Transcript of briefing on “Cs+ for Tomorrow 2021” Medium-term management initiative (FY 2019–2021) held on May 29, 2019

Asahi Kasei Corporation

Participants

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Presentation

Hamamoto: Good afternoon, ladies and gentlemen. Thank you very much for joining us for Asahi Kasei's management briefing. Your MC is Futoshi Hamamoto from Investor Relations. We would like to begin with a presentation from our President, Hideki Kobori, and later take questions. Participants today from the Asahi Kasei side are; Hideki Kobori, President, and Yutaka Shibata, CFO.

Let me give the floor to Mr. Kobori now.

Kobori: Good afternoon. This is Hideki Kobori. Thank you very much for joining us for this briefing. Today I would like to introduce our new medium-term strategic management initiative "Cs+ for Tomorrow 2021," which charts our growth strategy from FY 2019, which began this April.

The previous medium-term management initiative, "Cs for tomorrow 2018," focused on the "Cs" of "Connection," "Communication," "Challenge," and "Compliance," while building the base for the next phase. We decided on capital expenditure worth some ¥670 billion, with particular focus on "automotive" and "environment/energy."

The previous initiative began shortly after it was revealed that Asahi Kasei Construction Materials Corp. had manipulated data for the installation of precast concrete piles. The whole group has since worked hard to restore confidence.

Thanks to such efforts, we have successfully met our earnings targets. We also exceeded the target for the total return ratio, which came to 39%.

The new management initiative recognizes new challenges and current opportunities, such as higher expectations for sustainability as embodied in the sustainable development goals, or SDGs, the digital transformation, and trade tensions between the United States and China.

As we move ahead towards further growth, we shall continue to contribute to sustainable development of mankind and the earth. This stance is expressed as "Care for People, Care for Earth." We will build on the basic concepts of the previous management initiative, with an enhanced focus on contributing to a sustainable society, and sustainable growth of corporate value. We have thus named our new strategic management initiative as "Cs+ for Tomorrow 2021."

P. 2 Outline

My presentation today has three parts, as shown on Slide 2. First, I would like to review the previous initiative "Cs for Tomorrow 2018," and share our view on the business environment. Then, I would like to explain the vision and goals underlying the new initiative, "Cs+ for Tomorrow 2021," before discussing the initiative itself in further detail.

1. Review of "Cs for Tomorrow 2018" and business environment

P. 4 (1) Financial results

Let me begin with a review of "Cs for Tomorrow 2018." Please turn to slide 4. With regard to financial results, in FY 2018, the final year, we posted record highs for net sales and operating income. Operating income and net income attributable to owners of the parent both exceeded the initial target figures announced back in 2016, which were ¥180 billion and ¥110 billion, respectively.

With regard to shareholder returns, annual dividend per share in FY 2018 was ¥34.

Combined with the first share buyback in 17 years, total return ratio came to 39%, exceeding the target level of 35%.

And it's not just earnings. Investment efficiency also improved during the 3-year period, in terms of return on invested capital and return on equity.

In summary, we exceeded various targets and have been successful in our pursuit of growth and profitability.

P. 5 (2)-1 Capital expenditure

Slide 5 shows capital expenditure. As shown toward the right, over the past 3 years, we have made continuous, proactive investments, including M&A, so as to accelerate growth. Investments to expand existing businesses averaged at ¥180 billion per year on a decision-adopted basis. In addition, we invested ¥120 billion to acquire Sage Automotive Interiors, Inc. The 3-year total of capex decisions made, therefore, amounts to some ¥670 billion, which translates into an average of about ¥220 billion per year.

In comparison, during the 5 years of the second-previous management initiative, "For Tomorrow 2015," we executed two major M&As on top of investment decisions worth ¥110 billion per year in existing businesses, for a grand total of ¥1 trillion, which translates into an average of ¥200 billion per year. The annual average during "Cs for tomorrow 2018" was higher by 10% than during the initiative before. The challenge now is to fully harvest investment returns under the new management initiative and further on.

P. 6 (2)-2 Capital expenditure: target markets

Slide 6 shows the breakdown of investments worth ¥1 billion or above, by target market. As you can see, investments centered on key fields such as "automotive" and "environment/energy." Out of the total of ¥670 billion on a decision-adopted basis, such large investments accounted for ¥400 billion. Roughly 3 quarters of that was invested into four key fields.

The largest amount went to "automotive," for capacity expansion of our competitive products and acquisitions of Sage Automotive Interiors Inc. and Senseair AB, a manufacturer of gas sensor modules.

We also invested heavily in the field of "environment/energy," for a series of capacity expansions for battery separators.

The third largest amount went to "homes," as we accelerated expansion of this business outside of Japan. We have formed a capital alliance with an Australian partner and have acquired a US company.

In the field of "health care & hygiene," ZOLL Medical Corporation, the key operating entity of our Critical Care business, executed a number of M&As. We have also invested in additional capacity for Planova virus removal filters and in augmenting the pharmaceutical pipeline.

The focus from here will be to fully reap the fruits of such growth investments.

P. 7 (3) Business Environment

Now to slide 7, and our view of the business environment. In the past 3 years, we have witnessed higher expectations for sustainability, and faster rates of change in the industrial structure. As demographic trends had already suggested, the 100-year life society is arriving, and population growth continues. Over the past 3 years, there has been growing attention on global environmental issues such as greenhouse gases, or GHG, and marine plastics. On the industry front, there are also new trends, such as "Industry 4.0," "mobility-as-a-service," and the changing trade environment under the Trump administration.

We are very mindful of all such developments as we implement the new management initiative.

2. Vision and goals

P. 9 (1) Sustainability for Asahi Kasei

Turning to slide 9, I would now like to discuss our vision and goals for the medium- and long-term, which underlie the new management initiative.

The key word here is “sustainability.” There are two aspects here, and both are the pillars of our management philosophy. One aspect is about Asahi Kasei Group contributing to a sustainable society. The other is sustainable growth of the group’s corporate value. What we seek is a virtuous cycle between these two aspects of sustainability.

