



Realizing *Sustainable Growth* by Improving Quality

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Vision for around 2020

—Two years have passed since the 2014 Mid-Term Business Plan commenced. Let's begin our conversation with your outlooks for around 2020.

Tannowa:

Our primary mission under the 2014 Mid-Term Business Plan was to reform the business portfolio by expanding targeted growth business domains and restructuring the bulk and commodity products businesses. In fiscal 2015, we generated operating income of ¥70.9 billion, far more than we had initially forecast. We are becoming more confident in our ability to attain our target of operating income of ¥100 billion well ahead of our 2020 schedule.

What is your impression of the Mitsui Chemicals' growth story?

Watabe:

My impression is that Mitsui Chemicals is now on a clear path toward recovery. In February 2014, Mitsui Chemicals made the difficult decision to restructure the bulk and commodity products businesses, and progress since then has gone to plan. In addition, you can now see growth in the three targeted business domains.

Indeed, Mitsui Chemicals has faced headwinds in the external business environment with the yen weakening and crude oil prices declining. Regardless, its sales volumes have expanded, indicating that growth has been the result of effective management and not simply external factors.

—What are your thoughts on the targeted growth business domains?

Watabe:

Mitsui Chemicals is quite strong in the Mobility domain. Among the diversified chemicals makers in Japan, the profitability of Mitsui Chemicals' Petrochemicals business is exceptionally strong, especially for PP compounds. These strengths derive from the Group's extensive polymer technologies. I have high expectations for growth in these areas.

Mitsui Chemicals has a broad lineup in the Functional Polymeric Materials business, and sales have also been increasing in other fields including electronics.

Tannowa:

The Mobility business has a broad lineup of polymer products for applications other than automobiles. I believe we are effectively leveraging this strength through higher levels of complexity.

Watabe:

What about the Healthcare domain?

Tannowa:

Profit growth in the Healthcare domain seems to be slower than in the Mobility domain. We are continuing to focus on spurring growth in this domain.

We need to invest in the nonwoven fabric business in order to ensure that we have sufficient supply capacity to meet robust demand. In ophthalmic lens materials, we have commenced operations of expanded production facilities for xylene diisocyanate (XDI), a raw material used to make high refractive index ophthalmic lenses, a specialty of Mitsui Chemicals. In addition to improving the functionality of our products, we are keen to expand the range of applications and fulfill a larger variety of customer needs.

Watabe:

Over the past few years, many companies have pivoted toward the provision of solutions to customers. Mitsui Chemicals has also put "Creating New Customer Value" at the forefront of its activities and appears to be moving in this direction based on the three targeted growth business domains.

Lately, it seems that Mitsui Chemicals has expanded its product lineup. I think that this aligns with the "Revival of Mitsui Chemicals" mentioned elsewhere. Please provide more details about this endeavor.

Structural Reform That Makes the Most of Basic Materials

Tannowa:

The concept behind the 2014 Mid-Term Business Plan is to thoroughly utilize our technological strengths and our customer base. The Plan is indeed based on the combination of polymer technologies, organic synthesis technologies that for example are also linked to the development of agrochemicals, and basic material technologies.

In particular, polymers are an important downstream for petrochemical complexes. Adding value in this area is a strength of Mitsui Chemicals, and at the same time is an important task for the Group.

Tannowa:

I believe that, in the context of the overall debate about restructuring, it is not necessary for us to maintain our own ethylene center. If we are able to secure the necessary volume at a stable price, I have no issues with procuring ethylene from external sources. The key is enhancing and maintaining our overall competitiveness, including in downstream derivatives, as we have always stated. I hope that market participants base their judgments on our competitiveness.

Watabe:

Is Mitsui Chemicals' purpose in producing toluene diisocyanate (TDI), a raw material for polyurethane, similar to that for manufacturing meta-xylylene diisocyanate (XDI), namely, to facilitate the development of high-performance products?

Tannowa:

That is one reason why. Another reason is to support the overall operations of Omuta Works.

—What is your impression of the restructuring thus far?

