ANNUAL REPORT

Tosoh Corporation and consolidated subsidiaries
Fiscal year ended March 31, 2015

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 ¥120.17 = US$1, the prevailing exchange rate at the end of the fiscal year under review.

Tosoh Corporation’s 2015 fiscal year covers the period from April 1, 2014 to March 31, 2015.
Message from the President

Focusing on Growth

Tosoh started fiscal 2015 coming off an excellent fiscal 2014 performance. The company was ready to move ahead with core strategies to further its profitability and to position the Tosoh Group for growth in a rapidly changing business environment.

During the year under review, there were some unexpected developments, and many of them were positive. In the first half, several factors, such as rising raw materials costs and resulting product price increases, supported the company’s greater profitability, leading Tosoh to revise its fiscal performance forecasts upward in October 2014. Favorable trends persisted in the second half of the fiscal year, as the prices of oil and naphtha declined substantially. Meanwhile, the yen progressively weakened against other currencies during the fiscal year. These favorable trends notwithstanding, Tosoh will continue to observe and provide timely responses to shifts in the business environment.

Major developments during fiscal year 2015 included Tosoh’s reorganization of its R&D structure and absorption of Nippon Polyurethane Industry Co., Ltd. (NPU).

With another good year behind it, Tosoh is pressing ahead with strategies to bolster its commodities operations and to refocus its resources on expanding its specialties operations.

Core Operations Underpin Solid Performance

Commodities and specialties operations both contributed to our performance growth in fiscal 2015. Among our commodities operations, the Chlor-alkali Group continued to improve its performance following its fiscal 2014 recovery and posted increases in net sales and operating income. The group was, in fact, the major contributor to consolidated net sales among Tosoh’s operating groups, and its robust performance boosted the company’s overall growth. The Petrochemical Group, meanwhile, experienced a drop in profits but did achieve a slight increase in net sales.

Our specialties operations center on the Specialty Group, which in fiscal 2015 again upped its contributions to our consolidated net sales and operating income. It expanded its net sales contribution to 21.6% and generated 60.7% of Tosoh’s consolidated operating income.

Reflecting this balanced growth, year on year Tosoh’s consolidated net sales rose 4.8%, to ¥609.7 billion (US$6.7 billion), and its consolidated operating income increased 23.6%, to ¥51.4 billion (US$427.7 million). Our net income, meanwhile, soared 110.7%, to ¥62.3 billion (US$518.4 million). That jump, however, is partially attributable to the booking of substantial deferred tax assets associated with the carryforward losses of NPU, which were assumed by Tosoh Corporation as a result of its October 1, 2014, merger with NPU.

The Year in Review

Heading into the first half of fiscal 2015, we expected difficult business conditions. We anticipated in particular some backlash in the domestic market in response to the spike in demand in the last half of fiscal 2014 ahead of the hike in Japan’s consumption tax in April 2015. In addition, one of our ethylene plants underwent scheduled maintenance during the fiscal year’s first quarter.

The Chlor-alkali Group’s shipments of vinyl chloride monomer (VCM), polyvinyl chloride (PVC) resin, and urethane raw materials declined in the fiscal year’s first half as a result in part of that scheduled maintenance. But these declines were somewhat mitigated by increased shipments of caustic soda. The Petrochemical Group also saw shipments of many of its products contract, mostly because of declines in unit production due to the scheduled maintenance.

Our Specialty Group, however, recorded strong first-half shipments of such products as ethylenamines and high-silica zeolites (HSZ®). The group’s positive performance overall combined with rising export prices and a weakening yen to increase Tosoh’s consolidated net sales and profits. The increase in profitability so exceeded our early forecasts that we revised upward our full-year forecasts for consolidated operating and net income.

We entered the second half of fiscal 2015 buoyed by the favorable oil prices and yen rate. We were cautiously optimistic about business conditions despite the slow Japanese economy and the prolonged effect on domestic business of the hike in Japan’s consumption tax. Adding to our sense of caution, moreover, were the slowdowns in emerging countries’ economic growth and the heightened political tensions in the world’s oil-rich regions.

However, Japan’s gross domestic product (GDP) rose for the remaining two quarters of our fiscal year. Oil prices and the yen rate remained at favorable levels. And the Japanese government decided to postpone the second hike in the consumption tax that it had scheduled for 2016. Hard on the heels of this good news was the ruling coalition party’s landslide victory in an election that solidified support for Prime Minister Abe’s Abenomics economic and monetary initiatives and calmed anxiety about Japan’s economic direction.