The Asahi Kasei workforce share values of sincerity, challenge and creativity. Our business activities are based upon these values, through which we provide solutions to the world’s challenges. High-value solutions lead to confidence and trust of our customers and society at large, and therefore enhance profitability. That provides for further proactive investment in growth opportunities and R&D, and more return to stakeholders, while sustainably enhancing corporate value. Enhanced corporate value supports new business development and innovation, and further contribution to the sustainable society.

Sustainability for Asahi Kasei means implementing this virtuous cycle through “connections and dialogue” within the group and with external stakeholders.

P. 10 (2) Portfolio transformation

Here on slide 10, let us briefly review the history of our group. In the upper-left corner of the slide, there is a picture of our founder, Shitagau Noguchi, and his vision. Ever since our foundation in 1922, we have been guided by this vision and have continuously adapted to meet the changing needs of the times for almost a hundred years now.

Initially, the focus was on establishing the livelihood base. After World War II, it was about providing ample goods and materials. More recently, the focus shifted to comfort and convenience, and higher standards of living in developing countries. As such, we have always grasped social needs, dynamically transformed our business portfolio, and developed business that makes life better, and thus contributed to society.

Now we would like to explicitly focus on contributing to a sustainable society, while continuing to leverage our “diversity” and “capability to change.”

P. 11 (3) Priority fields for provision of value

Slide 11 describes the priority fields for provision of value. In the middle of the slide is our group mission, which is “contributing to life and living for people around the world.” Our group vision is enabling “living in health and comfort” and “harmony with the natural environment.” This is in synch with current societal challenges and needs, such as environmental issues and longevity. We want to contribute to a sustainable society based on this mission and vision.

To do so, we have identified 5 priority fields where we should provide most value. Under the Material business sector, the focus is on “environment & energy,” “mobility,” and “life material.” The remaining two are “home & living” for the Homes business sector, and “health care.”

P. 12 (4) How we create value

Now, how exactly would we create value in these domains? Please turn to slide 12. We will build on our business platform of diverse technology, market/customer alignment, and capability to change. By reallocating management resources to priority fields, leveraging M&A opportunities, our Corporate Venture Capital, or CVC, open innovation, and the digital transformation, we will transform the business portfolio, and create new businesses.

In this way, our businesses will have traits such as global No.1, one and only, or high profitability, and we will have developed a “portfolio of high-profitability and high value-added businesses” that realizes sustainable growth in corporate value.

P. 13 (5) Approach to realize sustainable society

Turning to slide 13. In addition to these 5 priority fields, we must always be mindful of how to support a sustainable society as described in the SDGs. As a manufacturer and a chemical company, there are two particularly relevant themes.

One is about reducing GHG emissions. Not just reducing emissions from our own production processes, but also expanding businesses that contribute to reducing emissions elsewhere.

The other is about plastics, a topic of increasingly wide concern these days. We have, from before, been focusing on the “3Rs” of reduce, reuse, and recycle. In addition to stepping up such efforts, we would also like to be part of the effort to elucidate the mechanism of microplastic formation, which is not well understood yet, and to identify true solutions, and share understandings with others.

The idea is not just to act on our own, but to proactively seek opportunities for collaboration.

3. Medium-term management initiative "Cs+ for Tomorrow 2021"

P. 15 (1) Stance for "Cs+ for Tomorrow 2021"

I would now like to discuss the new 3-year strategic management initiative, "Cs+ for tomorrow 2021," in more detail. Please turn to slide 15. As I just discussed, with higher expectations for sustainability, we are all the more aware of the relevance of our activities to the future of mankind and the earth. That is why we chose to express our fundamental stance under the new management initiative as "Care for People, Care for Earth."

P. 16 (2) Concept

Turning to slide 16. Under the previous management initiative, "Cs for Tomorrow 2018," we sought to reinforce our business foundation and create new value through connections within the group, and with those outside. We also identified the "Cs" of "Compliance," "Communication," and "Challenge," as our employee action principles. We have driven growth by leveraging strengths such as diversity and the capability to change. While maintaining this basic approach, we have decided this time to bring in additional "Cs" to the forefront, namely, "Care for People, Care for Earth," so as to further contribute to a sustainable society.

P. 17 (3) Financial objectives

Slide 17, please. Now, let me go over the medium-term financial objectives. Under the policy of realizing sustainable profit growth exceeding global GDP growth, for FY 2021, the last year of the current 3-year plan period, we aim to achieve operating income of ¥240 billion, operating margin of 10%, and EBITDA margin of 15%. Furthermore, for FY 2025, we aim to achieve ¥300 billion or more in operating income, 10% or more in operating margin, and 16% or more in EBITDA margin. By pursuing these objectives, we will be building a "portfolio of high-profitability and high value-added businesses."

For your information, when the previous mid-term plan started in FY 2016, we set our outlook for operating income for FY 2025 at ¥280 billion. Thanks to the favorable business environment, however, for FY 2018, we achieved an operating income of ¥209.6 billion, demonstrating a steady progress on building a "portfolio of high-profitability and high value-added businesses." That's why we have revised up the outlook from ¥280 to ¥300 billion or more for FY 2025.

P. 18 (3) Financial objectives: performance metrics

Slide 18, please. Next, I would like to take you through the more details of our financial objectives. Operating income, EBITDA, and earnings per share, or EPS, are defined as key performance indicators, which should ensure our focus on generating return on strategic investments made in the past.

As for capital efficiency, our intention is to maintain and improve ROIC and ROE, through disciplined screening of investment projects and transformation of business portfolio, in terms of return on investment, while making investment for future growth.

P. 19 (3) Financial objectives: capital allocation

Slide 19, please. Next is finance and capital allocation for the medium term. During the 3-year period, we believe that we can generate an operating cash flow of ¥600 to ¥700 billion. With this, maintaining a proactive stance, we plan to spend about ¥800 billion in capital expenditure, an amount higher than in the previous 3 years. As for shareholder return, our plan is to continue to increase dividends, based on our stable dividend policy, while flexibly carrying out share buyback programs. The planned capital expenditure cannot be supported only with operating cash flows. So we are planning to increase interest-bearing debt by ¥200 to ¥400 billion. Our basic stance is to maintain proactive capital expenditure through such funding, while keeping the D/E ratio at around 0.5 times.

