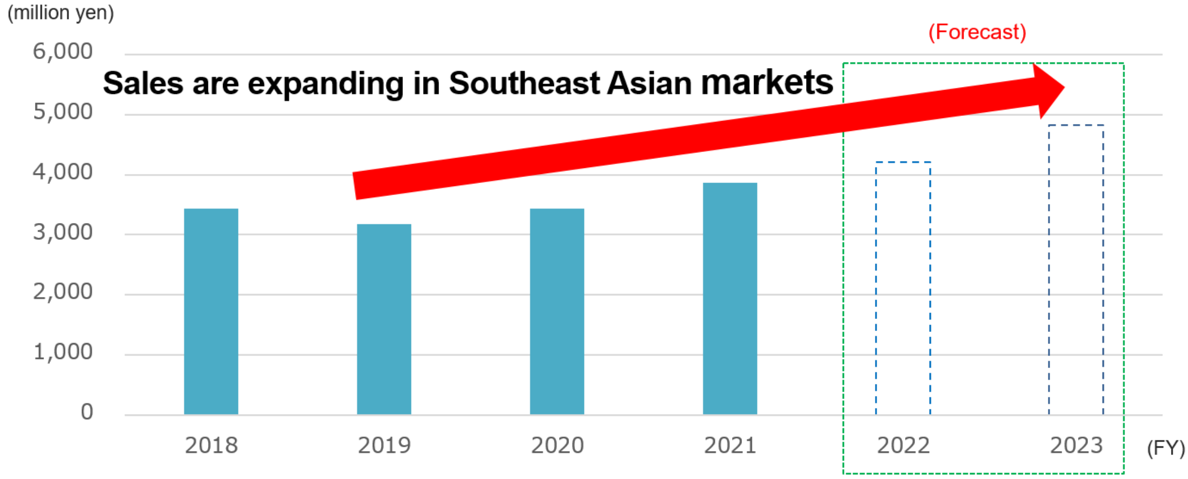
These products are used in a very wide variety of fields, mainly in the domestic market. As a result, sales have kept pace with the domestic economy. As this graph shows, our operating profit margin is not very high, so we believe that cost reduction and efficient production are key.

So what are we going to do in the future? In all of our businesses, raw materials and fuels have been rising in price against the backdrop of the weak yen, and we are currently working to overcome this situation by correcting prices. We will continue to expand the ratio of high value-added products and to liquidate low-profit products. By doing so, we will reduce the downward swing in operating income even during a domestic economic recession and create a structure that will allow us to earn stable profits.

Expand sales of plastic additives by targeting the Southeast Asian market

Efficiency improvement study Business

Sales Trends at Local Subsidiaries in Thailand and Vietnam



- The Southeast Asian market is expected to grow over the medium to long term, and demand for infrastructure-related products (construction materials, pipe materials, etc.) is expected to remain strong
- Progress in environmental regulations, such as Thailand's legalization of non-lead stabilizers, will be a boost for the Company.

13

Let me show you an example. First, this is plastic additives. In particular, we are focusing on expanding sales of plastic additives, with Southeast Asia as our target market.

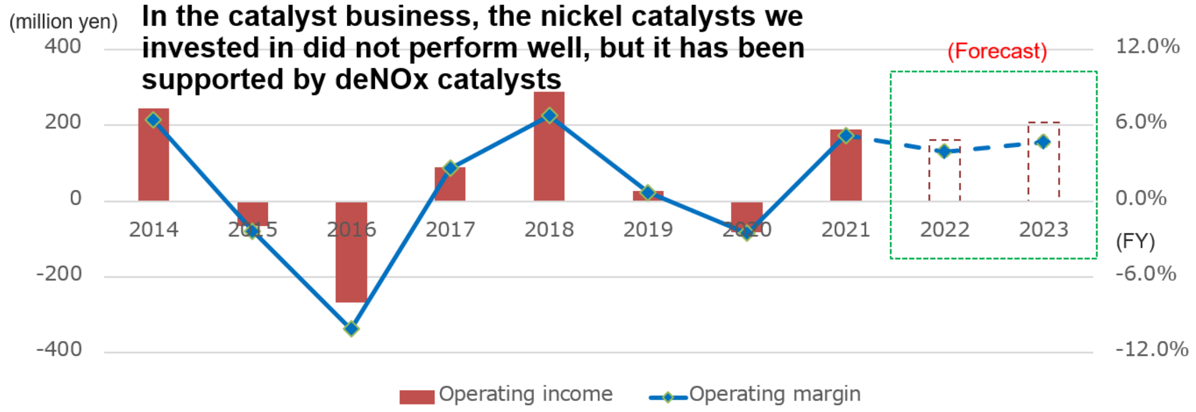
This graph shows the total sales of both subsidiaries in Thailand and Vietnam. I think you can see that we are steadily growing, little by little. And we expect this growth to continue.

In this Southeast Asian area, infrastructure is steadily being developed, including the installation of water and sewage systems, irrigation facilities, and the construction of large buildings. Accordingly, demand for PVC piping and other products is expected to grow.

In addition, due to safety and environmental considerations, Thailand, like Japan, has revised its law so that PVC pipes used for water supply do not contain lead, and we are convinced that this trend is spreading to Vietnam as well, while we are developing our business. This is a great tailwind for our company, which has a strength in non-lead stabilizers. We will focus on sales to take advantage of this opportunity.

There is an urgent need to rebuild the ability of the catalyst business to generate profits

Efficiency improvement study Business



- Nickel catalysts for hydrogenated resins have not been profitable because operating rates have not increased
- DeNOx catalysts, which have been supporting profits, are not always stable in terms of capacity utilization because the catalyst business is completely built to order

Toward Further Growth

(1) We will consider withdrawing from low-profit products and streamlining the production system to improve efficiency

-> Withdrawal from nickel catalysts for food products (expected completion by the end of FY03/2023)
-> Consider the consolidation of production bases for nickel catalysts for hydrogenated resins

(2) Focus on catalyst materials that contribute to carbon neutrality and make them a new pillar of growth

14

The second is the catalyst business. There is an urgent need to rebuild the profit-generating capacity.

The catalysts business has two main products: nickel catalyst and deNOx catalysts. Nickel catalyst is a catalyst used for hydrogenation in the production of hot bond and transparent film resins. DeNOx catalysts are environmental catalysts installed in thermal power plants and waste incineration plants to remove nitrogen oxides generated from combustion products.