Tosoh’s fiscal performance mirrored improving conditions. All of our product groups posted net sales growth and positive operating income. The Specialty Group recorded a strong performance, but the Chlor-alkali and Engineering Groups more than doubled their profits over fiscal 2014 results. Overall, the company’s robust performance can be attributed to a weak yen and declining oil prices, to increased shipments of some principal products, and to a recovery in demand for some key product lines.
The Merger with NPU

Progress toward the merger with NPU has been slow but steady. Tosoh’s association with NPU began in 2001. That was when Tosoh acquired a major stake in the isocyanate producer to position itself in Asia’s potentially high-growth polyurethane market and to enjoy other benefits of the association. NPU, for example, also offered synergies with our chlor-alkali business in particular because of relationships between Tosoh’s and NPU’s raw materials and products.

So close were those relationships that after making NPU a consolidated subsidiary in fiscal 2007, Tosoh raised its ownership in fiscal 2009. NPU, however, fell on hard times shortly thereafter amid the appreciation of the yen and the global economic tumult at the end of the decade. To enhance our oversight of NPU’s necessary restructuring, we purchased yet more of the company, in fiscal 2013 and made it a wholly owned consolidated subsidiary.

NPU’s restructuring succeeded, but the outlook for its still potentially high-growth business remains clouded by increasingly severe competition. Its global competitors plan capacity expansion, and the supply-demand balance for MDI is likely to worsen. Tosoh, therefore, chose to merge NPU’s operations into its own to provide the strong management platform required to face the challenges ahead. The merger enables faster decision making, unified manufacturing, and optimized R&D.

The merger occurred on October 1, 2014. The management resources of both companies have been consolidated at Tosoh’s head office in the newly formed Urethane Division of the Chlor-alkali Group. Some time, clearly, is required for full integration as a business unit. But we are pleased with progress to date and confident that the Urethane Division will rapidly capture the myriad synergies of the merger.

That confidence draws on our experience of earlier mergers. Tosoh absorbed Tekkosha Co., Ltd., in 1975 and Shin-Daikyowa Petrochemical Co., Ltd., in 1990. And we’re convinced of as much success with the NPU merger.

R&D Reorganization

Reorganizing our R&D facilities was another structural change that we undertook in fiscal 2015. This was prompted mainly by the merger with NPU but was, in fact, long overdue. The heads of our three main R&D centers were burdened with excessive responsibilities. We needed to free them up and better allocate our R&D resources among our three-pillared priorities of life sciences, energy and environmental conservation, and electronic materials.

We’ve done that and organized our new R&D structure by technical field and function and by whether our research laboratories engage in product and technology development research or long-term research. Where once we had three main R&D centers we now have seven research laboratories, including the Urethane Research Laboratory formed from NPU’s former R&D facility.

An advantage of the new R&D organization is our enhanced ability to concentrate our resources on specific themes relevant to growth areas in our target markets. We expect our new focus to yield exciting products and materials and to speed our development timelines.

Key Issues and Strategies Moving Forward

We addressed a number of important issues in fiscal 2015 that will continue to be the focus of our attention in the year ahead. Principal among these are improving the profitability of our commodity operations and expanding the role of our Specialty Group.

Improving the Profitability of Commodity Operations

The profitability of our commodity operations is a long-standing issue. These operations are highly sensitive to fluctuations in the global economy, in oil prices, and in exchange rates and must deal with the inevitable cycle of global production capacity leapfrogging demand.

In fiscal 2015, we concluded various initiatives to improve the profitability of our vinyl isocyanate chain operations. Our merger with NPU at the beginning of October will aid the recovery in the profitability of our urethane operations. And our completion of the 200,000-metric-ton production capacity expansion at our No. 3 VCM Plant, also in October, adds not just VCM capacity but PVC and caustic soda production capacity as well.

An ongoing focus of attention is achieving the best mix of products and raw materials, such as ethylene, based on market conditions. We are also devising ways to heighten our cost-competitiveness, including sharing the cost benefits of our electric generation capabilities among our domestic manufacturing companies.

The core issue in our petrochemical operations is their dependency on a mature and competitive domestic market. We continue to reduce production and logistics costs, strengthen business relationships with raw material suppliers and customers, and differentiate by developing specialty grades.

Our petrochemical competitors are in the same position and are downsizing. A plant closed in fiscal 2015, and two more are scheduled for closure in the next two years. The steady decline in supply will enable us to increase our operating rates and improve our profitability.

Some of our petrochemical products, of course, are not as dependent on Japan’s market as others. Chlorosulphonated polyethylene (CSM) rubber and polyphenylene sulfide (PPS) engineering plastic are prime examples. Tosoh is the world’s leading...
producer of CSM. And our principal PPS customer is the global automobile industry, which is estimated to grow 6% in the medium term. We are, therefore, expanding our CSM and PPS operations and maintaining their market positions through product differentiation.