P. 20 (3) Financial objectives: dividend policy

On slide 20, I would like to talk about our dividend policy. The blue line shows the trend in net income, and light blue columns show annual dividend per share. As you can see on the chart, we have either maintained or increased our annual dividend per share every year since 2011, as net income grew. We decreased annual dividend in 2008, at the time of global financial crisis. In the following 10 years, however, we have never done that. We have either maintained or increased it year-on-year. For FY 2019 onward, we will basically increase the dividend along with earnings growth to further enhance shareholder return.

P. 21 (3) Objectives for sustainability

Slide 21, please. Next, let me discuss the details of our objectives toward sustainable society. One of the key performance indicators we have been tracking is the ratio of greenhouse gas emissions to net sales. Our target is to reduce it by 35% by FY 2030, compared with the level recorded in FY 2013. On top of greenhouse gas emissions, we also promote greater use of low-carbon energy, and technological development and commercialization for emissions reduction.

As part of our effort to reduce greenhouse gas emissions, we also promote businesses that help saving energy and reduce emissions, and develop and commercialize new technologies for the environment and energy society. That’s how we intend to approach sustainable society.

It’s through both direct reduction and indirect contribution to emissions reduction.

P. 22 (4)-1 Growth Strategy: Material

Slide 22 please. Next, let me take you through our growth strategy in each segment, starting with the Material segment.

The basic strategy is flexible allocation of management resources to priority fields. As you can see on the chart below, while we are solidifying the earnings base of commodity businesses, we will be proactively directing resources to the 3 areas, namely, “environment & energy,” “mobility,” and “life material,” in an effort to expand high value-added businesses. These businesses accounted for ¥80 billion out of ¥135 billion in FY 2018. We would like to increase it to ¥105 billion in FY 2021, and ¥135 billion in FY 2025.

P. 23 (4)-1 Growth Strategy: Material -Environment & Energy

On slide 23, I would like to go through the growth strategy of each priority field of the Material segment.

First is “environment & energy.” we see global trends or issues, such as greater adoption of clean energy and transition to low-carbon society. To help addressing these issues, we would like to contribute to the environmental protection, using various technologies, including CO_2 chemistry and semiconductors.

Under the stance of “Care for Earth”, we will be addressing clean energy, energy conservation/environmental improvement, and realization of low-carbon society. In concrete terms, we are further expanding investment in battery separators and enhancing the existing businesses of CO_2 sensors, water filtration modules, and ion-exchange membranes, while commercializing an alkaline water electrolysis system and a new CO_2 separation/recovery system, which are under the R&D stage at the moment.

These activities should help expanding our sales in the “environment & energy” field, as shown on the bar chart to the right, sales are projected to grow several fold, from the ¥100 billion level in FY 2018 to the ¥250 billion level in FY 2025.

P. 24 (4)-1 Growth Strategy: Material -Mobility

The second priority field of the Material segment is “mobility.” As you can see on the left chart, even though the ratio of combustion engine cars is expected to remain as high as 90% in FY 2030, the growth of electric vehicles will likely be far greater than that for the overall market, which is growing at 2-3% annually. We are also anticipating dramatic growth of EVs and other eco cars, as well as so-called "CASE," meaning connected cars, autonomous driving, and sharing & services.

Under such circumstances, we will try to contribute to the future of mobility with our technologies of safety, comfort, and environment. Under the concept of "Care for People, Care for Earth," we will focus on safety, security, comfortable space, fuel economy, and EV/HEV. In each of these areas, we have unique products, such as fibers, engineering plastics, and sensors. We will enhance our contribution by strengthening these products and increasing collaboration between businesses.

The photo on the slide shows AKXY POD vehicle interior concept, which was exhibited last week at the Automotive Engineering Exposition 2019. It's the same tradeshow as we have presented AKXY concept car three years ago. The concept showcases 9 different products and technologies we have worked or are working on, including fibers, plastics, and sensors.

Through these activities, we aim to gain attention and recognition of the automotive market. Our target in this area is to increase sales from around ¥250 billion in FY 2018 to ¥550 billion in FY 2025.

P. 25 (4)-1 Growth Strategy: Material -Life Material

On page 25. The third priority field of the Material segment is "life material," where we see challenges ahead of us, such as global population growth and 5G communication revolution. In this area, we would like to contribute to the healthy and comfortable lives of people, with our unique products and technologies.

Under the concepts of "Care for People, Care for Earth," we are focusing on comfort/convenience, health, food loss reduction, and environmental burden alleviation. In addition to the existing products, such as disposable diaper materials and regenerated cellulose fibers, we expect to provide new solutions, such as deep-ultra-violet light-emitting diodes, or UVC LEDs, as modules.

Sales of "life material" is expected to grow from about ¥300 billion in FY 2018 to around ¥450 billion by FY 2025.

P. 26 (4)-1 Growth Strategy: Material -unit strategy

Slide 26 shows the basic strategy of each business, within the Material segment. On April 1, at the start of the new medium-term period, the segment announced an organizational change.

The objective is to enable speedy and flexible allocation of management resources to the priority fields that are adding value. In view of game-changing developments happening across the industries, we need to use market segmentation, instead of industry segmentation, to accurately identify social needs and challenges and provide relevant solutions to customers. That was the objective of the organizational change.

Previously, the Material segment had 6 strategic business units and 1 core operating company. Now it consists of 3 strategic business units and 1 core operating company. Under the new structure, the segment should be able to allocate resources flexibly, articulate strategic priorities clearly, and transform the business portfolio effectively.

P. 27 (4)-2 Growth Strategy: Homes (i)

Slide 27, please. I'll move onto the Homes segment. The basic strategy is to reinforce and extend value chain management. While reinforcing the business platform for the order-built and condominiums business as well as for the construction materials business, we would like to expand the Homes segment by driving new businesses and services. New businesses include overseas, senior, and middle-rise homes businesses, while services include remodeling, rental management, and brokerage services.