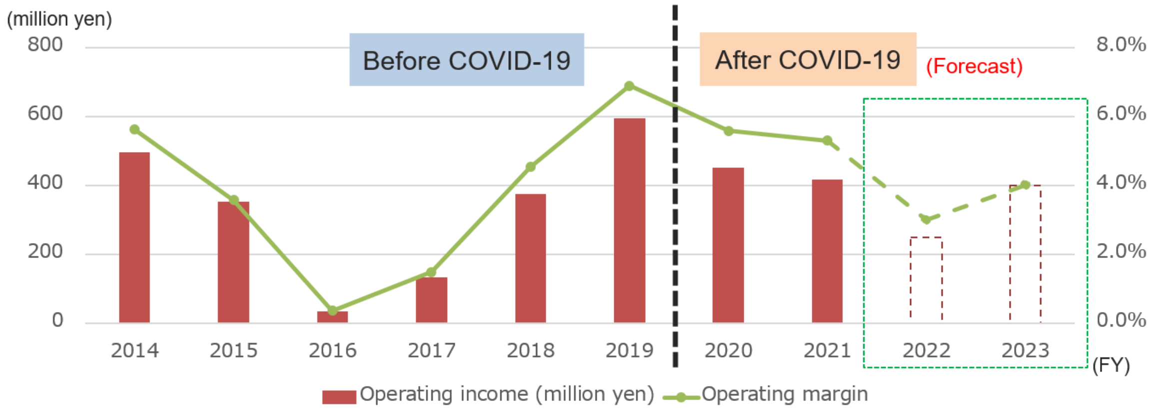
Please look at the graph. This graph shows changes in operating income for the catalysts business, which is a combination of these. The red bar graph shows operating income and the blue line graph shows the operating margin. As you can see, there is a strong increase or decrease from year to year, something that has not been seen in previous graphs. It is very unstable.

There are two factors that contribute to this. One reason is that nickel catalyst, despite capital investment, has not shipped as planned and have been stagnant due to continued low capacity utilization. The other is deNOx catalysts. The business is completely made-to-order, and operations are not stable due to fluctuating demand. In the most recent fiscal year, FY2021, operating income was solid, but this was due to the strong performance of deNOx catalysts. Profit has been secured.

So what can we do to further improve efficiency? We are considering withdrawing from low-profit products. We have actually started working toward that. We are already planning to withdraw from nickel catalyst products for food use, such as those used in resin processing of margarine and chocolate, by the end of this fiscal year. In addition, the Company is considering consolidating its production facilities for nickel catalyst for hydrogenated resins in order to improve capital efficiency.

At the same time, we will also nurture new pillars. Specifically, catalysts that contribute to carbon recycling. As with our existing deNOx catalysts, we are working on the preservation of the global environment as a major theme.

The medical business has been greatly affected by continuous NHI price reductions and COVID-19



Before COVID-19 (2016.3-2019.3)	After COVID-19 (2020.3-2022.3)
In addition to NHI price reductions, ulcer treatment Alloid G lost significant market share due to the spread of generics After that, profits recovered due to the withdrawal of competition	In addition to drug price reductions, sales decreased sharply due to the postponement of health checkups due to COVID-19 and voluntary restrictions on sales activities aimed at hospitals Furthermore, household medicine sales continued to be weak due to the thorough prevention of colds

Focus on new businesses less vulnerable to NHI price cuts and generics

(1) Supplement business (for affluent customers)

(2) Expand the area of application for medical devices (enter the field of otolaryngology)

(3) Establish new medical device systems (endoscope voice recognition input system)

15

Finally, we have the medical business. This business has been greatly affected by ongoing drug price reductions and the impact of COVID-19.

The red bar graph shows the amount of operating income and the green line graph shows the operating margin. There were significant changes before and after COVID-19, separated by the dotted line.

First, look at the graph on the left which shows the status before COVID-19. The two main pillars of this business have traditionally been barium contrast media and gastrointestinal ulcer agents. Before COVID-19, the situation was very difficult due to drug price reductions and the spread of generics. Operating income from FY2014 through FY2016 continued to fall all the way down.

However, profit recovered from FY2017 to FY2019, due in part to the withdrawal of competing generics and the growth of new businesses, such as endoscope cleaning equipment and the testing business.

Then look at the right side of the graph, after COVID-19. Profits deteriorated again as we entered the COVID-19 period. Sales of barium contrast media decreased due to ongoing drug price reductions as well as postponement of regular medical checkups. The voluntary restraint of sales activities to medical institutions led to a decline in sales of medical equipment, and above all, the slump of home remedies due to the prevention of colds by wearing masks, washing hands, and gargling. The situation remains unfavorable.

In order to overcome such a situation, we will focus on new businesses that are less susceptible to drug price reductions and generics. Specifically, this includes the supplement business, the expansion of the application area of endoscope cleaners to otolaryngology and other fields, and the establishment of new medical equipment systems.

This concludes our review of our business performance and our discussion of the future.

Issues often raised by investors

① Toward a Revision of the Business Portfolio

② Positioning of Medical Business

16

Finally, I would like to discuss two issues for which we have received a lot of feedback from our investors.

The first is about revising the business portfolio. These questions are still being asked. We have begun to review our business portfolio to achieve a more profitable product mix. I have talked about various things as for existing businesses, and I think I talked about those topics in the past.

Specifically, we are vigorously leveraging low-profit products by correcting prices and integrating or discontinuing current products. We will do it thoroughly, although it involves the risk of losing market share.

Next, we will discuss the positioning of the medical business. Until now, we have often been asked by investors about the significance of the medical business in our group. We supply active pharmaceutical ingredients for bulk barium contrast media to our subsidiary, Kaigen Pharma, and we have a deep supply chain relationship with the company.

Pharmaceuticals have a very heavy social responsibility to provide a stable supply, a relationship that cannot be easily severed. Kaigen Pharma is the only company in our group that offers a full lineup of BtoC products. For our group, which is developing its business with a focus on BtoB materials, they are also valuable in expanding our business downstream.

Finally, there is the significance of having a pharmaceutical manufacturing plant that requires strict management standards for the Group. In the future, chemical products will require even stricter quality control, and businesses that can comply with this will grow. The businesses of electronic materials and cosmetics materials, which we have positioned as growth businesses, will handle more delicate advanced materials in the future, and we believe that we can serve as a model for them.

In light of the above, we intend to retain the medical business as a valuable asset and use it to brush up our high value-added business as well as to expand our business.

This concludes my presentation. Thank you.

Mr. Nakanishi will now explain the current business performance.