Expanding the Role of the Specialty Group

The Specialty Group has long been a big contributor to our profitability because of its sales in high-margin niche markets. The group, moreover, has always served to offset the cyclical fluctuations in the profitability of our commodity operations. So, while our core commodities operations are our major source of cash flow, our smaller specialties operations ensure our stable profitability.

The global business landscape, however, is changing. The Specialty Group must play a more central role in Tosoh’s evolution to adapt to changes in its operating environment.

We are therefore increasing the Specialty Group’s production capacity and sales volume and launching new Specialty Group products. We are in particular determining which high-growth niche markets offer the best opportunities for Tosoh’s products, technologies, and other strengths.

HSZ is one of our top-earning products, and we have been quick to keep ahead of demand for HSZ. We added to our HSZ production capacity in fiscal 2015, bringing to 200% our increase in domestic HSZ capacity since 2008.

We also in fiscal 2015 added production facilities for RZETA®, our proprietary, new, and unique emission-free reactive amine catalyst for polyurethane (PU) foam. In addition, our subsidiary Tosoh Hyuga Corporation began its commercial production of chemical manganese oxide (CMO®), which is used for the lithium-ion battery market.

The Specialty Group also launched multiple products in fiscal 2015. Its Bioscience Division, for instance, introduced three new models of each of its major clinical diagnostic systems. And its Advanced Materials Division introduced Zpex® Smile, a high grade of translucent zirconia dental material especially for front teeth that has been an immediate success.

Numerous other high-performance products and technologies of the Specialty Group’s Organic Chemical, Advanced Materials, and Bioscience Divisions are outlined elsewhere in this report. We are confident that the Specialty Group will drive our growth.

Consequently, we are committed to investing aggressively in the Specialty Group. We are, for the immediate term, looking at investments to further our bioscience, CMO, electronic material, and optical polymer businesses.

Our reorganized R&D structure should fast track a stream of products and technologies for the Specialty Group. Tosoh’s R&D should also foster the Specialty Group’s growth in another important way. Specialty products have shorter product lives compared with commodity products. The Specialty Group, therefore, must rely on R&D to come up with new and improved products.

Being a Good Corporate Citizen

Tosoh is committed to good corporate citizenship. Around the world, it complies with regulations and guidelines, works toward safe operations, ensures employee health and welfare, and contributes to local communities through corporate social activities.

We participate in the global Responsible Care (RC) initiative, which seeks to improve chemical companies’ performance environmentally and in safety and health. The RC program sets policies and objectives that involve qualitative and quantitative targets and compliance with diverse standards.

Tosoh’s corporate governance system, meanwhile, ensures transparency, compliance, and operational efficiency. We firmly believe in the system’s ability to enhance corporate value and growth.

I am personally involved in setting up programs to improve the safety of our domestic production operations. I have visited our major production facilities in Japan and talked with their managers and employees about the progress and effectiveness of those programs. And I have increased the annual budget to address issues raised and especially the recent problems arising from faulty plant maintenance.

We value our people and have programs in place to oversee their health and welfare, job satisfaction and productivity, and personal growth. Our employee programs instill an awareness of such important issues as environmental concerns and social contributions. Recently, our efforts were validated by Japanese company rankings that recognize Tosoh as a good company for high school and university graduates to work for.

Perspectives

The price of oil and the value of the yen are among the most important factors for Tosoh’s business in fiscal 2016. Should oil prices and the yen remain at the levels as of this writing, Japan’s economic recovery will probably continue. Recent data suggests this to be the case. Corporate earnings remain solid and personal income and employment have improved.

Overseas, the economic outlook is mixed. Emerging economies, however, will continue to grow. Also expected to expand are the specific markets that we are targeting through our three-pillar R&D program and in each of our product groups, especially the Specialty Group.
Tosoh is well positioned to achieve growth in fiscal 2016 and beyond. Our vinyl isocyanate chain is back in balance. New and expanded production capacity for such of our products as VCM, caustic soda, HSZ, RZETA, and CMO will contribute to sales for the full year. And we are actively developing growth markets overseas, particularly for our specialties products.

Reflecting our strategic goals, we made public several new initiatives in April 2015, after the end of the fiscal year under review. We announced the start of construction on an HSZ production base in Malaysia that will substantially enlarge Tosoh’s HSZ production capacity and ensure stable supply. We also announced the acquisition of an in-vitro diagnostics company in India to position our bioscience business in that market.

In February 2015, Tosoh celebrated its 80th anniversary. A look at the company’s history makes it clear that Tosoh’s success owes itself largely to an ability to remain flexible—to evolve with the times and continuously find pathways to growth. We in management are dedicated to continuing this tradition.

In all of our endeavors, we look forward to your continued and much appreciated support in fiscal 2016.

Kenichi Udagawa
President