Watabe:

I was surprised by management's decision to restructure the bulk and commodity products businesses in February 2014, wondering how things had deteriorated so much. It must have been a difficult decision to shut down Kashima Works, but I think it was the right move.

However, I do not think it is simply a matter of scaling down the Basic Materials business, because of the cash flow it generates.

Tannowa:

I agree. Basically, the problem of weak commodity prices was caused by excess production capacity, underlining the importance of having in place a business structure able to withstand such trends. Looking at the big picture, I see no need to rush into a downward spiral.

—Speaking of ethylene, market conditions have not been that weak lately. The issues, such as the ethylene center in Asia and shale gas producers in North America, are problems for 2018 and beyond, based on market opinions. What do you think about that?

Watabe:

The ethylene center in Japan has been operating at nearly full capacity, and is likely to remain at this level for the time being. Are there any moves to build one large facility with other conglomerates, for example?

Tannowa:

Including Mitsui Chemicals, there are four chemical producers in Chiba Prefecture. Mitsui Chemicals and Idemitsu Kosan Co., Ltd. have formed a limited liability partnership and largely finished efforts to optimize operations, including downstream activities, accordingly. Our plants remain efficient as long as the utilization rate stays above 70%, so any excess can be addressed by suspending operations at some of the facilities that they supply. Our greater degree of flexibility regarding options ensures that we have the ability to align our operations with trends at other companies.

Watabe:

Overseas, it looks like Mitsui Chemicals will steadily ramp up operations at its shale gas ethane crackers in North America, albeit a bit behind schedule. However, I don't have an exact guideline for coal chemicals in China. Rather than shale gas in North America, coal chemicals in China have been considered a threat. What are your thoughts?

Tannowa:

Coal chemical production requires a fair amount of water, so water is apparently viewed as a bottleneck. Given uncertainties regarding profitability, supply capacity is unlikely to expand that much. However, our policy to

take the necessary steps now to prepare for when coal chemical production is up and running in earnest in China remains unchanged.

Improving the Quality of Global Regional Strategies

—In the Mobility business, the North American market has been seeing strong growth. What are your views on growth in North America?

Watabe:

Sales have expanded in North America, but investment in our production facilities has been less than in Japan and Asia. I think that Mitsui Chemicals should shift more investment to North America, given prospects for growth in demand and its competitiveness there, including shale gas in the United States.

Tannowa:

For example, our LUCANT™ gear oil additive is the outcome of a partnership with Lubrizol Corporation, so we need to have a supply base in North America. The key here is figuring out who to partner with and what markets to target.

Watabe:

Mitsui Chemicals is somewhat of a latecomer to developing business in Europe. I think that growth in Europe would accelerate expansion in the Mobility business.

Tannowa:

Indeed, Europe is a major factor in the Mitsui Chemicals Group's regional strategy, and we will pursue growth in this region.

We have been targeting Southeast Asia for growth in the Basic Materials business so far. It is important that we anticipate the type of functional products that will satisfy future needs in Southeast Asia. One of these products is EVOLUE™, a raw material for high functional sealant film, that we are launching.

Watabe:

Mitsui Chemicals has been shifting from commodity products to specialty products, striving



to improve quality in line with the needs of each region. As a global regional strategy, does Mitsui Chemicals intend to do the same in Asia?

Tannowa:

That's correct.

Growth Investments and M&A

—Mitsui Chemicals has announced its decision to increase growth investments. What is your take on this?

Watabe:

I have a rather positive view when it comes to expanding the investment framework in order to improve the quality of the portfolio, because such a move has the potential to create growth drivers. However, this does not mean Mitsui Chemicals has relaxed its financial discipline, right?

Tannowa:

Of course not. We are taking a balanced approach between stepped up investment and tightening investment criteria. We are also carefully considering the timing of investments. The first priority is warding off supply shortages through investment. Next, we are initiating preparations to increase supply capacity after taking into consideration the increase in future demand.

—Do you see a need for M&A in Mitsui Chemicals' business portfolio?