Key Points Of This Business Results Briefing

1, About the Interim Results for the Fiscal Year Ending March 31, 2023

[Chemical Business]

(1) In addition to the penetration of price revisions, the chemical business benefited from inventories from the previous period and responded to recent high raw material and fuel prices.

(2) The electronic material business showed a decrease in shipment volume due to the impact of the lockdowns in China and other factors, resulting in lower profits.

(3) Cosmetics materials recovered from the lows of the same period of the previous year and posted an increase in profit.

(4) The organic chemical business posted a large decrease in profit compared with the previous year, when orders were concentrated in the first half of the year.

[Medical Business]

(1) Manufacturing and sales of mainstay medical equipment (endoscope cleaners and disinfecting devices) were slow due to the shortage of semiconductors.

(2) The supplement business remained steady.

2. Forecast for FY2023.3

We expect further sharp increases in raw material and fuel prices, higher costs for imported raw materials due to the weak yen, and a delay in the recovery of the semiconductor market, so earnings will be revised downward.

18

Nakanishi: I'm Nakanishi. I am in charge of IR. Thank you for your cooperation.

First of all, the key points of the current business results and Q2 are as shown here. The financial results for this interim period and for the current fiscal year, as well as for the full fiscal year, have been very challenging compared to the previous period.

Summary of Interim Results for FY 2023 (compared to the same period of the previous year)

(million yen)

	2021.9	Net sales comparison	2022.9	Net sales comparison	Increase/decrease	
Net sales	39,905	—	42,694	—	2,788	7.0%
Operating income	4,356	10.9%	3,267	7.7%	▲ 1,089	▲25.0%
Ordinary income	4,599	11.5%	3,830	9.0%	▲ 769	▲16.7%
Net income attributable to owners of parent	3,180	8.0%	2,871	6.7%	▲ 309	▲9.7%

- Factors for increased revenue

Increase in revenue due to the penetration of price revisions. (mainly titanium dioxide and plastic additives products)

- Factors for reduced revenue

Details can be found on the following page.

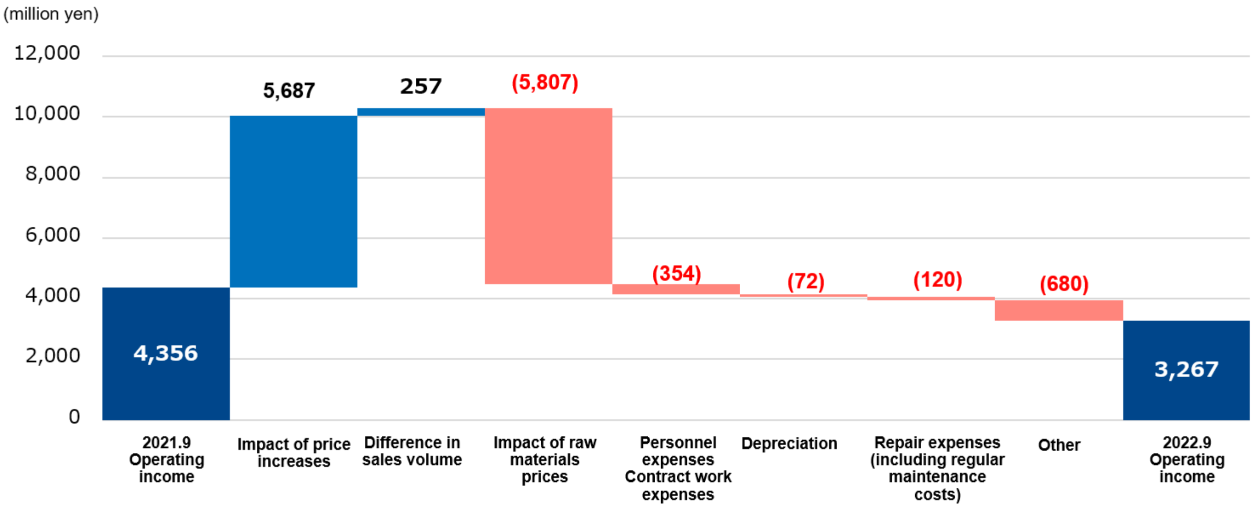
- Supplemental information

Foreign exchange gains (497 million yen) on dollar-denominated overseas investments

20

As you can see, operating income decreased by 25% to JPY1.089 billion, a significant YoY decrease, while net sales increased by 7%. Ordinary income decreased by 16.7%, and net income attributable to owners of the parent was JPY2.871 billion, a decrease of JPY309 million YoY. Operating income and below decreased by 9.7%, despite some recovery due to foreign exchange gains and other factors.

Factors causing an increase or decrease in operating income



- The sharp increase in raw materials and fuel prices was offset by price revision efforts, along with the benefit of inventories from the previous fiscal year.
- Labor costs/contract work expenses increased
  -> Due to employee wage increases and bonus payments to directors.
- "Others" includes ▲352 million yen in organic chemical products.
  -> Particularly for bulk pharmaceutical intermediates, there was a large decrease in profit compared with the previous year, when orders were concentrated in the first half of the year.

21

I will now explain the factors behind the YoY increase or decrease in operating income.

First of all, the amount of JPY4.356 billion in the previous fiscal year was the launching pad, which unfortunately dropped to JPY3.267 billion. As you can see, first of all, we achieved an increase of over JPY5.6 billion due to the effect of price increases. However, the negative effect of the increase in raw materials and fuels was JPY5.8 billion, which canceled out the effect of this increase in profit. This is largely due to soaring prices of raw materials and fuels, as well as the impact of the yen's depreciation, since the majority of raw materials are imported.

Other major factors contributing to the decline in profit include increases in labor costs and contracted work costs. The increase in employee wages, as well as the increase in bonuses for subsidiaries and affiliates due to favorable performance in the previous fiscal year, and bonuses to directors and corporate auditors had a significant impact.

As for the other JPY680 million, JPY352 million is the factor of the contracted subsidiary for active pharmaceutical ingredients and intermediates. Compared to the previous fiscal year, when orders were extremely concentrated in H1, profit decreased significantly.

Net sales and operating income by business (compared with the same period of the previous year)

(million yen)

		2021.9	2022.9	Increase/decrease	
Chemical Business	Net sales	35,809	38,572	2,763	7.7%
	Operating income	5,101	4,163	▲ 938	▲18.4
Medical Business	Net sales	4,096	4,122	25	0.6%
	Operating income	233	240	7	3.3%
Expenses for the entire company	Net sales	—	—	—	—
	Head office department expenses	▲ 977	▲ 1,136	▲158	—
Total	Net sales	39,905	42,694	2,788	7.0%
	Operating income	4,356	3,267	▲ 1,089	▲25.0%

- **Chemical business operating revenue**
  Despite higher revenue due to the penetration of price revisions, income decreased due to a reversal from the previous year's results in organic chemicals (bulk pharmaceutical intermediates) and a slowdown in electronic materials, which had driven the previous year's results

- **Medical business operating revenue**
  Existing businesses are in a difficult situation.
  However, both revenues and income increased due to strong performance in the dietary supplement business and some advance shipments of medical equipment.