In FY 2018, the segment's operating income was ¥68 billion, of which new businesses and services accounted for ¥17 billion. We will grow new businesses and services to ¥27 billion by FY 2021 and ¥44 billion by FY 2025, while increasing their shares in the entire segment.

P. 28 (4)-2 Growth Strategy: Homes (ii)

Slide 28 shows the growth strategy of the Homes segment. We see domestic challenges and trends, such as frequent natural disasters and diversification of people's lifestyles in more mature society. Our strategy here is to contribute to superior social infrastructure and comfortable living through our know-how gained in urban markets.

Under the concept of "Care for People, Care for Earth", we will focus on safety/security, comfort/health, and the environment, and offer 60-year long-life homes, based on the reinforced Hebel brand, disaster-resisting homes, long-term retention of asset value, living in a good thermal environment, diverse modes of residence, ZEH or net zero energy house, photovoltaic power, and high-performance insulation materials.

With these initiatives, the segment sales are expected to grow from ¥660 billion in FY 2018 to ¥1 trillion in FY 2025

P. 29 (4)-2 Growth Strategy: Homes (iii)

These are some details of the Homes strategy on page 29. The value chain starts with the order-built and pre-built business.

By leveraging our strengths here, we will develop related and growing markets, such as urban development and overseas development. The former includes medium-rise buildings and senior housings, and the latter includes Australia and North America. These were already included in the previous medium-term initiative, but we will continue to focus on them, so that they will become next growth drivers.

In the service business, we will be leveraging the existing relationships with our customers and rental apartment owners, in order to maximize business opportunities and business values. This is another area of potential growth.

In the construction materials business, the main growth driver is insulation panels. We will be offering them not only for housing applications, but also for industrial and infrastructure-related applications, to maximize business opportunities.

P. 30 (4)-3 Growth Strategy: Health Care (i)

Next is the Health Care segment. The basic strategy is to further accelerate transformation towards becoming a global health care company. As you can see at the bottom of the bar chart, while striving to strengthen the profitability and the platform of our business in Japan, we hope to grow our profits in our overseas business.

In overseas business, our mainstay currently is Critical Care represented by ZOLL, as well as the bioprocess including Planova virus removal filters, but, in addition to going overseas with the existing businesses we have, we want to explore opportunities to enter new businesses, so we can make Health Care a third major pillar of Asahi Kasei Group.

More specifically, in FY 2018, of the ¥42 billion in operating income, ¥35 billion worth was accounted for by overseas businesses. We want to grow our overseas business further by increasing the operating income to ¥44 billion in FY 2021 and ¥65 billion in FY 2025.

P. 31 (4)-3 Growth Strategy: Health Care (ii)

Please turn to page 31. More specifically, we hope to discern the needs of society such as rapidly aging population, and heightened necessity for critical care, so as to contribute to healthy longevity with pharmaceuticals and medical devices.

Under the concept of "Care for People," in addition to further strengthening such businesses as drugs in orthopedic area, where we can offer solutions to issues around aging society, critical care to address diseases ranked among leading causes of death and dialysis business, we will work to reinforce Planova and other bioprocess equipment in order to provide safe biotherapeutics from the perspective of providing sense of security.

In terms of net sales, in FY 2018, we achieved only slightly more than ¥300 billion in Health Care, which we hope to rapidly grow to about double the amount, ¥600 billion, in FY 2025. As I said, we want to establish the position of the Health Care as our third major pillar following Material and Homes.

P. 32 (4)-3 Growth Strategy: Health Care (iii)

Please move to page 32. Let me now explain about the growth strategy of Health Care.

There are two main perspectives.

First, transition to global operations. Considering the expected rise in the share of overseas businesses in our profit structure, we will accelerate transformation to be a global health care company by optimizing business infrastructures to develop worldwide businesses. To this end, we will create new products and services by promoting connections within the group, and by incorporating innovation globally

Furthermore, in order to promote strategic business development, we will seek M&A opportunities not only in existing areas but also in new areas, and proactively work on potential deals that we believe will contribute to sustainable growth.

The second perspective is to focus on strengthening of existing businesses. We hope to strengthen profitability of existing pharmaceuticals and medical devices, building a stable business platform able to withstand changes in the market environment. In order to do this, we hope to focus on building a stronger organization and ensuring steady implementation of other measures to strengthen sales of existing products and reinforce the product pipeline.

P. 33 (4)-4 Growth Strategy: Key financial objectives by sector

Please turn to page 33. Next, let me go into more details of key financial objectives by sector. The top line is the Material sector. In the period of the previous medium-term management initiative between FY 2015 and 2018, we posted a 17.8% growth per annum in operating income, an extremely high growth rate, mainly because we benefitted from a very favorable petrochemical business environment and contributions by the growth of businesses with competitive advantage.

In the 3 years of the current medium-term management initiative, it would be difficult to expect such a high growth, and yet we will want to show growth outperforming that of the global GDP. Thus we set a goal of a 5% annual growth in operating income to reach ¥150 billion in FY 2021.

In Material sector, we will focus more on growing EBITDA further, rather than operating income by setting a goal of generating cash and increasing cashflow.

In Homes, unfortunately in the previous medium-term management initiative, we recorded a negative growth. This was because the issue of manipulated data for the installation of precast concrete piles by Asahi Kasei Construction Materials led to a slight difficulty in taking orders. Another reason was increased expenses related to the workstyle reform initiative. However, as you know, in FY 2018, orders for both unit homes and apartment buildings grew more than 11% year-on-year. Based on such performance, we have planned for an annual growth of 3.2% in operating income for the three years covered by the current medium-term management initiative, to achieve ¥75 billion in FY 2021. In Homes sector, we hope to increase the operating income to ¥100 billion in FY 2025 by growing its absolute amount, while maintaining a stable growth.