Watabe:

Not really. I am interested in M&A that would buy time for non-contiguous growth. I also think that partnerships and capital participation that seek out synergies can be quite beneficial. In this context, I believe that Mitsui Chemicals' technologies are a good match with mold producer Kyowa Industrial Co., Ltd.

Industry Reorganization

—Major industry reorganization is under way in Europe and the United States. Do you think that reorganization is needed in Japan as well?

Watabe:

From the standpoint of the equity market, investment valuations have historically been low for Japanese chemicals companies, owing to the large number of companies in the sector and weak profitability in the face of competition from Asia.

As demand grows for agrochemicals and functional materials, Mitsui Chemicals cannot lose out to competition from other Japanese companies. In this case, industry restructuring may be necessary.

Tannowa:

In my opinion, the key here is whether companies can benefit from scale. Combining the operations of companies and eliminating redundancies in peripheral operations does not always result in a considerable boost to pricing through stronger competitiveness and

higher market share in the business.

I think that, ultimately, it is important to have perspective on each business. For example, the agrochemicals business needs scale, because R&D spending is a key. We are confident in our R&D capabilities, but looking ahead, we must consider our options with regard to teaming up with other companies.

Boosting Speed with Management System Reforms

—Mitsui Chemicals announced new reforms to its management system the other day.

Watabe:

Statistics have shown that companies with excellent governance systems have high returns. We are considering how to reflect corporate governance systems in valuations of companies.

What are your criteria when making decisions about reforms?

Tannowa:

Since being appointed CEO, I have worked to improve not just the structure but how our corporate governance system functions—while setting out a vision for corporate governance.

I am aware that our governance system lacks speed. To fix this issue, we are revising the agenda criteria for the Board of Directors so that there is more focus on evaluating the broader direction of business strategies and major investment proposals. We are also making progress on delegating decision-making authority from the CEO to executive officers. By reducing the number of agenda items submitted to the Board of Directors, we are ensuring that each agenda item can be fully deliberated.

Moreover, it is quite important to incorporate the views of outsiders, especially those with business experience, in our decision-making process. Mitsui Chemicals has cut-back two inside directors and added one outside director. By reducing the number of inside directors, we have given business divisions in particular more independence on various matters without placing a director directly in charge. This has also accelerated decision making.

Also, in my efforts to enhance corporate governance, I have focused on improving overall speed, while ensuring proper risk management.

Expand Shareholder Returns by Improving ROE through Stable Profit Growth

Watabe:

Mitsui Chemicals has increased dividends each year for the past two years. What are your thoughts on shareholder returns?

Tannowa:

We aim for sustainable growth over the long term. We intend to increase dividends alongside stable growth in profits. I believe this approach is the most reassuring for investors.

Watabe:

Mitsui Chemicals has set a target for ROE. The Group came close to achieving an ROE of 10% when it posted record-setting operating income of ¥91.7 billion in fiscal 2006. ROA is on a par with levels in fiscal 2006, but the net income margin could still improve, in my opinion. What measures are being taken to improve ROE?

Tannowa:

I think that stable profit growth is a key here, as we reform our business portfolio. We would like to achieve ROE of at least 10% as soon as possible.

Watabe:

Mitsui Chemicals aims to expand net income, the numerator in the ROE equation, by improving quality, correct?

Tannowa:

Yes. We will not squeeze shareholders' equity only for the purpose of increasing the ROE score.

Watabe:

Since the content of equity is different, Japanese companies tend to have lower ROE than their counterparts in Europe and the United States. However, ROE has become a global benchmark, so I hope that Mitsui Chemicals attains an ROE of at least 8%.

Companies with low levels of shareholders' equity naturally have high ROE. I would like to see Mitsui Chemicals improve ROE by increasing its EBITDA margin and operating margin.

Expectations for Mitsui Chemicals

—In conclusion, what are your expectations for the Mitsui Chemicals Group?

Watabe:

The chemicals industry serves a wide range of customers and has deep ties to the automotive, housing, electric power, electronics, and other industries. I believe Mitsui Chemicals is a company that can improve the general standard of living by increasing quality on various fronts. I hope that Mitsui Chemicals sets its sights on operating income of more than ¥100 billion.

