

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

Date: 13:00 – 14:30, December 7 (Thu), 2017  
Location: Kurita Water Industries Head Office  
Speaker: President Michiya Kadota

**Notice: This summary is provided for the convenience of those unable to participate in the management meeting. Please note that this is not a word-for-word transcript but a summary prepared by Kurita Water Industries Ltd.**

Q. The CoGS ratio for water treatment facilities hardware for the electronics industry improved dramatically in 1H Fiscal Year Ending March 31, 2018. What were the specific initiatives that made this possible?

A. In addition to an improvement in the capability of installment management contractors compared to several years ago, there has been a shift toward modularization of hardware, particularly for the electronics industry. This has made it possible to complete installations with shorter lead times. We have also been more selective in accepting orders, with a focus on profitability. This lowered the CoGS ratio at the time of order intake. In the overseas business, we have seen an improvement in the EPC capabilities of our Korean and Chinese subsidiaries.

Q. What is the situation for water treatment facilities hardware for general industries?

A. Compared to the electronics industry business, the shift to modularization has been slower, but we have been able to improve profitability by being selective in accepting projects, and focusing on priority projects.

Q. Would it be difficult to get back to the 8 – 10% operating margins previously generated in the general industries' business?

A. Achieving 10% would be challenging, unless the proportion of service business revenue increases. Previously, there was a consistent level of revenue generated from the resin recycling business for nuclear power plants, but there is virtually no contribution from this business at this time. It might be possible to achieve 10% if revenues from the biomass power generation-related business and other contract-based businesses increase. However, if the mix remains concentrated on EPC, then the ceiling for operating margins is probably 7–8%.

Q. Is the contract business for biomass power generation an operations and maintenance model?

A. In this business, we take a stake in the power-generating entity. Kurita then sells equipment to this entity, and subsequently provides operations and maintenance services. An increase in this type of project would give us a stable source of profits.

- Q. If nuclear power plants are restarted, what sort of work would increase?
- A. At the time of a restart, there will be demand for chemical cleaning. Once the power station begins operations, there is an ongoing need to recycle resins, which creates a steady profit base.
- Q. Why is the Water Treatment Chemical business running behind plan?
- A. For the overseas business, in addition to failing to win major international tenders for pulp & paper chemicals in China and Indonesia, the alumina business was weak. Excluding these factors, overall growth was solid, generally outpacing GDP growth. For the domestic business, revenue is picking up but we have seen a deterioration in the CoGS ratio on contract-based businesses for the pulp & paper and the petrochemical industries. Consolidation of our customers' plants has also exacerbated competition, depressing margins. This is why profit growth was weaker than sales growth.
- Q. Will the number of domestic Ultrapure Water Supply (UPWS) projects increase going forward?
- A. The key will be demand from the semiconductor industry. Total investments on a per fab basis have been increasing, so if chip makers continue to invest, the impact will be significant.
- Q. Will you be competitive when semiconductor investments in China start in earnest?
- A. For leading-edge technology, which requires huge volumes of ultrapure water, we have competitive superiority due to short construction periods and our ability to rapidly ramp up facilities.
- Q. How will you make progress on enhancing the value you provide to your customers?
- A. We are already making progress with initiatives in our UPWS business. We have made positive contributions by raising the cleaning capability of our ultrapure water which enhances yields. We have leveraged our analysis of operations and maintenance data to proactively prevent operational problems. Our analytical capabilities can be further enhanced by the use of AI and IoT.
- Q. How large was the project in Korea where the customer chose not to use the UPWS model?
- A. Several billion yen. In an environment like the current, where we are seeing a significant number of large-scale projects, we will strive to win packages that include contracts for water treatment chemicals and services, rather than simply winning just the EPC business.
- Q. What is the expected level of capex in Fiscal Year ending March 31, 2019 for the UPWS business?
- A. It should be in line with Fiscal Year ending March 31, 2018 levels. The focus will be on the domestic semiconductor industry. Although there are several overseas projects, at this stage we do not have clear visibility.

Q. What is your view of the market for the Water Treatment Facilities for the electronics industry in Fiscal Year ending March 31, 2019?

A. We expect investments for leading-edge semiconductors to continue. The domestic operating environment over the next 12 months should be favorable; we expect demand from the electronic components industry to be strong as well. For China, we think there may be a need to be slightly conservative given the possibility of an increasingly selective market driven by diverging trends in device applications.

Q. With regard to large-scale M&A that would require Kurita to rely on debt financing, is there something specific under consideration?

A. To date, we had been looking at transactions in specific geographies for the Water Treatment Chemicals business but going forward, we would like to take a broader approach, without limiting ourselves to a specific scale of transaction or business domain.