In Health Care sector, the operating income grew by 4.9% per annum in the previous medium-term management initiative. But the environment of the domestic pharmaceutical and medical device businesses has changed significantly, compared to the days before the previous medium-term management initiative period started. Under an extremely challenging environment, which saw reductions of NHI prices, we partially reviewed the strategies at some points but managed to achieve a 4.9% annual growth, due partly to the steady growth of the Critical Care business especially in the US. Despite such background, we came forward with a target annual growth of the operating income of 10.2% in the Health Care sector for the current medium-term management initiative. We aim to reach ¥56 billion in FY 2021 and ¥80 billion in FY 2025 with high operating margins such as 13% and 15%.

It would be one of the very important strategies for us in creating a “portfolio of high-profitability and high value-added businesses” to maintain such a high profitability in Health Care, while enhancing the share of the sector in Asahi Kasei Group, and therefore we have set these goals for ourselves to carry out.

P. 34 (5)-1 Action plan: Business portfolio transformation

Please see page 34. Let me now discuss the action plans to execute these growth strategies. First, the business portfolio transformation. In order to engage in businesses that will contribute to sustainable society, while achieving sustained growth of group corporate values at the same time, we will need to make business management decisions from the following four perspectives in carrying out the business portfolio transformation.

We will first need to see if the business is highly profitable, secondly if the target application markets for that business have potential to achieve high growth, third, if it falls under our priority fields, and fourth, if the business has affinity with sustainable society, which we believe will be important going forward.

Therefore, from these four perspectives, we will proceed with the business portfolio transformation by preferentially allocating and reallocating human resources and capital to priority fields, and continuously seeking non-linear and immediate opportunities including M&As.

P. 35 (5)-2 Action plan: Strengthening global operations

Please turn to page 35. The second action plan is to strengthen global operations. As the ratio of overseas sales increases, we will need to strengthen this operation. Basically, we hope to expand businesses in accordance with market characteristics, promote growth and create synergies through regional coordination among different businesses.

Europe is a leading region of environmental and automotive trends. In this region, we established Asahi Kasei Europe GmbH in FY 2016 at the beginning of the previous medium-term management initiative. And now, we are focusing on the automotive area to expand businesses. We expect an average annual sales growth rate of 11% over the 7 years between FY 2018 and 2025 in Europe.

In China, which is beginning to become an enormous market, is expected to grow 6% on the average annually in sales with enhanced activities.

In the US, with the awareness that it is a source of new business models and leading region of Health Care, we expect the average annual sales growth rate at 10%.

India is expected to become a large market for us around 2025, and therefore we hope to take solid measures to prepare for that.

ASEAN is a large growing market, where we already have a lot of production sites. Our plan is to strengthen our efforts as we continue to position it as an important region for production.

At each of the regional headquarters, we will make sure to disseminate the mission of Asahi Kasei Group to local employees, strengthen the management capabilities of the local executive team, and reinforce the recruiting and training of local personnel in order to deepen the businesses in the region. Also provided as the regional headquarters' functions are sharing information among the members in each region, group-wide marketing, and promoting R&D suited to the particular region.

P. 36 (5)-3 Action plan: Creating new businesses (i)

Please now see page 36. The third action plan is about creating new businesses. As a basic concept, we would like to create new businesses by combining various core technologies, group-wide marketing functions, and internal and external connections.

As we started the current medium-term management initiative in April 2019, in order to focus on group-wide marketing functions, Marketing & Innovation was newly established. We will strive to engage in activities from a new and broad perspective, freed from the conventional market channels, which, we hope, will lead to creation of new businesses in the end. Instead of the conventional practice of making improvements on existing applications to develop new ones, we hope to carry out marketing activities which will enable us to participate in making new technical standards in the market and create new businesses by reinforcing the collaboration with R&D and business units.

P. 37 (5)-3 Action plan: Creating new businesses (ii)

Please take a look at page 37. As for specifics in creation of new businesses, by using our core technological areas as a basis, with the concepts of "Care for People, Care for Earth," we will seek to develop and commercialize new businesses targeting at such themes as alkaline water electrolysis for hydrogen production, high performance composites including cellulose nanofiber, UVC LEDs and their modules, new sensors including CO_2 and odor sensors, and materials related to new batteries and cells such as solid-state batteries and fuel cells.

P. 38 (5)-4 Action plan: Strengthening the platform -heightening businesses

Please turn to page 38. Next, I would like to talk about the fourth action plan, which is strengthening the platform, highlighting three aspects.

First, following the previous medium-term management initiative, we will put in our efforts to heighten the businesses by digital transformation. More specifically, we will focus on digital marketing, materials informatics, production technology innovation through IoT, and IP landscape. By doing so, we would like to create new business models, accelerate R&D activities, improve productivity and formulate strategies based on IP.

As a result, in three years, we should be able to increase digital professional personnel to a total of around 150, especially data engineers and data scientists, who are expected to lead the digital transformation in Asahi Kasei Group, so that it will be established as one of the sources for competitive advantages for us.

P. 39 (5)-4 Action plan: Strengthening the platform -HR

Please move to page 39. Next, I will discuss the second aspect of the fourth action plan to strengthen the platform, or human resources, where we will need to ensure the linkage with business strategies and business portfolio transformation. Even if you put together a business strategy, if you lack personnel to execute it, it will end up being a mere pipe dream.

We will need to develop human resources and provide them with opportunities to succeed in their jobs through leadership development program targeting people like ourselves, development and recruitment of experts as well as line managers, and leveraging of local personnel, which would be essential for global business operations.

At the same time, we also need to create the working environment where everyone in Asahi Kasei Group will be highly motivated to act proactively. To that end, we will provide the continuous human resources development support, enhance the engagement, improve support for life events and increase options for working styles. In so doing, we hope to help them enhance their expertise as well as liveliness and creativity, so that we will be able to create new values by diversity and capability to change.

P. 40 (5)-4 Action plan: Strengthening the platform -safety, quality, risk management, compliance

Please move to page 40. The third aspect of platform strengthening is about safety, quality, risk management, and compliance. We have significantly reinforced this aspect during the three years of the previous medium-term management initiative. We will continue to position this as a key management issue, and work to raise the overall level so as to strengthen the platform for Asahi Kasei Group. And we hope to create new values through our diversity and capability to change.