22

Next, I will explain the trends in sales and operating income by segment.

Sales in the chemicals segment increased by 7.7%, while operating income unfortunately decreased by 18.4%. The increase in sales and decrease in profit for the entire company is almost entirely due to the chemicals business.

Sales in the medical business remained almost unchanged, but increased slightly by 0.6%, and profit increased by 3.3%.

Expenses for the headquarters increased by JPY158 million to JPY1.136 billion. This increased slightly. As I mentioned earlier, there was an increase in personnel expenses and travel and transportation expenses.

Balance sheet: Inventories increased substantially

Consolidated balance sheet	2022.3	2022.9	Increase/decrease
Current assets	65,496	70,520	5,023
Cash and deposits	10,800	11,893	1,093
Inventories	23,110	28,218	5,106
Non-current assets	58,423	57,842	▲ 580
Property plant and equipment	48,134	47,648	▲ 485
Intangible assets	1,519	1,406	▲ 112
Investments and other assets	8,769	8,787	17
Total assets	123,919	128,362	4,443
Current liabilities	26,771	29,130	2,358
Non-current liabilities	14,439	13,429	▲ 1,010
Total liabilities	41,211	42,559	1,347
Net assets	82,708	85,803	3,095
Liabilities and net assets	123,919	128,362	4,443
Equity-to-asset ratio (%)	63.6	63.6	—
Interest-bearing liabilities (total)	16,958	18,620	1,662

Background: (1) Increased product inventory due to the slowing economy
(2) Advance purchase of important raw materials such as those for electronic materials (to avoid risk of supply chain disruption)
(3) Increase in unit prices of products and raw materials

23

Next is the balance sheet.

The biggest factor on the balance sheet is the JPY5.1 billion increase in inventories, as shown here. The main reason is the increase in the unit price of raw materials for products due to price hikes and the yen depreciation. In addition, the Company intentionally built up inventories to avoid the risk of supply chain disruptions, especially for imported raw materials, and the recent economic downturn has caused a sharp decline in sales. In response, some current liabilities, such as accounts payable and short-term loans payable, have also increased.

However, the equity ratio was 63.6%, maintaining the same level as the previous year.

Cash Flow: Operating CF decreased significantly

	2021.9	2022.9	Increase/decrease
Cash balance at start of period	11,153	10,549	▲ 603
Profits before tax	4,537	4,218	▲ 318
Depreciation	2,107	2,191	83
Inventories	▲ 509	▲ 4,860	▲ 4,351
Other	▲ 752	▲ 427	325
Operating CF	5,383	1,122	▲ 4,261
Capital investment	▲ 3,837	▲ 1,319	2,518
Sale of shares	128	181	52
Other	▲ 109	▲ 147	▲ 38
Investment CF	▲ 3,818	▲ 1,285	2,533
FCF	1,565	▲ 163	▲ 1,728
Financial CF	▲ 1,025	1,006	2,032
Cash balance at end of period	11,774	11,667	▲ 107

(FCF = CF from operations + CF from investments)

Due to the increase in inventories, operating CF decreased significantly and FCF became negative.

24

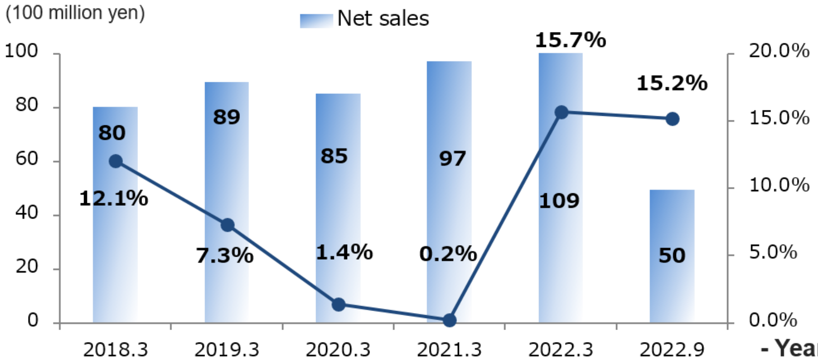
Next, cash flow.

As I just explained, there was a significant decrease in operating cash flow due to an increase in inventories. As a result, operating cash flow was negative by more than JPY4.2 billion compared to the same period last year.

Next, in the area of capital expenditures, investment cash flow decreased significantly due to the curbing of large capital expenditures. As a result, free cash flow decreased by more than JPY1.7 billion YoY due to the large increase in inventories here, and unfortunately, free cash flow was negative in this interim period.

Electronic materials

Chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	5,087	4,956	▲131	▲2.6%
Operating income	892	753	▲139	▲15.6%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Shipment volume decreased. (▲16.0%)

  Shipment volume decreased due to lockdowns in China and a slowdown in the market for consumer devices such as personal computers and mobile phones.

  Sales were slow for both dielectrics (barium titanate) and dielectric materials (high-purity barium carbonate).
- Sales of high-end dielectric products were generally steady.

25

Next, we will move on to an explanation by sub-segment.

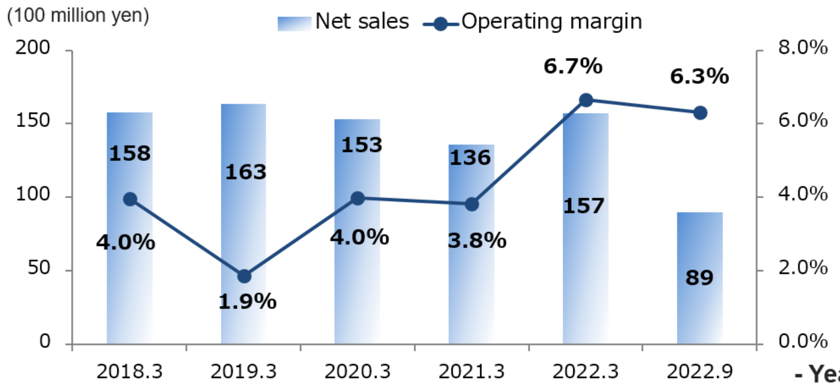
First, electronic materials.

