

## Summary of the Q&A Session at the Management Meeting

Date and Time: May 24, 2017 (Wed.) 13:00 - 14:30

Venue: Kurita Water Industries Ltd. Head office conference room

Briefer: Michiya Kadota, President and Representative Director

**Notice: This summary is a reference designed for the convenience of those who could not attend the Management Meeting stated above. Please note that this is not a word-for-word transcript of all remarks made at that session, but is a summary prepared by Kurita Water Industries Ltd.**

Q. In the services business, what are your expectations for annual sales of the standardized wastewater reclamation system and the profit margin?

A. The individual units of this system are not very differentiated but become highly efficient in combination with treatment using water treatment chemicals. We must think carefully about what selling approach and pricing to adopt for the system as a service business. In China, although the unit price of water is high and water reclamation demand is strong, especially in inland areas, we must fully consider what sort of service model will induce customers to pay for the service. In addition, we want to carefully consider a sales approach suited to each country. With regard to profit margin, I think that the system has value comparable to that of the Ultrapure Water Supply (UPWS) business.

Q. Are you also considering offering this system to customers in industries other than the electronics industry?

A. We believe that the system is fully applicable to any industry that uses large amounts of water, not only the electronics industry.

Q. Is it the same as the technology previously delivered to automakers in China?

A. Since the previous facilities were for treating paint booth wastewater, this is different.

Q. By the method in China, do you mean the payment collection method?

A. That's right. In view of credit risk, we will consider factors such as contract period and how we earn profits. We will use a short-term contract if we aim to reduce credit risk and consider a long-term contract if a customer has a stable business. Targeting a broader customer base than the electronics industry will result in higher credit risk.

Q. What is the position of Korea in the UPWS business?

A. The way of thinking differs depending on the individual customer, not so much according to country. What's important is whether a customer recognizes the value of production stability and troubleshooting ability.

Q. Do customers in segments in which Kurita excels that are pursuing global business expansion represent an opportunity?

A. We think so. However, risks differ according to the individual manufacturing country. For instance, in emerging nations, there are problems associated with labor costs and the skills of operation management personnel.

Q. Won't Japanese companies making investments in China be target customers for wastewater reclamation services?

A. We think they will. This is because there's no difference in the amount of water used or the unit price of water according to capital.

Q. Doesn't APANA Inc.'s water conservation support service model have high added value in China?

A. Since at this time APANA still provides services to commercial facilities, we will have to perfect the model after studying in Japan how it will apply to plants, Kurita's area of expertise.

Q. How quickly do you expect cross-selling of products for which individual acquired companies have strengths to progress?

A. Expansion in Japan of sales of the water treatment chemicals of European subsidiaries has been somewhat slower than expected. Evaluation testing, research into laws and regulations, and other matters took time. On the other hand, since progress in Singapore and elsewhere in Southeast Asia has been relatively rapid, I think it is necessary to develop the business after ascertaining what products will be strongest in what regions.

Q. Does this take time in developed countries?

A. That's right. For instance, although Fremont Industries, LLC has highly effective, excellent products, they cannot be used as is in Europe. Microbicides tend to get caught up in regulations.

Q. The pace of cross-selling doesn't seem to be increasing.

A. It's necessary to test and evaluate products near the sites where they are used. Also, the pace will increase if we make changes to evaluation methods and systems, such as evaluating products all at once after strategically prioritizing target markets. We recently opened a new R&D base in Singapore.

Q. I have long had the impression there is a lack of agility at Kurita. From the outside, it's hard to see how things have changed.

A. Although we have a long history of overseas expansion in the Water Treatment Chemicals business, our traditional business policy was for overseas subsidiaries to fund investments from their own earnings. That approach resulted in a slow pace of organic growth and also made it difficult to introduce the latest facilities in R&D operations. Now,

since we provide funds from the parent company and have recruited talented human resources in Europe, I think that our employees working at overseas subsidiaries are experiencing a strong sense of change.

Q. I heard in December of last year that investment of ¥50 billion in the UPWS business would be possible. Has that point of view changed in view of various facts that have come to light since?

A. I think that if we can secure a production structure, there will be no problem with funding, and it will be possible. On the other hand, although investment of ¥5 trillion in semiconductors in China is forecast, since subsidies are provided to state-run companies, there is no enticement in the form of reduction of the initial investment burden. I get a sense that things won't go smoothly in China right away. However, there will be opportunities when Korean and Japanese customers expand into China, and I have no doubt that investment in the UPWS business will increase.

Q. For how many years can you use ¥50 billion for investment in the UPWS business overseas, not only in China?

A. Since it will depend on our customers' capital investment, it's difficult to say categorically how many years, but I think investment will increase. The capital investment plan of a certain customer may be moved forward a year, or the investment cycle for leading-edge semiconductors, a sector in which we excel, may shorten.