P. 41 (5)-4 Action plan: Strengthening the platform -corporate governnance

Please turn to page 41, my last page describing the last action plan. I have talked about new strategies for growth, but they can only be achieved when we have an appropriate governance system in place. Therefore, we will continuously develop sound corporate governance to ensure diversity and capability to change, so that we will be able to achieve the targets in the current medium-term management initiative and continuously enhance the corporate value.

That is all for my presentation on “Cs+ for Tomorrow 2021.” Thank you very much for your attention.

Question and Answer Session

Hamamoto: We will now take questions.

Mr. Watabe: Watabe from Morgan Stanley MUFG Securities. First on Material. You mentioned that this business sector comprises both high value-added businesses and commodity businesses, the latter being positioned as the earnings base. But currently, the latter, the basic materials business is most profitable. What do you expect of the business environment for basic materials in the next 3 to 5 years? Would you really not need major investment into these businesses?

And, with regard to separators, while you currently enjoy a strong position, competition is intensifying. What is your expectation for the next 3 years, particularly for competition?

Kobori: During the three years of the previous management initiative, the petrochemical-related business environment was much more favorable than we had expected. But given trade tensions between China and the United States, and rising capacity utilization of crackers using shale-oil and shale-gas derived feedstock, it would be too optimistic to expect that favorable environment to continue. The supply-demand balance going forward would be rather unfavorable.

Consequently, for the commodity businesses, we will focus not so much on single-year operating income, but more on realizing total cumulative operating income of ¥100 billion over 3 years. There can be volatility, but the idea is to have a strong-enough earnings base so that the business is profitable even in difficult times and earn big when the economy is strong.

This, however, does not mean the end of R&D efforts in this field. We will continue efforts to develop new chemical processes and catalysts that leave a smaller environmental footprint. But these efforts take some time.

Our production processes are environmentally friendlier relative to competition. We want to convert this into competitive advantage, a reason for users and the market to choose our products over others. That is why we will continue to step up technological development of environmentally friendly and efficient processes for commodity businesses as well. The idea is to keep these businesses strong and viable.

Obviously, the higher the percentage of commodity businesses, the larger volatility we would be subject to. So we want to increase the percentage of high value-added businesses and be less susceptible to cyclical changes or fluctuation in market prices. For future growth, there will be more focus on high value-added businesses, and consequently more management resources investments. At the same time, our commodity businesses will steadily continue.

With regard to your question on separators, the Chinese government may, as part of their “Made in China 2025” state policy, choose to beef up their domestic battery and separator manufacturing. But market growth of electric vehicles and batteries is happening globally. We are ahead of competitors in terms of production capacity, and we have a proven record of supplying high performance, high durability separators. Chinese battery manufacturers may currently be sourcing their lithium-ion battery separators from a single supplier, but eventually, as the market grows, they would also seek supply stability through diversifying their supplier base.

We seek to remain the No.1 supplier of choice for leading, technology-focused battery manufacturers. And our technological development and market development efforts will be geared to that goal. This does not change in the presence of competition. We are confident about maintaining a technological edge.

Mr. Watabe: My next question is on Health Care. You mentioned that you would accelerate overseas growth. So far, Health Care growth has been driven by Critical Care. Is there not a risk of a slowdown there? And still on overseas growth, on the pharmaceuticals side, can you also tell us about ART-123? I understand that the overseas clinical study for ART-123 is not going very well, and while you probably have not discontinued development, you did recognize impairment loss, so what is the outlook?

Kobori: With regard to Critical Care, for the 7 years since the acquisition of ZOLL in 2012, the operations have realized consistent double-digit growth for both net sales and gross operating income. Net sales converted to the Japanese yen have grown to a ¥180 billion level from a ¥50-some billion level. Now that the business is much larger, maintaining double-digit growth may be more challenging. But we still enjoy overwhelming competitive advantage when it comes to defibrillators for professional use and LifeVest wearable defibrillators.

At one point in time, LifeVest growth appeared to be slowing down a little, but with additional efforts, we are seeing signs of growth again. And while the current business may be concentrated in the United States, there is potential for geographical expansion. In Japan, too, sales is growing at Asahi Kasei ZOLL Medical Corp. In summary, we expect high growth to continue for the Critical Care business. It certainly is the No. 1 growth engine of the Health Care business sector.

With regard to overseas expansion of our pharmaceutical business, it is true that the ART-123 clinical study that we pursued on our own did not exactly yield the results that we expected. But the clinical study did confirm efficacy in some areas, which we intend to leverage going forward as we accelerate globalization of the business.

Our initial hope was for ART-123 to drive overseas expansion in one big step, but we have now adjusted course. ART-123 will still be one of the drivers, but we will take a fresh look at other opportunities as well, such as pharmaceuticals that have synergy with Critical Care or medical devices, or ways of better leveraging our strength in orthopedics.

Mr. Watabe: Thank you very much.

Mr. Yamada: Yamada from Mizuho Securities. First is about allocation of resources to priority fields. Generally speaking, the investments made up to FY 2018 do appear to be contributing to growth. But I am concerned about separators. You have invested ¥85 billion in separators, including lead-acid battery separators and dry-process separators as well. According to my calculation, the cumulative amount including the Polypore acquisition would come to about ¥350 billion, which translates into return on invested capital below 5%.

You are supposed to have competitive advantage. And, unlike positive- or negative-electrode materials, you should be able to leverage technological differentiation for lithium-ion battery separators. Despite all that, if your asset turnover is so low, how do you justify further investment here?

Kobori: With regard to the separator business, the Polypore acquisition was completed in 2015, when it became a consolidated subsidiary.

During the 3 years under the previous management initiative, we executed significant growth investment in separators. Even so, at the end of FY 2018, our production capacity for lithium-ion battery separators was only about 730 million m^2 per year, including both dry- and wet-processes. Therefore, contribution to earnings is still limited.

But, also during that 3-year period, we decided to further increase capacity, initially to 1.1 billion m^2, and later, in March this year, up to 1.55 billion m^2, almost double the current capacity. These are also included as investments during the previous initiative, as the figures we shared are on a decision-adopted basis.