Q. What kind of metrics are you considering in assessing capital efficiency?

A. In our next Medium-term Management Plan, we would like to focus on ROE and ROIC. In the absence of such metrics, I believe we cannot set the order of priority for our businesses. On an overall basis, I would like to look at ROE but to use ROIC in assessing the profitability of individual business units.

Q. What scale are you assuming for business units?

A. As an example, we could look at business domains such as water treatment systems for general industries, water treatment systems for electric power generation or soil remediation, broken down by region or customer. This approach might make it difficult to differentiate between facilities and chemicals. It will probably be about 10 – 15 units.

Q. Related to your strategy for Korea going forward, please discuss the background to your decision to make the local Korean entity a subsidiary.

A. Our water treatment facilities subsidiary, Hansu Technical Service Ltd., and Hansu Co., Ltd., the water treatment chemicals business which recently became a subsidiary, have both been able to develop strong relationships with major Korean companies. The change makes it easier to put comprehensive contracts in place. In industries like steel making and chemicals, which use large volumes of water, the water treatment chemicals business has already developed relationships which may create opportunities to provide services using water treatment facilities. We are focused on developing service business models; we expect to see progress with service businesses in the Korean market.

Q. Given the strength of chaebol relationships, it would seem challenging to provide services like UPWS in Korea. Is a breakthrough possible?

A. If we can deepen our relationships with customers on the back of further localization, we do believe we can grow the UPWS business. We have made progress on transferring technology to our Korean subsidiary. It is now possible for the subsidiary to handle projects on a standalone basis. If we include the Korean global players, the potential is significant.

Q. What about the potential for China?

A. Chinese customers value the short construction periods and the quality of the completed work by Kurita; as such, the percentage of repeat business is high. The key will be whether we can move beyond simple EPC business to deploy a comprehensive profit structure that includes sales of operations and maintenance services and/or chemicals.

Q. I understand that Hansu has approximately 200 employees. How many employees are there at Hansu Technical Service?

A. Approximately 160. Hansu is a top player in water treatment chemicals in Korea.

Q. You are now coming up on your second anniversary as president. Earnings have been stable even as you have made changes to the organization. What worries you now?

A. I am struggling to break down the internal silo mentality within the company. This is not just between Water Treatment Chemicals and Water Treatment Facilities businesses. Even within the manufacturing divisions of the Water Treatment Facilities business, the speed of the business and technical specs for the electronics industry, general industries and electric power generation are very different. This has led to the development of different cultures. I am not tied to any one business, which allows me to speak frankly.

Q. Is this what you are aiming to address in integrating the overseas Water Treatment Chemicals and Water Treatment Facilities organizations?

A. Yes. The Water Treatment Chemicals business began its overseas operations 40 years ago. While scale is relatively smaller, the businesses have localized and through M&A, we have seen the development of a multinational governance structure and human resources. However, the exposure to overseas markets for the Water Treatment Facilities business has been on a project basis. As a result, the overseas organizational structure was weaker and there had been some ambiguity in internal rules. By integrating with the Water Treatment Chemicals organization, the quality of operational capabilities and infrastructure has improved. By harmonizing the performance metrics, focusing on profits or cash rather than order value, we have seen a change in behaviors, where we are no longer overstretching to win orders.

Q. Does this mean that we will see further improvements in profitability for the overseas water treatment facilities hardware business?

A. There is room for further improvement. We have only just developed EPC capabilities, including the management of contractors. On the fabrication side, the Japanese UPWS business is the most advanced. Our engineers in the domestic UPWS business are able to creatively apply engineering skills using their own judgement. If we can make more progress in modularization for the overseas business, we will be able to enjoy better efficiencies.

Q. Would you consider narrowing the focus of the general industries business to a select number of industries going forward?

A. We are currently focused on initiatives to deepen our relationships with our customers. For industries that consistently use large volumes of water, we assign a dedicated sales person for each account. Rather than waiting for inquiries, we are proactively seeking out high margin business opportunities. Also, another way of being selective would be to consider focusing on service businesses.

Q. Another company commented at their earnings briefing that Kurita had exited the pharmaceutical industry business. Is this true?

A. No, it is not true.

Q. What is your objective in shrinking assets?

A. The focus is on reducing investment securities, assets with low utilization, overseas sales receivables and inventories. With regard to the level of cash we hold, while working capital needs are likely to rise on the back of new consolidations and the increase in large-scale EPC projects, I am comfortable in seeing the cash level decline from the current 70 billion yen to approximately 50 billion yen.

Q. As you move forward with these changes, have previous and former senior executives voiced complaints?

A. Of course, there are differences in how we each view risk, but I have been very lucky in that no one has intervened or commented on what I am doing.

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