Q. In developing the UPWS business, does risk vary according to country?

A. I think that country-specific risks, including credit risk, are highest in China. When making investment decisions, we add a risk premium to the standard hurdle rate and set a higher risk premium for Korea than Japan. We also add a premium if the contract period is long.

Q. In the UPWS business, will remote monitoring make labor issues less of a concern?

A. Staff permanently stationed at customer sites will become necessary. Accumulated operation management knowhow and troubleshooting skills are necessary in this business. Although human judgment based on accumulation of case examples is important, in the future we would like to store case examples in a database to enable judgment by artificial intelligence. In addition, understanding of customers' manufacturing data makes possible preemptive, efficient operation management. As entire plants are converted to smart factories, it will become possible to integrate management of utilities and ultrapure water supply.

Q. Do customers expect that sort of added value?

A. Since before-and-after comparisons cannot be made without actually engaging in operation management, it's difficult for customers to recognize reduction in the frequency of problems. To ensure that customers recognize added value, we must have knowledge, including of leading-edge semiconductor manufacturing processes, that keeps pace with

the evolution of our customers' manufacturing processes. Since enormous losses occur when operation at a semiconductor plant is disrupted, once the model has been adopted and the customer is able to appreciate the value of stable operation, the probability of repeat business increases.

Q. As the number of sites with UPWS business contracts nearing expiration increases in the future, will there be any changes in the business model?

A. Although I think needs will differ from customer to customer, I think that as customers in Japan become unable to employ their own onsite personnel because of employee aging, Kurita will increasingly receive recognition for our operation management skills and ability to utilize databases.

Q. How does the profitability of overseas water treatment facilities compare to profitability in Japan? Also, what is the growth potential for maintenance services overseas?

A. It's difficult to be profitable relying on EPC alone. The situation with maintenance services in China isn't very different from that in Japan. Since overseas deliveries of water treatment facilities are increasing, I look for sales of maintenance services to roughly double from the current level.

Q. Is the presence of local competitors in China a concern?

A. It's not a concern. Anyone can provide low-level water purification technology. Our proposals will be in the very high-end sector, where I expect capital investment by customers to continue.

Q. Competitors are promoting systems similar to the standardized wastewater reclamation system. Will they be competitive?

A. I doubt that competitors can achieve stable operation without water treatment chemicals technology. In China, there are many reclamation facilities that can't be operated and stand idle. A company that doesn't have both water treatment facilities technology and water treatment chemicals technology can't succeed in this business.

Q. In your discussion of solutions, you said that Kurita will focus on the sales aspect in providing solutions. What does that mean?

A. It's no good to propose solutions that involve water treatment chemicals only, water treatment facilities only, or maintenance services only. For starters, in April we changed the previous horizontal organizational structure by integrating water treatment chemicals and maintenance services. Now we can share information and provide service on an individual customer basis. We think that removing divisional barriers and changing the performance evaluation structure will increase the speed of solutions.

Q. In the water treatment chemicals industry, where the market share of companies has hardly changed, recently a deep-pocketed competitor has begun aggressive business

expansion, including M&As. Is there a sense of urgency at Kurita?

A. In the domestic Water Treatment Chemicals business, although we have advanced response capabilities for large customers, there is a sense of urgency about small and medium-size customers. Although until now we have provided uniform consulting services regardless of customer size, the best approach will probably be to change service quality according to customer needs. We will switch to a value-based sales approach to cut waste by eliminating excessive services. We consider reform of the domestic Water Treatment Chemicals business a task of comparable importance to transformation of the Water Treatment Facilities business into a service-based business.

Q. Will market share in Japan change going forward?

A. Since the size of the domestic water treatment chemicals market has been approximately ¥200 billion and our sales approximately ¥40 billion, our share of about 20% hasn't changed much. We are not saying that we will not pursue M&A activities in Japan in the future. We will consider companies with processes closer to ours and companies to which our business model can be applied.

Q. In the results presentation the other day, there was a comment about aiming for an operating income margin of 15%.

A. Since in the past the margin reached 15% several times, as a business manager I of course want to achieve this. However, over a three-year or five-year time span, I think a profit margin of 15% will be difficult to achieve unless all conditions are favorable. I would like to revisit this at the time of the next medium-term management plan after carefully examining the figures.

Q. You spoke of business restructuring. What must be done?

A. With regard to the Water Treatment Chemicals business, I expect profitability in Japan to recover provided we change our business approach. In overseas markets where profitability is low, it's necessary to identify the causes. The key in the Water Treatment Facilities business is how far we proceed with shift to a service-based business. It's necessary to create several business models like the standardized wastewater reclamation system, and we must transition towards a service-based business, such as a model that utilizes the feed-in tariff system even in general industries. Although a 10% operating income margin is difficult to achieve from EPC alone, we can aim for a margin of 15–20% from service businesses.

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