Sales declined sharply in Q2 after a strong performance in Q1. The lockdown in China has had a significant impact on smartphones and consumer applications. Sales of grades that are considered to be used for automotive applications are firm. As a result, this segment saw a large decrease in both sales and income, as shown here.

However, although the operating profit margin declined slightly to 15.2%, it still remains high.

Titanium dioxide and zinc products

Chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	7,491	8,945	1,454	19.4%
Operating income	461	565	104	22.5%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Cosmetic materials: Both domestic and overseas demand recovered, and revenue and profits increased. In particular, operating income increased by 107.1% year-on-year.
- Titanium dioxide: Revenue increased due to the penetration of price revisions, but income decreased due to further increases in raw material and fuel costs.
- Zinc products: Both sales and profits increased due to a sharp rise in zinc prices (+44.9% year-on-year) and steady demand.

Next, titanium dioxide and zinc products.

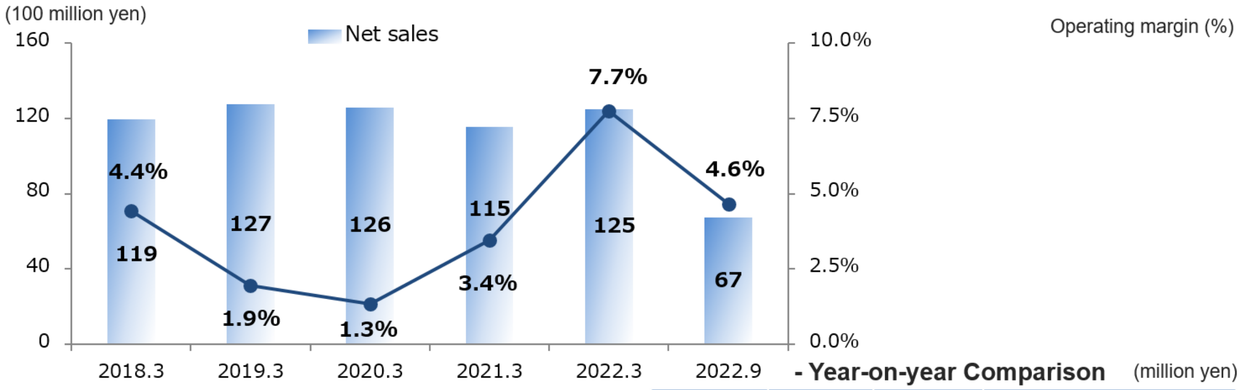
As President Yagura explained earlier, this sub-segment includes cosmetics materials. In the cosmetics materials, sales and profits increased in H1, as the business is getting over the impact of COVID-19. In particular, operating income was up more than 107% YoY.

As for titanium dioxide, sales increased due to the penetration of price revision, but income decreased due to cost increase caused by soaring raw materials and fuel prices. For zinc products, sales and income increased as zinc quotation prices continued to rise and demand remained strong.

Profit increased for the sub-segment. Cosmetics materials drove this segment.

Plastic additives

Chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	6,209	6,712	503	8.1%
Operating income	562	312	▲250	▲44.5%

Key points for the second quarter of the fiscal year ending March 31, 2023

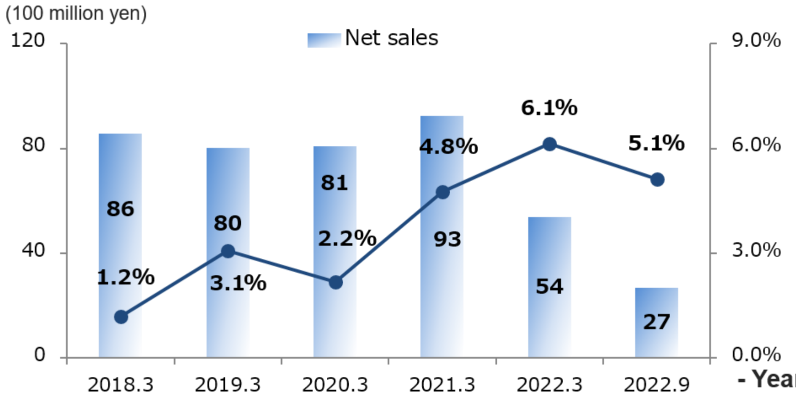
- Domestic sales remained slow for housing and automobile-related applications, with the exception of industrial sheets for semiconductor facilities. Although price revisions were implemented, further increases in raw material and fuel costs resulted in higher revenue and lower income.
- In overseas markets, sales of hydrotalcite for wire harnesses remained slow due to lower automobile production. Sales of non-lead stabilizers remained slow due to a decline in public works projects as a result of budget cuts for irrigation equipment. As in Japan, price revisions penetrated the market, but further increases in the cost of raw materials and fuel led to higher revenue and lower income.

27

Next, plastic additives.

In plastic additives, domestic demand remained strong for vinyl chloride stabilizers for industrial plates for IT-related equipment, but unfortunately, demand for housing and automotive applications remained sluggish. Price revisions have penetrated the market and sales have increased significantly, but unfortunately, the higher cost of raw materials and fuels has exceeded this increase, resulting in a significant decrease in profit.

Hygienic products



- Year-on-year Comparison

(million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	2,507	2,652	145	5.8%
Operating income	152	136	▲16	▲10.5%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Regarding sales, the market remained strong and sales increased.
- On the other hand, regarding income, operating profit margins declined due to high raw material and fuel costs and higher export freight costs for our Indonesian subsidiary, resulting in lower operating profit margin and lower income.

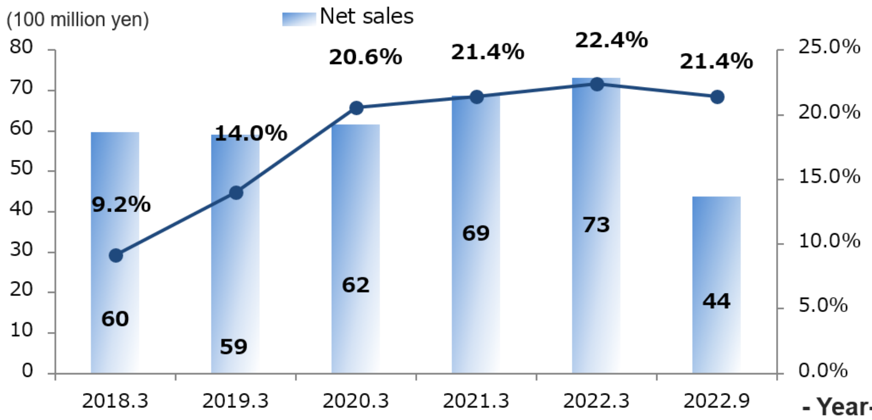
28

Next, hygienic products.

