

# Talk with the President



## Atsushi Yoshida

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Mizuho Securities Co., Ltd.

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**In this year's Denka Report "Talk with the President", we welcomed Mr. Atsushi Yoshida, a top analyst at Mizuho Securities. He has long been engaged in the chemical sector, and observed management at a number of chemical manufacturers.. We had Mr. Yoshida talk with President Imai about changes in Denka's management, current challenges, and expectations for the future from a analyst's perspective.**

## Toshio Imai

Denka Company Limited  
Representative Director, President

### Atsushi Yoshida Career Summary

Senior Analyst, Equity Research, Mizuho Securities Co., Ltd.  
1988 Joined Wako Securities Co., Ltd.  
1996 Wako Economic Research Institute  
2000 Corporate Research Dept. at Shinko Securities, Co., Ltd.; (after the merger) Equity Research Dept. at Mizuho Securities Co., Ltd.  
Engaged in research in the chemical sector until today

## 1. Revising the initial year in "Mission 2030"

**Okabe:** Denka started its 8-year Management Plan "Mission 2030", in fiscal 2023. President Imai, could you please explain how you evaluate this initial year?

**Imai:** 2023 was a year that shook the foundations of management as a company manufacturing chemical products, due to the occurrence of a fatal accident as well as improprieties regarding quality. With these two incidents, I thought that we should get back to our core values: integrity, empathy, and challenge.

The heart of the first core value, "integrity", is to keep promises. It was unveiled that Denka and Toyo Styrene, an equity-method affiliate, was engaged in an activity that led loss of trust in product standards. This incident made us reaffirm the importance of keeping promises with our customers, in other words, integrity. The second core value is empathy. We failed to keep safety of the employees from our partner company in the fatal accident at Omi Plant. It is most important that the people who work at the same workplace ensure each other's safety, and feel "empathy" to one another. And finally, "initiative". We translated the word "chousen (challenge)" to Initiative. It means we take the initiative to do what needs to be done. To hold responsibility and sincerely facing safety and quality, is to keep on taking "initiative" while prioritizing "integrity" and "empathy".

2023 turned out to be a year of reexamining our core value through these two incidents.

**Yoshida:** Fatal accidents and improprieties regarding quality give significant impact to the business continuity of a company, and are impermissible. Regaining trust is really difficult. I would really like to ask you to enforce risk management and safety. However, perfection is non-existent in a human's activity. What matters is the continuous effort to reduce risks as low as zero, and how you recover from the aftermath of an incident.

**Imai:** For the quality problem, more than 200 issues were extracted through an internal survey after the introduction of a leniency system, a system to reduce and exempt self-reported violations. Our workplaces should allow anyone at any job position have a voice to point out violations, and "hazardous actions. I think the employees' mind state and psychological safety are important to achieve this,, and we are implementing various measures for this.

**Yoshida:** It is indeed very important to improve internal communication and build a working environment where people can say what is wrong is wrong.

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### 2. Trend in the chemical industry and expectation to Denka

**Okabe:** 2023 was a tough year for Denka. But it was also a year with a difficult business environment for the entire chemical industry, including decline of the petrochemical demand and more restrictive environmental regulations. Mr. Yoshida, you have long observed the chemical sector. What is your impression about the industry in the recent years?

**Yoshida:** It is said that, while reorganization of the primary industry in Japan has progressed in, say, the glass, pulp and paper, and iron and steel, reorganization in the chemical industry has not advanced much. I think, however, the management teams in the chemical industry have very good insights in trend of the times. I feel confidence on them that they are showing their reasons of existence while responding to the trend of the times.

It is often said that the chemical industry is adaptable. The target markets range from electronics, automobile, life science, and so on, and each company can leverage its characteristics in its respective market. A company will grow unless management makes a mistake in deciding what to concentrate or which direction to take. It is true that declined profitability in the petrochemical industry has led to reorganization in the chemical industry and portfolio transformations, but it is just in the last few years. I believe the chemical industry will stay in a stable condition.

**Imai:** I perceived the “Three-star businesses” consisting of the three elements – “Specialty”, “Megatrends”, and “Sustainability” – as Denka’s “work we do better than anyone else”, and am concentrating our management resources to it. As a part of this initiative to substantiate our business portfolio shift, we decided to withdraw from the cement business in October 2022. In this year, we transferred three companies in the dissolved acetylene area to Koatsu Gas Kogyo Co., Ltd., from the top leader’s viewpoint. We now are proceeding some specific investigations at the Portfolio Transformation Committee, for example, and I expect more results this year.

