



TOSOH

ANNUAL REPORT

Tosoh Corporation and consolidated subsidiaries
Fiscal year ended March 31, 2016

TOSOH CORPORATION

Forward-Looking Statements: Annual reports contain estimates, projections, and other forward-looking statements, which are subject to unforeseeable risks and uncertainties. Readers should understand that Tosoh's business and financial results could differ significantly from management's estimates and projections.

For reference purposes only, US dollar amounts have been translated, unless otherwise indicated, from yen at the rate of ¥112.68 = US\$1, the prevailing exchange rate at the end of the fiscal year under review.

Tosoh Corporation's 2016 fiscal year covers the period from April 1, 2015, to March 31, 2016.

STRATEGY

Medium-Term Business Plan

Just after the start of fiscal 2017, Tosoh announced a medium-term business plan that will guide the company through fiscal 2019 as it builds on its hybrid management, dual commodities and specialties approach to consistently generate value for its customers, investors, and other stakeholders well into the future. This feature presents highlights of that plan for fiscal years 2017–2019 and of the strategies that the company is employing in its commodity and specialty operations to stabilize profitability in the years ahead. It is based on information available at the time of writing, so be advised that changes in economic conditions and other, unknown factors in Japan and internationally could cause actual results to differ significantly from any projections presented.

Plan Overview

Our medium-term business plan has three policies. The first is to focus on hybrid management. That involves balanced efforts to strengthen our commodity and specialty businesses. As part of those efforts, Tosoh will optimize production capacity to make its commodity products more competitive and profitable. Tosoh will also invest to expand its capabilities in offerings with high-growth potential, broadening its business scope through research and development (R&D) and mergers and acquisitions.

The plan's second policy is to maintain and strengthen Tosoh's financial position to support a flexible investment strategy for growth. And the third policy is to drive safety reforms, the two elements of which are to develop safe, stable operational technologies and to effect improvements that eliminate safety problems and incidents.

Business Positioning

Tosoh's business is positioned on the company's commitment to hybrid management. This entails a robust portfolio of commodity and specialty products that is impervious to fluctuations in the operating climate and that enhances corporate value through balanced growth.

Tosoh's commodities operations generate profits and cash flows to underpin its business. And Tosoh will continue to ensure that it sources highly competitive high-quality feedstocks for its commodities products and that it equips its commodities operations with state-of-the-art technologies. Amid swings in the business climate that adversely affect profits, Tosoh will take advantage of continuing firm demand for basic raw materials.

The company's focus in regard to specialty products includes pursuing higher earnings to drive growth and maintaining high profitability through the continued development of new offerings. Tosoh expects lead times of more than 10 years from development to profitability.

Financial Targets

Tosoh looks to maintain steady overall revenues and to lift operating income from ¥69.4 billion in fiscal 2016 to ¥85.0 billion by fiscal 2019. The objective is an operating income ratio exceeding 10%, up 0.8 percentage points from fiscal 2016. This requires raising the operating income ratios for commodity products by 2.1 percentage points, to 8.6%, and for specialty products by 3.0 percentage points, to 21.7%.

Management anticipates a slightly stronger yen in fiscal 2019 and assumes exchange rates of ¥110 to the US dollar and of ¥120 to the euro. Management also assumes a domestic naphtha price for fiscal 2019 of ¥40,000 per kiloliter, an increase of ¥2,775 over fiscal 2016.

Through fiscal 2019, Tosoh will undertake ¥130 billion in capital spending, of which it will allocate ¥30 billion for acquisitions. Two policies guide the company's capital expenditures. The first is to invest in renewal and productivity improvements that maintain and improve supply stability and competitiveness in commodity products. The second is to boost investment in specialty products—to increase the production capacity of existing growth businesses and to leverage R&D with universities, start-up ventures, and other partners and acquire bioscience and other firms to broaden Tosoh's business scope.

Capital expenditures will center on increasing production capacities in various areas. Priorities are HSZ, zirconia, Toyopearl[®] separation and purification media, polyvinyl chloride operations in the Philippines, and functional polymers and functional urethanes. Additional investment will go toward enhancing Tosoh's power generating efficiency.

Financial Position and Shareholder Returns

Tosoh plans to generate an equity ratio exceeding 50% by fiscal 2019 while continuing to reduce its interest-bearing debt. The company will in the meantime continue its policy of paying stable dividends and of determining dividends based on comprehensive assessments of performance, free cash flow, and business development potential. Over the medium and long terms, Tosoh will target a payout ratio of 30%.

Balanced Growth

The medium-term business plan builds through fiscal 2019 on Tosoh's competitive edge globally in supplying diverse industrial chemicals and functional and advanced materials. The company will continue to balance large-volume commodity operations with high-value-added specialty operations to bolster revenues and earnings in good and bad operating climates.

Tosoh's operational structure—with chlor-alkali and petrochemicals on the commodity side and advanced materials, bioscience technologies, and organic chemicals on the specialty side—

helps it weather the inevitable downturns and rapid changes in business environment experienced by its commodity operations. That structure also enables it to secure high margins from participating in the world's most technology-intensive industries.