The delay between capex decision made and new capacity coming online is usually 2 to 3 years. So, the capex decisions made in the past three financial years will translate into additional capacity in FY 2020 or FY 2021, when it should significantly boost both top line and bottom line, and deliver good return on investment.

Mr. Yamada: On page 23, it says sales for the “environment & energy” business in the Material segment will increase by ¥150 billion from FY 2018 to ¥250 billion in FY 2025. Suppose that the capital expenditure made for the separator business will make a full contribution by FY 2025, is it correct to assume that the separator business would account for more than half of the incremental sales?

Kobori: Yes, the separator business should account for a major part of the incremental sales.

Mr. Yamada: Are there any other projects, included in the medium-term initiative, which require a long lead time for making contribution, like in the case of the separator business?

Kobori: In the Material segment, there are a fairly large number of projects which require 2 to 3 years from the decision to invest to the start of mass production. For example, we made a decision to expand the production capacity of Lamous, microfiber suede back in FY2017. It is expected to take until FY 2019 to realize the benefit of mass production and we will continue to expand sales towards

FY 2021. In the Material segment, there is a time lag between decision to invest and profit contribution. Therefore, it is critical for us to make right judgements and decisions, for accelerating recovery of investment ramping up production, and enhancing investment efficiency.

Mr. Yamada: My second question is about financial objectives on page 19. If the capital expenditure of ¥800 billion is made, the D/E ratio would be around this level. Then the equity required to achieve an ROE of 11.1% by FY 2021 would be about ¥1.65 trillion. If that's the case, a payout ratio of 30 to 40% does not make sense, unless the company expects a significant decline in earnings in FY 2020 or plans to carry out a share buyback program. Is that the case? Or is there a circulation error? That's all questions I have.

Shibata: Let me respond to your question. The amount of capital expenditure we are talking about here is on a decision-adopted basis, whereas the financial forecast was calculated based on cash flow figures. That's the reason behind the slight difference. I hope we have your understanding.

Mr. Yamada: That factor alone does not explain the entire discrepancy with the ROE target. The assumption is the shareholders equity will go down, isn't it? It says ROE is 11%.

Shibata: The shareholder return of 30 to 40% shown on the material is basically coming from dividends, though the balance changes every year. So, 30 to 40% is basically on a dividend basis.

Kobori: Let me make some supplementary comments. On page 19, you see a discussion on capital expenditure and shareholder return on the right-hand side, and a discussion on financing and operating cash flow on the left-hand side. They are not necessarily consistent with each other, especially when it comes to capital expenditure, it may not be kept within ¥800 billion, and it may be substantially above that level if we have a chance to carry out a major acquisition.

At the moment, it is true that each business unit is showing a strong appetite for capital spending. In view of financial discipline, however, we would like to carefully select investment themes, and make steady progress. That's the background of how we set the target and outlook.

Depending on the situation or investment theme, if we think we can enhance our competitiveness or grow business, we may spend more. That's definitely a possibility.

Mr. Yamada: Thank you.

Mr. Ikeda: I am Ikeda from Citigroup Global Markets Japan. Regarding variance of the high added-value businesses in the Material segment on page 22, the target is to increase operating income from ¥80 billion in FY 2018 to ¥105 billion in FY 2021. My assumption is that separator sales are growing around ¥60 billion, and after depreciation operating income will be up around ¥20 billion. Am I on the right track? What are major drivers, other than separators, engineering plastics, and SAGE? Earlier, there was no specific comment about it, but are there any specific major factors?

Kobori: During the previous medium-term, we've made several major investments, such as separators, SAGE, Lamous microfiber suede, and S-SBR for fuel-efficient tires, as well as Leona nylon 66 filament for airbags. So, there are many areas and products where we made investments to enhance our competitive advantages further. Compared with the previous medium-term, we invested more in the competitive existing businesses, rather than in mergers and acquisitions. We should be able to gain return on those investments, especially in the areas of "environment & energy" and "mobility."

Mr. Ikeda: During FY 2018, we saw a slowdown in the Electronics, and despite being the top player in the industry, the company did not generate substantial sales volume, probably because sales to the ESS or energy storage systems market was less than expected. Or, were there any technical issues? In other words, what makes you believe that the separator business will grow in the future?

Kobori: In the latter half of FY 2018, we saw a slowdown of the Chinese economy and production output of smartphones as well. The slow trend of separators, however, was caused by the suspension of ESS production of our customers. It was not because of the technical issues of our products. The competitiveness of our products has not been undermined.

Mr. Ikeda: Could you give us some comments on Critical Care, or regrowth of LifeVest. What are the chances for Thermogard temperature management systems, or other third pillars, making contribution during the current medium-term or towards FY 2025? How is the growth of Critical Care realized going forward? Could you elaborate on this?

Kobori: For Lifevest, we are taking multiple actions, such as expanding the scope of indications, and hiring area managers and other talent to enhance management capabilities. So, after some slowdown during FY 2018, we are seeing a sign of recovery already this year. Thermogard products are expected to become a third pillar of the business, following LifeVest and defibrillators for professional use. To strengthen the pipeline, ZOLL has been carrying out small-scale M&As. Those efforts should bring about benefits in next 2 to 3 years.

Mr. Ikeda: As a third pillar, are they expected to make a meaningful contribution to earnings?

Kobori: ZOLL's new business is expected to have competitive advantage when it's commercialized. We will build on the trust we have earned from our patients and doctors. We believe we can secure high profitability.

Mr. Ikeda: Thank you.

Mr. Okazaki: This is Shigeki Okazaki from Nomura securities. My first question is on page 19. Total capital expenditure is ¥800 billion for 3 years. Out of that amount, how much is for M&A? In the last 3 years, the company spent about ¥120 billion if I remember correctly. So what is the perception at the moment? And how about cash outflow from capital expenditure? It was around ¥300 billion in the previous 3 years, I believe. What would be cash outflow for next 3 years?

Kobori: When we put together the current medium-term management initiative, business divisions showed their strong appetite for investments in increasing the production capacity of the existing businesses. However, as it is hard to tell how the overall economy will perform and what is going to happen to the trade friction between the US and China, we want to implement well-balanced capital investments by scrutinizing each of the candidate projects.