As you pointed out, Mr. Yoshida, our petrochemical business is in a tough situation due to the recent decline in demands for petrochemical products in the domestic and overseas markets. The Polymer Solutions division, which supported Denka’s management prior to the COVID-19 pandemic, is experiencing a drop in profitability. While we see reorganization of the petrochemical complex in Chiba Prefecture and Shell’s withdrawal from the petrochemical business in Singapore, we will examine our business direction while leveraging Denka’s strength and characteristics.

**Yoshida:** Denka has grown through mutual complementarity between businesses in its diversification of management. However, two out of four segments are currently losing money, and Denka is in one of the most difficult financial conditions in its long history.

While the withdrawal from the cement business was announced in October 2022, I had thought it would have taken longer time to decide due to issues in handling by-products. Denka has the ability to resolve such a difficult issue, and the stock market is expecting a lot from President Imai’s decision-making capability.

**Imai:** Regarding the by-product handling in the cement business, Taiheiyo Cement Corporation, to which the business was transferred, took care of it.

As the issue was clear in the top leader’s viewpoint, I did not have difficulty in making a decision about this business.

What’s difficult in this kind of decision-making is that the withdrawal from a non-profitable businesses and transition of managing resources to new business have to be done simultaneously. New businesses may experience slow growth, and simple withdrawal from the existing non-profitable business would gradually make the situation worse. Because of this, our management Plan “Mission 2030” explicitly states that we will concentrate our management resources into three focus areas: ICT & Energy, Healthcare, and Sustainable Living.

### 3. Concentration of management resources to growing products

**Imai:** I would like to talk about some new products I have good expectations for growth in the future.

Especially in the focus area of “ICT & Energy”, we have a number of new products, as a result of our strategic investment since the days of previous management plan “Denka Value-Up”.

The first one is, the organic insulation material “SNECTON” (LDM: Low Dielectric Macromonomer). It is used for things such as substrates for high-speed communication and various intercalation materials. It



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is a big hit product once in a long time that we expect annual sales of 20 billion yen by 2030. While it is a product from the Electronics and Innovative Products, it is based on polymer solution technologies. This resin was created through coordination polymerization of styrene and ethylene that hardly undergo polymerization, and proves to be a good achievement enabled by Denka's wide portfolio. We also focus on the LCP film (crystalline polymer film) for commercial release. This is also a product utilizing Denka's resin film formation technologies. We expect growth in the flexible circuit board for high-speed communication. TBM is a highly heat-resistant temporary bonding material that can withstand 300°C, capable of high-temperature processing in the manufacturing processes of power semiconductors and the next generation semiconductor packages.

On the other hand, we are proceeding aggressive equipment enhancement in prospective existing businesses. Silicon nitride, a product that we have long had, is expanding its demand for xEV motor bearings. This is a material that offers high reliability for substrates and bearings because of its high mechanical and electric characteristics, thus doubling the production capacity. We expanded our manufacturing capacity of spherical alumina by five times in comparison with fiscal 2018 by building a new plant in Singapore to meet its growing demand for on-board chargers for xEVs and PHEVs. We also doubled the manufacturing capacity of heat dissipation sheets to satisfy its demand for 5G and xEV applications, by concentrating the production capacity to Shibukawa. Our production capacity of Acetylene Black will be enhanced by annually 11,000 tons once a joint venture in Thailand is established. It would help us meet growing demands for high-voltage transmission lines for automotive LiB and offshore power generation.



Denka SCGC Advanced Materials Co., Ltd

In the focus area of Healthcare, we doubled our influenza vaccine production capacity, and expect it contribute to profitability this year. Expansion of POCT (Antigen Diagnostic Test Kits) kit production facilities will complete in March 2025, resulting in 2.5 times of production capacity.

The expansions start contributing to our performance from 2024 and for new products, they will start contributing from 2025 or 2026. We are struggling from semiconductor related products, chloroprene rubber, and petrochemical products, resulting in a triple demand decline. But there is now a sign for recovery in the semiconductor field. We would like you to expect our growth as this business will definitely be back on track for growth after the 2nd half of this fiscal year.

