

## Discussion between the CFO, the CSO, and an Analyst

# Working to Be a Company Continuing to Create Value in a Sustainable Manner

**Showa Denko invited Mikiya Yamada of Mizuho Securities Co., Ltd., to join Hideki Somemiya, Showa Denko's chief financial officer (CFO), and Tomomitsu Maoka, the chief strategy officer (CSO), for a discussion on the Company's financial and capital strategies, to ensure that it continuously creates value in a sustainable manner.**

(The discussion was held in a Showa Denko conference room on April 13, 2022.)



### Hideki Somemiya

Managing Corporate Officer and CFO  
Showa Denko K.K.

#### Profile

Hideki Somemiya held positions at Nomura Research Institute, Ltd., Merrill Lynch Japan Securities Co., Ltd., and JPMorgan Securities Japan Co., Ltd., where he was managing director of the Technology, Media & Telecommunication Group of the Investment Banking Division prior to joining Sony Corporation. At Sony, Mr. Somemiya was in charge of Groupwide M&A activities, served as CFO of semiconductor operations, and took part in the launch of an AI sensing solution business. He joined Showa Denko in October 2021 and took up his current position in January 2022.

### Mikiya Yamada

Senior Analyst, Equity Research  
Department, Mizuho Securities Co., Ltd.

#### Profile

Mr. Yamada began his career at Dow Chemical Japan Ltd., where he served in a number of positions, including general manager of research and development and of financial planning as well as financial planning manager for Dow's Pacific region. After working for Goldman Sachs Co., Ltd., JPMorgan Chase & Co., Lehman Brothers Japan Inc., and Barclays Securities Japan Limited, he joined Mizuho Securities in 2016. Mr. Yamada covers the chemical and textile sectors extensively in his current position.

### Tomomitsu Maoka

Managing Corporate Officer and CSO  
Showa Denko K.K.

#### Profile

After starting his career at A.T. Kearney, Inc., Tomomitsu Maoka moved to Infineon Technologies Japan K.K., and then to Lenovo Japan K.K., where he was involved in business strategies and business model transformation, before joining Renesas Electronics Corporation. At the company, he covered various roles including corporate planning, the entire operations in China, etc., as senior vice president. He joined Showa Denko in October 2021 and took up his current position in January 2022.

## Aiming to Become a Global Top-Level Functional Chemical Manufacturer from Japan

**Yamada** Let me begin by saying that the strategy outlined in the update of Showa Denko's long-term vision—of clearly committing management resources to business areas where the Company can prevail—was very straightforward. With the adoption of semiconductor materials and mobility as the two pillars of its investments, the Company has set out a well-defined scenario for the semiconductor materials area in which it will invest in semiconductor gases, a strength of Showa Denko; back-end process materials, a strength of Showa Denko Materials (formerly Hitachi Chemical); and ceria-based slurry, where vertically integrated synergies can be utilized.

In contrast, I believe that challenges remain in mobility. I wonder if Showa Denko's mobility business is of a sufficient scale for it to operate successfully in the mobility area. I have my doubts regarding both the significance of positioning mobility as one of the two priority investment areas and the likelihood of the Company prevailing in competition. Prevailing in growth areas naturally requires the commitment of abundant management resources. Unfortunately, however, I do not believe that Showa Denko's financial standing allows for the investment of adequate management resources in both areas at the present time. While I applaud the Company's determination and its approach to semiconductor materials, I think that many investors are looking for a more persuasive narrative on how it will implement its strategies.

**Somemiya** Thank you for your comments. As you correctly point out, we recognize that improving our financial standing is our highest priority. We must achieve a more appropriate capital structure and develop the strength to facilitate our next major growth investment. Under the new leadership of president and CEO Takahashi, Showa Denko has laid out a management approach with an emphasis on return on invested capital (ROIC), with a view to not only instilling portfolio management (④ P.28) within the Company but also making disciplined investment an aspect of our appeal to external communities. This stance reflects our intention to respond to the points raised by capital markets.