Basically, we will watch out for opportunities for M&As to achieve non-linear growth, while ensuring to make investments to expand the existing businesses with competitive advantage. We will decide on the appropriate timing to execute the investments as we closely monitor the trends in society and the economy.

At this moment, we do not have any specific figures to show how much to spend on M&As and on capital investments.

Mr. Okazaki: Do you think the amount of capital investments on a cash-outflow basis will increase from the past three years? Do you have any specific figures in mind?

Shibata: The amount of investments is expected to increase on a decision-adopted basis, and therefore I believe the amount on the basis of cash outflow will also increase, but it also depends on the timing of commissioning.

Mr. Okazaki: I see. My second question is about shareholder returns. In the previous medium-term management initiative, the total return ratio was targeted at 35% in FY 2018, but in the current one, you have changed the tone slightly and now target at a payout ratio of around 30 to 40% with the share buyback to be performed flexibly. Could you explain more about the background? As the president said, since you could carry out M&As as well, are you trying to remain flexible in your plans?

Kobori: The previous medium-term management initiative was our first attempt to set a target in terms of the total return ratio, which was set at 35%. Previously, we used to aim for a payout ratio of around 30%.

As we look at the future economic trends now, we see much higher uncertainty. Basically, we primarily place our first priority to investments for growth and expansion to achieve sustainable growth, while at the same time keeping an eye on shareholder returns. Then what is important is not focusing on the percentage of payout ratio but ensuring the stable and continuous dividend increases, which, we believe, will in turn result in an increase in the payout ratio.

Therefore, our intention is to ensure dividend payments as we closely watch the economic trends, while maintaining a certain degree of freedom in the amount of investments in business activities. That is how we came forward with the plan that we did.

Mr. Okazaki: Thank you.

Mr. Umebayashi: Umebayashi from Daiwa Securities. I have two questions. The first is about Health Care. I want to ask about how you plan to develop ZOLL business in countries other than in the US. You said ZOLL business has also been performing well in Japan. Will it be LifeVest that you are planning to grow for the next three years? Or something else, such as AEDs, which I believe is increasing in Japan? Could you elaborate more on that?

Kobori: Our basic plan is to expand the business in the US. But we will also continue to grow LifeVest in other countries including Germany and France, and to expand AEDs. However, the health care business generally depends on the insurance system and government policies of each country. The LifeVest business in the US has been steadily growing as it succeeded in taking full advantage of the insurance system there.

On the other hand, in Europe, different countries have different insurance systems and we need to address each one separately. In other words, we will strive to get the regulatory authority of the country to realize how ZOLL products can contribute to patients and allow them to be covered by the insurance. We will need to expand our business in each region and country through such efforts and therefore expect it to take time in some areas.

In the US, prior to our acquisition, ZOLL had gone through a lot of negotiations with the authority, which resulted in their success in fitting into the government policiy and realized their subsequent rapid business growth. Those activities need to be replicated persistently in each of the major regions.

As for the defibrillators other than LifeVest, we also still have much room to grow globally. Defibrillators for professional use are especially promising for further growth as they have excellent characteristics as products.

Mr. Umebayashi: Could you give us a ballpark figure of sales in countries other than US for your Critical Care business in the last fiscal year?

Hamamoto: To give you a very rough figure, the rest of the world accounts for about 20%.

Mr. Umebayashi: Thank you. My second question is about your strategy for Homes. If you look at page 27, you can see the operating income is not going to grow much during the period of the current medium-term management initiative between FY 2018 and 2021. In fact, there will be only a slight increase in FY 2020 and 2021, when compared to the budget in FY 2019.

On the other hand, from FY 2021 to FY 2025, new businesses are expected to increase rapidly and even the conventional order-built business is indicated to grow from the current level. As for the new businesses, I would assume the next three years is the period when you make upfront investments, but what kind of actions do you plan to take?

And how are you going to grow the order-built business? Your focus will probably be in Japan. Recently two of your competitors announced their business integration. After the impact of the consumption tax hike dies down, as the total market is expected to contract, are you going to take some measures to enhance your market share for the next three years? Could you tell us more about those strategies?

Kobori: As you rightly pointed out, with regard to order-built business, due to backlash after the last-minute demand surge before the consumption tax hike, we expect orders to slow down slightly until FY 2020. That is reflected in the plan for FY 2021.

As we move to 2025, we hope to enhance our brand equity by strengthening our consulting businesses to help customers address issues such as vacant homes mainly in urban areas, more effective use of land, and inheritance tax, so that we can capture the opportunities to achieve steady growth. It is not the case that we have some dramatic strategies, but what is extremely important is our steady efforts to improve the capability and productivity of every individual employee and build homes that can meet the future living needs.

On the other hand, in the new businesses, we just started our activities in Australia and US. By providing homes that will suit the context of each of the countries, we hope to accelerate the growth. We acquired Erickson Framing Operations in the US, and formed capital alliance with McDonald Jones Homes in Australia, and so we will continue to implement PMI, or post-merger integration, properly, hoping that these operations will become one of the major growth drivers in three or five years.

Now, as for our business related to seniors, we have been building quite a number of rental homes for senior citizens mainly in urban areas. As soon as they are completed, they get almost fully occupied. This demonstrates extremely high needs for rental homes for seniors, as we see increasingly aging population mainly in large cities. We hope to provide more values by offering more services for residents.

Mr. Umebayashi: In Japan, as I said, the industry consolidation is underway as seen in the integration of Toyota Housing Corp. and Panasonic Homes Co. Ltd. Don’t you have intention to lead the consolidation in the domestic industry as part of your strategies?

Kobori: For now, we do not have any such specific ideas. We will keep focusing on the urban areas, enhance our brand equity, provides homes with distinctive characteristics, and propose new ways of living in those homes, so that we can continue to run our business by taking advantage of our unique strength. That basic policy remains unchanged.

Mr. Umebayashi: Thank you.

Hamamoto: Thank you very much. That concludes today’s briefing. Thank you for your attendance.