**Yoshida:** Indeed, you have a lot of cards in your hand. Many investors and analysts are often not sure what Japanese chemical companies are engaged in because they have diverse businesses. I recall that ex-President Mr. Seiki Kawabata (President from 2006 to 2011) always referred to his company as “my company” My Home.

He often said, “My company is a society-friendly company,” while referring Denka's joint function improvers agent with macromolecular sodium hyaluronate as a “product friendly to senior citizens” and a concrete structure repair system as a “building-friendly technology”. I thought he accurately represented Denka's business models that meet the demands at the time. I think the keywords representing today's social needs are: Generative AI, Environment and Mobility, and Healthcare. Denka's current three focus areas – “ICT & Energy”, “Healthcare”, and “Sustainable Living” - match these social needs. As President Imai explained, I have high expectancies in Denka's growth investments in “ICT & Energy”. While Sustainable Living has a rather humble impression, I have a positive and steady growing image of it in measures against food problems and natural disasters, as well as effective use and recycling of limited resources. Meanwhile, “Healthcare” is a difficult area to forecast. I understand that there are high demands in infectious disease, in vitro diagnostic agents, and cancer treatment drugs, but I have difficulty in getting a clear picture of Denka's technological characteristics, growth potential in the market, and ability to meet the social needs. I would like you to give us detailed explanation about this area. I see “Healthcare” is the key for Denka's mid-/long-term growth, and it can change the idea in the market about Denka's business strategies.

**Imai:** I will explain about our growth investment in “Healthcare” in detail. Let me start with the expected product development. First is our joint research project for replicon (next generation mRNA) vaccines for seasonal influenza. The second is intelliplex, a simultaneous multi-item diagnosis technology, now reaching its highlight. We expect that this technology contributes to significantly shortened diagnostic time for septicemia pathogen and drug resistance. I really want this product to succeed. DELYTACT®, an agent for malignant brain tumor for which we did not have effective therapeutic approach, is the second oncolytic virus product in the developed countries, and the first in Japan. Although this is a high-hurdled theme, I would like to see an early goal.

You just told us about “a society-friendly company”, and we have technologies in Sustainable Living that are capable of social contribution in terms of environment. We have established a consortium for carbonated admixture LEAF®, a key material for carbon negative concrete, utilizing the Green Innovation Fund Project<sup>1</sup>. FASTRONG, another special cement additive for concrete, is used for Hume pipes and U-tubes, and has excellent environmental characteristics in terms of decarbonization and shorter production process.



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In addition, a polystyrene chemical recycle plant started its operation in March 2024. We now have a chain of monomer, polystyrene, BOPS (biaxial stretching), food container formation connected to materials made of collected used food containers and packages (post-consumer materials). This is a very meaningful project to form a circular styrene chain out of a single plant, which we are working for social implementation in a collaboration with Ichihara City, Chiba Prefecture. By tackling this project as an entire society, we can generate merits and profit with all the participants. It is undoubtedly an "initiative".



Chemical Recycling Plant

**Yoshida:** Polystyrene chemical recycling is ideal as it does not consume petroleum resources. Companies have technologies, but the issue is how to collect the post-consumer materials. There is a limit for what a single company can do for this matter. And cost effectiveness is another question. It requires support from the national government to involve local governments and communities to generate a social trend.

**Imai:** And what I expect most in Sustainable Living is the methane-to-acetylene technology. It is a low carbon acetylene production technology. Approximately 400,000 tons of CO<sub>2</sub> is emitted annually from the current carbide manufacturing process. This is a new technology to resolve this issue, by generating acetylene from ionizing methane. What is excellent about this technology is that the portion is 1:4 for hydrogen and generated acetylene. Instead of burning hydrogen in a gas turbine, we can find a highly value-added application to increase the effectiveness of this production method. We can product green chloroprene in a way that significantly reduces CO<sub>2</sub> emission. We will examine this technology in a pilot plant built at Omuta Plant.

## 4. Review of the investment plans

**Okabe:** In the announcement of financial statements in May 2024, Denka announced a reduction of 100 billion yen in investment cash flow for eight years. How do you evaluate this decision, Mr. Yoshida?

**Yoshida:** I take it very positively. I kind of thought that 360 billion yen for strategic investments and 180 billion yen for R&D for eight years were a bit too high. I think this correction, as well as the idea of curation of investment projects and review of the investment timing show integrity with the management plan. I would like to keep my eyes on the new production site for SNECTON and Acetylene Black in Thailand, and introduction of the "methane-to-acetylene" technology to Omuta Plant and roll out to Omi Plant.