Specialty Operations Expansion

Tosoh has increasingly come to rely on its specialty operations to shore up its profitability when the cash-generating capabilities of its commodity operations lag. Specialty products regularly contribute a substantial portion of Tosoh's consolidated net sales, and this is especially vital amid tough years mainly for their chlor-alkali- and petrochemical-based commodity counterparts.

Until recently, specialties accounted for around a mere 20% of the company's net sales. That increased to 23.1% in fiscal 2016 and should reach 23.5% in fiscal 2019. Specialty products are even more important as earnings drivers. They represented 47.1% of operating income in fiscal 2016 and should remain around that level for fiscal 2019.

Tosoh plans, however, to expand the role of its specialty operations and will give them a more central role in overall corporate growth. That specialties already play a rising role in Tosoh's operations is indicated in part by their growing physical presence around the globe. This is particularly true for the company's bioscience business.

Tosoh's Bioscience Division has added several companies in the past two years or so to strengthen its clinical diagnostics operations. Tosoh Latin America SpA, in Chile, supports the division's expansion in Latin America. To better serve customers in Europe and the Middle East and Africa, the division established Tosoh Europe International N.V. in Belgium and then opened a branch office of that subsidiary in Dubai. The division also acquired India-based in vitro diagnostics firm Lilac Medicare Private Limited to strengthen Tosoh's presence in India.

Advanced materials, too, are on the move. Tosoh is constructing an HSZ plant in Malaysia that is slated for completion in fall 2016. The plant will expand Tosoh's HSZ production capacity and stabilize its supply of HSZ.

Commodity Operations Profitability

Commodity products are a core Tosoh business and, like the company's specialty products, are being optimized. They continue to earn the lion's share of consolidated net sales, but they are sensitive to changes in the market. The latter is especially true for chlor-alkali, a longtime core Tosoh product. Tosoh will improve the profitability of its Chlor-Alkali Group by enhancing the group's ability to deal with market pressures and to control costs, by adjusting the group's product mix, and by furthering the integration and the efficiency and effectiveness of the vinyl isocyanate chain.

Among the Chlor-Alkali Group's products, Tosoh is particularly intent on raising production capacity for vinyl chloride monomer (VCM). Doing so will ensure an abundant and stable supply of VCM for increased production capacity at Tosoh's domestic and overseas polyvinyl chloride (PVC) production facilities. Tosoh's PVC business will, in turn, capitalize on the stability and abundance of VCM supply by boosting sales of PVC to customers worldwide.

Caustic soda is central to Tosoh's operations. The company was, after all, founded in 1935 as Toyo Soda Manufacturing Co., Ltd. Tosoh's ongoing production of caustic soda should benefit from the medium-term plan's aim of full electrolysis operating rates at the Nanyo and Yokkaichi Complexes. The higher production of caustic soda that results should strengthen profitability through heightened sales of soda and chlorine derivatives.

Tosoh's 2014 absorption of Nippon Polyurethane Industry Co., Ltd. (NPU), augments the Chlor-alkali Group's polyurethane (PU) capabilities. And our medium-term plan ensures that the group is better able to control the development, manufacture, and sale of commodity grades of isocyanates, or PU raw materials. The plan, moreover, also ensures the group's leverage of NPU's expertise in functional urethanes and PU foaming system products and of NPU's manufacturing and sales facilities in China.

Other commodity operations that Tosoh will strengthen include the Petrochemical Group's olefin operations. The company intends on raising the operating rate of the naphtha cracker at its Yokkaichi Complex, which contributes to the manufacture of VCM and PVC as well as olefins. In addition, Tosoh will work to heighten the responsiveness and flexibility of its olefin manufacturing and sales system.

Tosoh's emphasis, meanwhile, for the Petrochemical Group's polymer operations is on the further development of high-value-added functional and specialized polyethylene products. This includes improved engineering grades of polyphenylene sulfide (PPS) resins and better, non-contaminating grades of chloroprene rubber (CR). As well, the polymer operations will increase sales of their advanced and specialty grades of functional polymers, especially chlorosulphonated polyethylene (CSM), of which Tosoh is the world's leading producer.

Commodities and Specialties Innovation

Tosoh supports innovation in its commodity and specialty operations through leading-edge technology and R&D. That support enables these operations to generate the next-generation products for the advancement of civilization, including increasingly versatile and functional products for niche applications.

Tosoh's recently revised R&D organization is favorably poised to undertake a growing volume of R&D projects. It can also bring its R&D resources to bear more fully than ever on short-term development initiatives for products and technologies related to organic, inorganic, polymer, and polyurethane materials. In addition, the new R&D organization makes possible enhanced

R&D for Tosoh's three long-term priorities: life sciences, energy and environmental conservation, and electronic materials. The commanding focus that these priorities have in our specialty operations reflects Tosoh's shifting of its specialty operations from a supporting role—whereby they shore up profits when the business cycle for commodity operations takes a downturn—to a leading role as a driver of the company's business.

As Tosoh's markets have shifted, the company has faced the challenge of managing increasingly frequent crises while keeping its long-term business plans on course. Each of Tosoh's groups and divisions faces different issues, but overall are united by Tosoh's strategy to expand its specialty businesses, to reinforce its commodity operations, and to thereby continue to grow and to ensure its ability to fulfill its commitments to its stakeholders and society. That strategy is well expressed in the company's new medium-term business plan, the achievement of whose aims will set Tosoh on sound footing well into the future.