In line with the old saying "Mitsui is People," I think that Mitsui Chemicals has a good, optimistic atmosphere. I wish the best for you and the Group.

Tannowa:

I think we still need to work on our ability to consistently create new products and businesses in order to meet expectations. We are focusing our efforts on making steady progress toward sustainable growth.

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Moderator:
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Non-financial information plays an important role when evaluating corporate value over the medium to long term. On this occasion, we spoke with Kazuya Uesako about the use of MBIS®, a method developed by Sumitomo Mitsui Trust Bank for evaluating non-financial information.

● What is MBIS®?

MBIS® is a means for evaluating the strengths of companies in order to ensure sustainable growth. This evaluation method increases confidence in companies' performance forecasts while fostering trust in their ability to enhance corporate value going forward.

Financial data comprises information that reflects business performance, with all other areas seen as non-financial information. The overly general evaluations given to date in such areas as women's participation and the employment of outside directors have not significantly impacted corporate performance and are not regarded as valuable non-financial information. By systematically evaluating non-financial information using MBIS® while leveraging the expertise of analysts in other sectors, we aim to establish more sophisticated analysis content and ensure consistent quality throughout organizations.

● Which evaluation category do you focus on in particular?

That would be Management (M). Within this, I focus on the ability to execute strategies. Beyond management systems, I also evaluate ancillary mechanisms and the ability of frontline employees to implement strategies. I place particular emphasis on the ability to improve and reform businesses when addressing risks and environmental changes.

	MBIS®	Example Checkpoints
M	Management	Ability to execute strategies, ability to improve/reform businesses, scandal/risk management, capital/investment efficiency
B	Business Franchise	Customer value, customer base, entry barriers
I	Industry	Market assumptions, competitive environment, regulations/policies
S	Strategy	Business portfolio, environmental/social policies, marketing, investment/M&A, etc.

● Which evaluation category is most important for chemical companies?

In my opinion, that would be "business portfolio" under Strategy (S). It is necessary for chemical companies to ceaselessly pursue innovation while eliminating obsolete areas as manufacturers in emerging countries catch up. I focus on whether companies are making ongoing, appropriate portfolio improvements, which includes creating new businesses.

● How do you evaluate the Mitsui Chemicals Group?

I evaluate the Mitsui Chemicals Group based on additional checkpoints under the Management and Strategy categories. I give the Group high marks for its ability to execute strategies, the ability of its frontline employees to promote its strategic vision throughout the organization, and business portfolio innovation that strikes a good balance between restructuring unprofitable businesses and accelerating the growth of target businesses.

● What medium- and long-term issues do you think the Group faces?

I believe there are three issues.

① **Shifting from austerity to growth-oriented strategies**

To make this shift, it is important to be willing to take on challenges. Is the Group making this shift effectively? I focus on this change in attitude.

② **Sowing the seeds of growth from 2020 onward**

I think the Group will very likely reach its ¥100 billion operating income target through organic growth. After that, however, seeds need to be sown for growth that has not yet been realized. To this end, the focus needs to be on how much to invest in new businesses, how much profit to aim for, and how many product candidates are being put forward.

③ **Pay heed to businesses not in target domains**

I am concerned about declining forward momentum in, for example, electronic material businesses, which do not appear to fit into the Group's segments, as well as businesses that straddle segments. Looking ahead, I would like to focus on how the Group ensures forward momentum at an organizational level.

● Do you have any requests regarding information disclosure?

I would like to see corporate governance innovation added to the topics discussed at regular IR meetings. I would also like to see more opportunities for dialogue with outside directors. Moreover, I think plant tours and business briefings are valuable events that help to foster a deeper understanding of the Group through direct interaction. I would certainly like such activities to continue.

Taking Mr. Uesako's opinions to heart, we will focus on efforts to enhance corporate value over the medium to long term as well as initiatives that more deeply instill these ideas within the Mitsui Chemicals Group. (See p. 74)