## 5. Best Practice Project

**Okabe:** You explained Denka will curate and continue growth investments to the areas where growth is expected.

Can you tell us about the Best Practice Project you are currently engaged in to get back to the track of growth illustrated by the management Plan "Mission 2030"?

**Imai:** Manufacturing companies like us always think about potential cost reduction. It is not easy to achieve significant reduction unless new thoughts and mindsets are introduced. In this project, we are incorporating insights from third parties and benchmarks to learn best practices. It does not have to be special, but we would like to acquire intellect to perform common practices in a common way.

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Comparing 2023 to 2021, when we achieved the our top profit, the fixed cost rose by 15 billion yen. We would not be able to get back to the growth path without a determined mindset for cost reduction. We plan to achieve cost reduction of 1 billion yen this year, 5 billion yen next year, then 10 billion yen in the following year. 10% of the achievement from this project will be returned to the employees. Without achieving this target, we will not be able to achieve the management Plan “Mission 2030 targets. I will be spearhead this initiative, and encourage each employee to acquire best practices to polish up the practices. As specialists at a manufacturing company, we keep our bars high for the future growth.

### 6. Stock price

**Yoshida:** I think 10% return from the Best Practice Project cost reduction achievement to the employees is a key to emphasize the mutual success. I really want to see more than 10 billion yen cost reduction effect. While I highly evaluate this initiative at Denka, the current valuation (evaluation) in the stock market (as of June 2024) shows about 0.6 in PBR. As the average in the past five years is about 1, it is at a low level in a long-term view.

As my personal impression, I think it is because the growth areas in the Electronics and Innovative Products and Life Innovation failed to achieve expected results, in addition to the decline in profitability in the Elastomer & Infrastructure Solutions and Polymer Solutions divisions. Additionally, the market is



concerned about the impact from the temporal recording of expenses associated with the fundamental measures for the chloroprene rubber business. However, Denka, with these impacts in mind, announced an anticipated dividend of 100 yen per share in 2024, taking improved cash flow after 2025 into consideration. As the stock market feels negative about potential risks for reduction in dividend, I think the market took this announcement positively.

**Imai:** In our management plan “Mission 2030”, we will maintain the total shareholder return ratio at 50%. The ratio in the last fiscal year was 72%, and 96% this fiscal year, that are well above 50%. The announcement of preserving 100 yen dividends show our confidence to getting back to the track of growth after the upcoming fiscal year.

**Yoshida:** I take the total shareholder return ratio at 50% positively. On the other hand, it can be seen as a stock buyback with a purpose as an announcement effect, or progressive dividend to determine the lower limit of the dividends, if the current stock price is judged to be relatively low. If there is no risk for reduction in dividend, the current dividend yield is relatively high at 4.7%. The upcoming reorganization can trigger an increase in the stock price.

**Imai:** At this point, we prioritize dividends, and we are not thinking about a stock buyback with reduced dividends.

I think we have more options in the upcoming fiscal years once we have solid clues for resolution of various issues and regain profitability

### 7. Human Capital

**Okabe:** I have a question for you, Mr. Yoshida. As an analyst, where do you focus on when you evaluate human capital management?

**Yoshida:** While it is difficult to reflect to the stock price, I think the happiness of employees is essential for a company to grow. A company with low employee satisfaction would not grow. That is why I expect Denka to take actions in “Human Resources Value Creation”, and would like it to be led to corporate value creation and sustainable growth. While there are various elements of the human capital, such as enhancement of human resource development and promotion of diversity, equity and inclusion (DE&I), it is difficult for the external parties to see what results can be achieved by doing what. I would like the company to have an employee-first mindset, and then examine the relationship between each initiative and employee satisfaction improvement.

**Imai:** I want to make Denka a company where the employees can feel their growth by working at Denka. Also, I want to establish a company where each employee feel they are treated right and valued by the company. The company has empathy for the employees and the employees have empathy for the company - I think such a company is expected in terms of compliance and safety.

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Then, what can we do to build such a company. First, we need to foster a self-learning culture. For this purpose, we are proceeding with a KPI to double the training cost per employee in FY2030 in comparison with FY2021. And we set up Career Planning Committee so that the company can think of each employee's future career. At this point, the Committee primarily consists of senior officers. Managing directors and managers should join the Committee to develop future management personnel and succession plans.