Sales of hygienic products were firm, but profitability deteriorated significantly due to soaring raw materials and fuel prices, as well as soaring export freight costs from our Indonesian subsidiary, which produces hygienic materials. Unfortunately, compared to the same period of the previous year, sales increased and profit decreased.

Chemicals

Organic chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	4,422	4,383	▲39	▲0.9%
Operating income	1,291	939	▲352	▲27.3%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Although shipments of pharmaceutical intermediates increased, there were no shipments of bulk pharmaceuticals, which had been strong in the previous year. This had a negative impact on the segment as a whole, resulting in lower revenue and profits.
- Regarding thio products, both revenue and income increased due to strong sales for plastic lenses and the success of price revisions.

29

Next, organic chemicals.

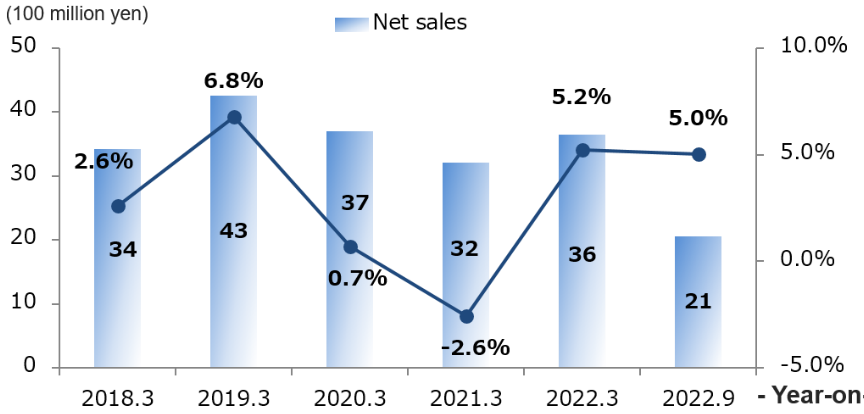
In the contract manufacturing of active pharmaceutical ingredients and intermediates, sales of mainstay intermediates were strong, but there were no shipments of highly profitable active pharmaceutical ingredients in H1 although there were in H1 of the previous fiscal year, resulting in lower sales and profit compared to the same period last year. However, we plan to recover for the full year.

Thio products, mainly for plastic lenses, performed well. Although we were hit by high raw materials and fuel prices, we achieved an increase in both sales and income through price revisions.

The sub-segment results in lower sales and profit are due to the special factors I mentioned earlier compared to the same period of the previous year. We plan to recover for the full year. The operating margin, as shown here, declined slightly, but remains high at 21.4%.

Catalysts

Chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	1,486	2,062	576	38.8%
Operating income	92	104	12	13.0%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Sales of nickel catalysts used in the hydrogenation process of plastics increased due to a sharp rise in raw material nickel prices and price revisions.
- Sales and earnings of deNOx catalysts used in thermal power plants and waste incineration facilities increased due to the large overseas shipments that continued from the previous fiscal year.

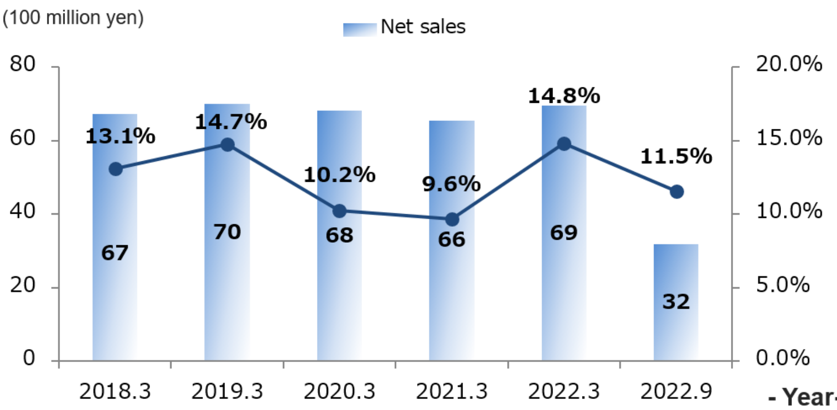
30

Next, catalysts.

Regarding nickel catalyst, sales and income increased due to higher nickel market prices and price revisions, which led to higher unit sales prices. As for deNOx catalysts, sales and income increased due to the contribution of a large project for China in the current period. As a result, sales and profit increased for the sub-segment. Profit margins have remained mostly unchanged.

Contract processing

Chemicals



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	3,589	3,129	▲397	▲11.1%
Operating income	615	368	▲247	▲40.2%

Key points for the second quarter of the fiscal year ending March 31, 2023

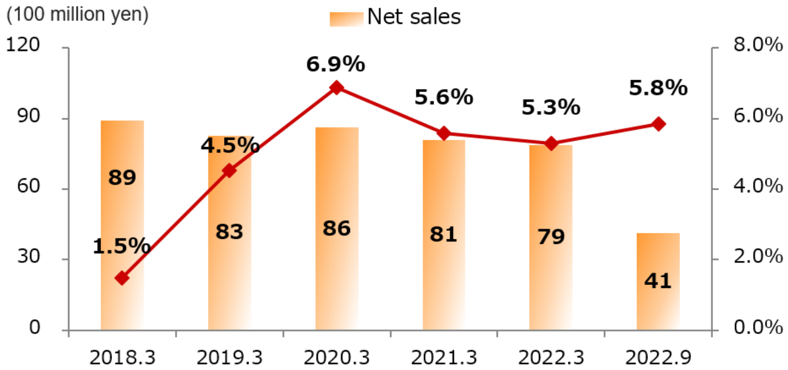
- Regarding processed pigments, both revenue and income decreased due to the impact of the lockdowns in China and weak sales, particularly in the automotive industry, compared to the previous fiscal year.
- Revenue and income form contracted processes such as calcination, mixing, and drying decreased due to weak sales of highly profitable contract products and lower operating profit margins.

Next is contract processing.

Processed pigments were affected by the lockdown in China and stagnated mainly in automotive applications. In the contract processing, the highly profitable projects that had driven past performance have slowed down, resulting in an unfortunate decline in sales and a significant decrease in profit for the sub-segment.

