Summary of the Q&A Session at the Financial Results Briefing for the First Half of the Fiscal Year Ending March 31, 2018

Date and Time: November 1, 2017 (Wed.) 10:00-11:00
Location: Belle Salle Tokyo Nihonbashi

Notice: This summary is a reference designed for the convenience of those who could not attend the financial results briefing 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. With regard to the improved cost of sales ratio for hardware, is this a reflection of an improvement in overall profitability rather than the contribution of specific projects? Is this sustainable into 2H?

A. For the overseas business, the foundations for the EPC business at our China group companies and other overseas group subsidiaries are now in place. This should allow us to reduce the cost of sales ratio steadily. For the domestic business, we had undertaken initiatives to improve design efficiency and are now seeing the cost of sales ratio decline. Near-term orders are strong, so excluding the risk of tight production capacity, we believe this trend should be sustainable.

Q. Recently we have seen an increase in commodity prices. Does this not affect your raw materials prices?

A. It is having an impact but it is not significant at this stage. We have been able to more than offset the impact through improved production efficiency and the modularization of water treatment facilities.

Q. What drove the significant overshoot in 1H overseas water treatment facilities orders?

A. There are several factors but the biggest is the shortening investment cycle at semiconductor and FPD customers. To date, the typical cycle had been two years, but the pace accelerated with investment waves happening on a 6-month cycle.

Q. If that is true, should the implied increase in repeat orders be positive for profitability?

A. There are some orders where competition is fierce, so the profitability on some projects is suboptimal.

Q. How were hardware orders for the electric power industry in 1H? Are you being affected by the changes in the electric power industry's operating environment?

A. 1H orders were down slightly. So far we have not seen significant changes.

Q. Are tighter wastewater regulations in China starting to have a positive impact on your business?

A. For now, we are not seeing a sharp increase in systems for wastewater treatment. We do see the tighter regulations as a tailwind but we are not targeting all industries. Our targets would be industries that either use large volumes of water or require a high technical level of wastewater treatment.

Q. How much of your Asia sales are from China? How much of your China sales come from electronics?

A. Combined Water Treatment Chemicals and Water Treatment Facilities sales for 1H was approximately ¥9 billion and our full year plan is for more than ¥22 billion. Almost all of our Water Treatment Facilities' sales for China are from the electronics industry.

Q. Please tell me the soil remediation orders and sales for 1H and your forecasts for the full year.

A. 1H sales were approximately ¥3 billion. We project ¥8 billion for the full year. 1H orders were approximately ¥6.5 billion and we project approximately ¥10 billion for the full year.

Q. You have indicated that the key for growth is the overseas business. Are you happy with the progress you have made with Kurita Europe GmbH (KEG) and Fremont Industries, LLC following the acquisitions?

A. The alumina and pulp and paper chemicals business at KEG has fallen short of our expectations but the Water Treatment Chemicals business is growing. We are seeing particularly strong regional growth in areas such as the Middle East. We have now put a business foundation in Europe and expect to aim for growth in the next medium-term management plan. For Fremont, we are expecting to be profitable this fiscal year, even after the amortization of goodwill. We have seen order flow for both water treatment chemicals but standardized water treatment facilities.

Q. Why is the capex for the Ultra-Pure Water Supply (UPWS) business running ahead of plan?

A. Semiconductor customers decided to proceed with investments earlier than expected, leading to the additional investments. I believe this reflects an acceleration of investment decisions.

Q. How much of the ¥17.3 billion in UPWS capex is for overseas, and which countries are impacted?

A. Roughly ¥4 billion is for overseas, only for Korea.

Q. How should we think about the potential for UPWS capex in FY ending March 2019?

A. We expect that the current investment environment for semiconductors and FPD will continue for another 2 years. We believe the scale of capex for next fiscal year will be flat YoY.

Q. What is the outlook for new services in China?

A. We are currently developing a model for wastewater reclamation. It will improve customer wastewater recovery rates across a wide range of industries. We are looking at developing services that are appropriately tailored for specific industries.

Q. Should we be expecting to see investments for new services in China be of the order of several billions of yen?

A. We think hitting those sort of levels is a few more years away, so we don't expect to be at the several billion yen stage in the next fiscal year.

Q. 1H OP for the Water Treatment Facilities segment was ¥2.7 billion higher than initial forecasts. How much of this was due to a contribution from higher margins on the hardware business?

A. The contribution from the improved cost of sales ratio (not limited to hardware) for the overall Water Treatment Facilities segment was a positive ¥0.7 billion YoY.

Q. You have not changed your 2H earnings plan from your initial forecasts, but if the cost of sales ratio continues to improve, should we expect the magnitude of the improvement to the cost of sales ratio will be larger in 2H than it was in 1H?

A. We are taking a conservative view of 2H as we anticipate that there will be a few projects in 2H where profitability will be challenging. However, we expect the overall positive trend to continue given the production base is in place.

Q. Has we seen an inflection point for the UPWS business on the back of an improved operating environment?

A. If we factor in the strength of near-term capex, we believe that sales for this business should increase. For contracts on the verge of maturing, we expect to see customers renew.

Q. Please describe the benefits you get from moving to a single organization for the domestic Water Treatment Chemicals and maintenance businesses.

A. Historically, there had been three sales people per customer, each separately responsible for Water Treatment Chemicals, Water Treatment Facilities and maintenance respectively. This led to sales people being focused narrowly on their existing businesses. However, we have now selected a single person to be the initial point of contact for each customer. This person is responsible for making all proposals. As we develop a better understanding of our customers' manufacturing processes, it is leading to the development of new solutions.

Q. Does the integration of the organization ultimately lead to a more efficient use of the work force?

A. Our customers' perception of added value is different depending on the scale of their operations. We are not taking a cookie cutter approach in allocating human resources, but will provide solutions in response to customer demand.

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