For DE&I, we set up a KPI to hire female workers, those with foreign nationalities, and experienced workers, and additionally, we welcome Rumiko Nakata-san, a human resource strategy expert, as an outside director in this June to drive this initiative. Nakata-san will take a role of chairperson at the Nomination and Remuneration Advisory Committee.

When I think over the past, I'm afraid we did not have enough dialogs between the management and the employees. We started Townhall Meetings, where President and employees communicate this year. We previously had plant tours on a regular basis, but it was our first attempt to have meetings targeting the headquarters and all sites. We should refrain a one-sided dialogues, and focus on bi-directional communication. With our core values (Integrity, Empathy, and Challenge) as the axis, we talk about safety, quality, and cost reduction, and so on.

## 8. Conclusion

**Okabe:** Can you please tell us about what you expect from the Denka Group in a transitional phase?

**Yoshida:** My primary message for Denka employees is: Do not fear "change".

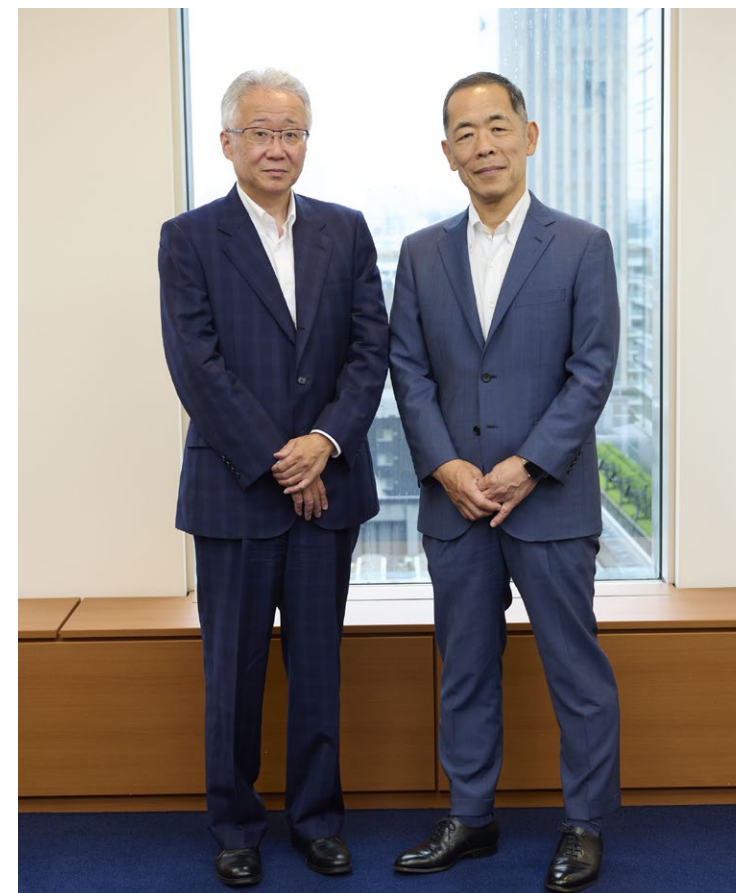
Denka has grown through some business portfolio transformation according to the changes in time. I would like Denka to make the most of this critical phase and revitalize itself as a specialty chemical company.

My definition of a specialty chemical is a company with high profitability and a company that can achieve profit growth in a stable manner. To meet this definition, the company must align its non-profitable businesses with the management structure at some extent. And what is important is growing businesses. The growth in the current Electronics and Innovative Products and Life Innovation divisions is not enough yet. I would like the company to use enough resources to achieve high growth. I do not want a company to strive for scale. Previously, some chemical manufacturer companies had a principle of sales for the sales' sake. Such companies do not exist any longer, and the market does not evaluate it either. When proceeding portfolio transformation and the top leader's mindset, the company can constantly achieve 10% of an operating income ratio and 10% of ROE, while the scale of the company may get smaller. A specialty chemical company focuses on the absolute profit and income ratio. I would like Denka to aim to be the best at what we do.

This transformation requires physical strength and patience. I would like President Imai to take care of his health and spearhead this transformation with confidence.

**Imai:** Thank you for your clear and solid message. To make the world a better place as specialists, we will not pursue for scale, but focus on the "Three-star businesses" in which we can do work we do better than anyone else.

Thank you very much for your time today.



Date: June 21, 2024, Location: Denka Company Limited Head Office