Medical business

Medical



- Year-on-year Comparison (million yen)

	2021.9	2022.9	Increase/decrease	
Net sales	4,097	4,122	25	0.6%
Operating income	233	240	7	3.0%

Key points for the second quarter of the fiscal year ending March 31, 2023

- Sales of barium contrast media increased due to growth in exports, mainly to South Korea, despite the impact of the decline in medical examinations due to the COVID-19 pandemic.
- Regarding "Aluloid G", both revenue and income declined due to the impact of NHI price reductions.
- Regarding medical equipment, sales of endoscope cleaning and disinfection equipment decreased due to the shortage of semiconductors, but revenue increased due in part to anticipatory demand for electrolysis accelerators and other related products before the price revisions.
- Revenue and income from over-the-counter (OTC) pharmaceuticals, such as the cold remedy "Kaigen", decreased due to measures to combat morbidity that have been ongoing since the COVID-19 pandemic.
- Revenue and income increased due to strong sales of products for beauty salons (ultraviolet light supplements), which are a new business focus.

32

Finally, we have the medical business.

Although drug price reductions and OTC products such as Kaigen caused unfavorable results, this was more than offset by strong sales of barium contrast media exports, medical device-related products, and products for cosmetic medical institutions such as drinkable sunscreens.

Forecast for FY 2023

Amount units: million yen

	2022.3		2023.3					
	Full year results		First half results		Second half forecast		Full year forecast	
		Net sales comparison		Net sales comparison		Net sales comparison		Compared to previous period
Net sales	80,135	—	42,694	—	42,306	—	85,000	6.1%
Operating income	7,494	9.4%	3,267	7.7%	2,233	5.3%	5,500	▲26.6%
Ordinary income	8,840	11.0%	3,830	9.0%	1,970	4.7%	5,800	▲34.4%
Net income attributable to owners of parent	6,747	8.9%	2,871	6.7%	1,329	3.1%	4,200	▲37.8%

In the second half of the year, we plan to increase prices further, as we did in the first half, but income is still expected to be slower than in the first half for the following reasons.

[Operating income]

(1) Further increase in raw material and fuel prices

(2) Decrease in revenue from electronic materials, which were strong in the previous year, due to the slowdown in the semiconductor market.

(3) Lower than expected sales volume due to the economic slowdown in Japan and overseas.

[Ordinary income]

As part of non-operating income, there was a decrease in net foreign exchange gains (497 million yen in the first half of the current fiscal year)

[Net income for the period]

As part of extraordinary operating income, there was a decrease in insurance claim income (379 million yen in the first half of the current fiscal year)

Next is the forecast for the current fiscal year.

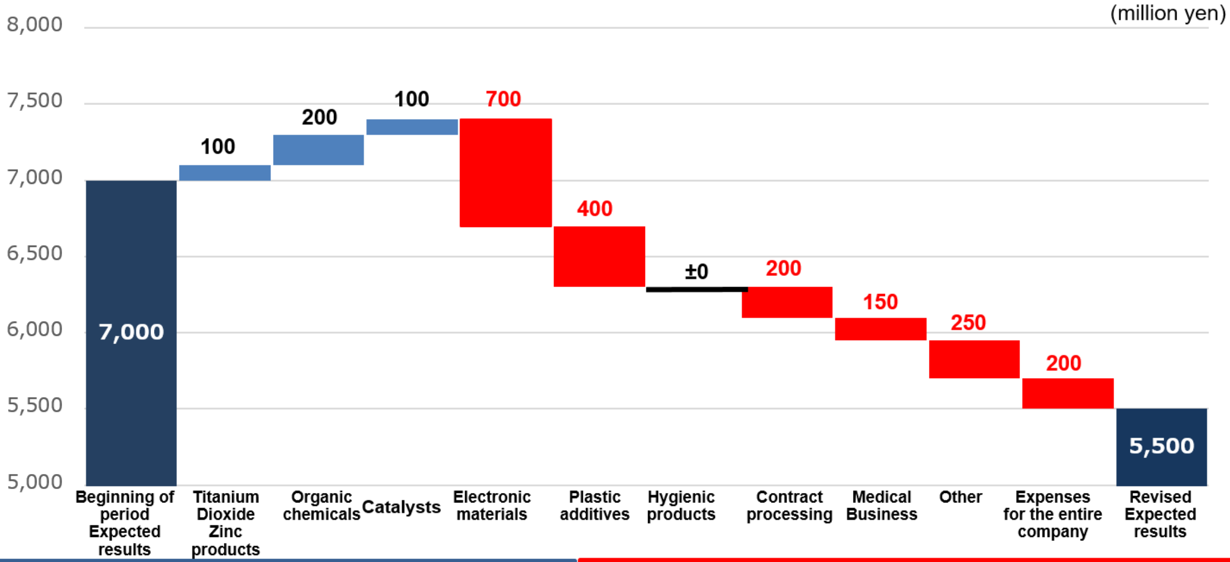
As disclosed in the earnings announcement on November 9, we maintained our previous forecast of JPY85 billion in net sales for the current fiscal year, but unfortunately, we revised our operating income forecast downward by JPY1.5 billion to JPY5.5 billion from the initial forecast of JPY7 billion.

Below, ordinary income has been revised downward from JPY7.1 billion to JPY5.8 billion and net income attributable to owners of the parent has been revised to JPY4.2 billion.

Next is a comparison of H1 and H2. Comparing H1 with H2, we forecast a slight decrease in net sales and a 31.7% decrease in operating income. Net income attributable to owners of the parent decreases by 53.7%.

The reason for the larger decrease in ordinary income compared to the decrease in operating income is that foreign exchange gains and insurance income, which were recorded in H1, are not expected in H2. The sharp rise in raw materials and fuel prices, taking into account foreign exchange factors, has penetrated into inventory unit prices, and sluggish demand for electronic materials and other products has led to a decline in sales volume. This is the main reason for the slowdown in price correction.

Forecast increase/decrease in operating income by subsegment (approximate figures)



[Positive side]
- Cosmetics materials:: Entering a period of demand
- Organic chemicals: Supported by firm demand

[Negative side]
- Electronic materials: Slowdown in market conditions, especially for consumer products
- Loss of benefit from inventories at the end of the previous fiscal year
- Further increase in raw material and fuel prices
- Slowdown in sales of endoscope cleaning equipment due to a shortage of semiconductors

35

The changes in operating income from the initial forecast for each sub-segment are shown here.

Among titanium dioxide and zinc products, cosmetics materials are expected to be strong in the demand season, and organic chemicals are also expected to turn to positive growth compared to the initial forecast, supported by firm demand.

However, in the electronic materials segment, the slump in sales that began in Q2 is expected to continue through H2 and in the other segments, a slowdown in price revisions is anticipated due to the economic slowdown, and an increase in unit prices due to the replacement of raw materials inventories as well as the stronger impact of the yen’s depreciation are anticipated.

In medical products, sales of endoscope cleaning equipment, which have been the driving force behind our business performance, are expected to be put on the brakes due to the effects of the semiconductor shortage. Although a recovery in the electronic materials market was initially expected to begin in Q4, at the moment, it is expected to be from the next fiscal year onwards.

Trends and forecast for capital expenditures, depreciation, and research and development expenses

Amount units: million yen

	2018.3	2019.3	2020.3	2021.3	2022.3	2022.9	2023.3
Capital investment	3,771	6,891	8,403	9,567	5,967	1,319	**3,000**
Depreciation	3,005	3,189	3,686	4,243	4,331	2,193	**4,500**
Research and development	3,217	2,951	2,898	2,487	2,376	1,366	**2,500**

(Forecast)

- Capital investment

In FY 2019 and FY 2020, strategic investments were made, mainly in the fields of electronic materials and cosmetics materials, resulting in a large increase.
Currently, we have no plans for major investments beyond this fiscal year.
However, we expect to invest 3,000 million yen, 1,000 million yen less than the initial plan, because of lower expected investment in maintenance and renewal than originally planned.

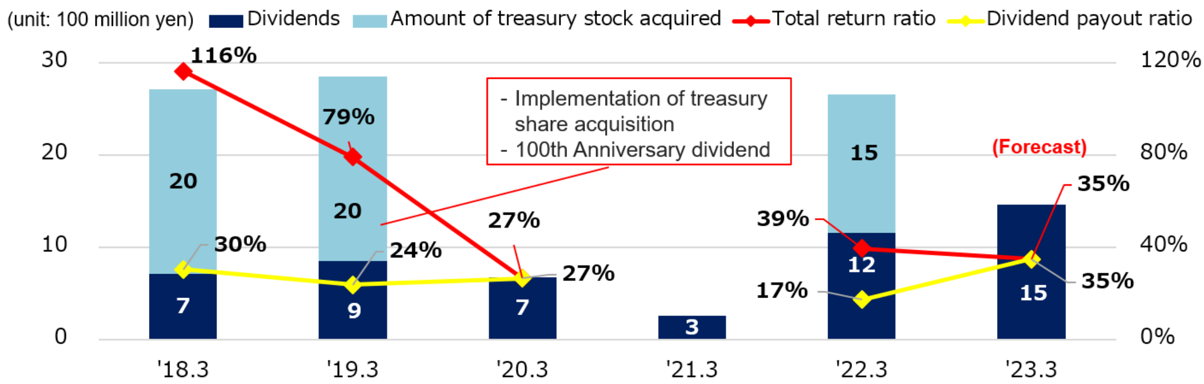
- Depreciation

There will be no increase in depreciation and amortization, due to the 7,041 million yen impairment loss on the above-mentioned strategic investment recorded at the end of FY2020.

36

Next, capital investment. Capital investment has slowed, and recurring renewal investment is also on the downside. Depreciation will remain mostly flat for the time being as a result of the 20-year impairment charge. We will strive to recover past large investments. Research and development expenses remained mostly unchanged.

Shareholder Return



Basic Policy on Dividends of Surplus

We will implement the distribution of profits with **a target payout ratio of 30%** or more (2 times/year).

About the Fiscal Year Ending March 2023

Annual dividend of 90 yen per share (interim 45 yen, year-end 45 yen) implemented (estimated)

(*Annual dividend increased of 20 yen from the previous year)

38

Lastly, I would like to talk about shareholder returns.

The Company plans to pay JPY45 for the interim period and JPY45 at the end of the fiscal year. The dividend payout ratio is expected to be approximately 35% based on current earnings forecasts. This would maintain the current dividend policy of 30% or more.

At this point, despite the forecasted downward revision of business performance, our policy is to maintain the dividend amount as planned at the beginning of the fiscal year in order to return profit to our shareholders.

That’s all from me. Thank you.

Moderator: Thank you very much for your explanation.

Question & Answer

Participant [Q]: Thank you for the detailed explanation. I would like to know your thoughts on the business environment for the next year and beyond.

Compared to half a year ago or a year ago, I can see that it has changed considerably. I would like to know how things have changed and what you are looking at for the next year and beyond.

Also, if you don't mind my asking, regarding sales and income, especially in terms of sales, how much operating income do you have in mind for next year? I had the impression that you have become a company with a cruising speed of over JPY7 billion in profit, but since that is not where you are at this fiscal year, I would like to know what your natural profit level will be next year and beyond. Thank you.

Yagura [A]: Thank you for your question. The business environment for the next year and beyond. As shown in the outlook for changes in operating income by segment, we expect operating income to be affected considerably by the movement of electronic materials.

According to the information we have received from our customers, it is difficult to recover it during this fiscal year. So, we do not know at this point whether or not it will be fine in the next fiscal year or April. I think the only way forward is to check the situation around January, while visiting customers, etc. again.

Normally, the IT recession takes six months to recover from, but the general view is that it will not be the case this time and will take longer, so it is currently unclear what will happen after April.

Participant [Q]: Is it correct to understand that the outlook is less clear compared to half a year ago?

Nakanishi [A]: I'm Nakanishi. Although most of our electronic materials are concentrated in our MLCC materials, they are a little behind the world's semiconductor trends. In fact, it was Q2 that affected sales this time. I think that semiconductors were affected from the beginning, but the impact on our company began to be felt rapidly in Q2.

Therefore, as the President mentioned, one of the major keys will be when the electronic materials industry and business conditions as a whole will recover. However, as I explained earlier, the growth rate of MLCC itself is expected to be stable enough in the industry, and their applications are expanding. In addition, since we have sufficient manufacturing capacity, we expect our business performance to grow in tandem with the turnaround in this area.

We believe that the recovery of cosmetics will be fast, as the global penetration of With Corona is increasing and we have sufficient manufacturing capacity.

Participant [Q]: Do you have a feeling that it will bottom out around H2 next year, or something like that? I am afraid I am asking in a sketchy way.

Yagura [A]: Frankly speaking, we are a company that produces and sells dielectrics and dielectric materials for electronic materials, and we have a dilemma of not being able to generate demand. Looking at the semiconductor business and the strong capital investment of capacitor manufacturers, we believe that a recovery will probably occur somewhere in the next fiscal year, but at this point it is still unclear when that will happen.

[END]

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