When I joined the Showa Denko Group in October 2021, head office and individual divisions communicated in a manner resembling a hub-and-spoke system. However, as we set about implementing portfolio management, those who lead stable earnings businesses within the Company are entitled to know how the businesses receiving the cash they have generated will invest that cash and what returns are being targeted. Therefore, to improve on the previous structure, we updated it to allow all the general managers of divisions to also take part in discussions on the plans of other divisions, beginning in December 2021. With the updated structure enabling each division to understand its own role in overall optimization, we have introduced ROIC and key performance indicators (KPIs) as a shared language and aim to make the structure function effectively. This structural change was not achieved overnight. Rather, it was realized by president and CEO Takahashi (the then CSO), who established the foundations over a period of three years, including the unification of reporting formats.

Acquiring the former Hitachi Chemical entailed a financial risk in terms of generating cash flow. The acquisition was the biggest decision in our history. Given Showa Denko's current position, I regard achieving a more appropriate capital structure as an urgent priority to take the Company to a point where it can carry out strategic investments under normal conditions. We are aiming to generate ¥1 trillion

in operating cash flow over the next five years and plan to invest between half and two-thirds of this amount with a focus on semiconductor materials. In the update of our long-term vision, we have indicated our intentions for capital structure and capital allocation as part of our financial strategies. We will also continue to refine our targets, such as the appropriateness of a debt-to-equity (D/E) ratio of 1.0—a long-term numerical target—and implement financial management to establish a balance sheet with capacity for further investment.

Although remuneration linked to our stock price currently applies only to directors and corporate officers, we envisage introducing this system for all employees at some point. In promoting portfolio management, we believe that our corporate value will improve if employees strive to achieve overall optimization with an awareness of the roles of each portfolio category, which in turn allows us to show them that they will be rewarded accordingly. We therefore aim to implement this system for employees after providing a sufficient explanation of its introduction.

**Maoka** Showa Denko and the former Hitachi Chemical have a good relationship, with each strength complementing the other's weaknesses. Although Showa Denko, which is positioned in the midstream section of the value chain, has capabilities in materials development, difficulties in understanding how its products are used in the downstream section made it challenging to develop products with high added value. On the other hand, the former Hitachi Chemical, which is positioned in the downstream section of the value chain, has outstanding insight into how its customers wish to use its materials in their products and a wealth of know-how on meeting their requirements. However, over-optimizing its adaptability has resulted in the gradual erosion of its capabilities in midstream materials composition and development as well as in investment. We view the integration of the two companies as an excellent combination, because it facilitates value creation using the entire value chain, applying Showa Denko's material development capabilities to address the requirements of Showa Denko Materials' customers.

Going forward, the way in which we solve social issues will be an important theme. The main area in which we have been able to demonstrate our ability to create synergies is in semiconductor materials. We must set forth a more specific value creation scenario in the mobility area, exactly as Mr. Yamada points out. Today, our business activities involve the connected, autonomous, shared, and electric (CASE) field for automobiles. Within this field, we focus on electrification trends, as we believe it is crucial for us to enhance added value while creating new products and services that leverage the synergies of both companies.

Vertical integration that strengthens the value chain from midstream





Discussion

to downstream in such a manner is highly unusual. For this reason, I believe that we can create unique models and value and I aim to take on a variety of challenges.

**■ Yamada** You mean that the newly integration of Showa Denko and Showa Denko Materials will enable the integrated Company to proceed to a new dimension. To make that happen, I believe that it will be vital for everyone involved to work together, as Mr. Somemiya has explained. The Company will not be able to record great achievements unless all concerned are aware of their own roles and understand each other's specific characteristics and ideas. In that sense, communicating collectively, rather than on a one-to-one basis, surely holds the key to creating synergies and accomplishing strategies.



**■ Somemiya** You are absolutely right. If one excludes the large petrochemicals, hard disk, and graphite electrode businesses, Showa Denko is a collection of 20 or more medium-sized businesses with net sales on a scale ranging from ¥20 billion to ¥60 billion, as opposed to a corporate entity with net sales of ¥1.4 trillion. Accordingly, we view achieving overall optimization through portfolio management and ensuring that everyone understands the trajectory of our overarching strategy as critical aspects of our business management.

To this end, we will strengthen cross-divisional functions that transcend the boundaries of each organization. To give an example, the organization of the CFO, which I preside over, reports to Chief Human Resource Officer (CHRO) Nori Imai on frontline conditions and other matters as a member of the organization under the CHRO. In addition, those engaged in accounting in all divisions—who have thus far been closely affiliated with their own divisions—will report to me on such issues as division expenditures, as members of the organization under the CFO. In this way, we have put in place a system in which the CFO and the CHRO provide support for the operation of divisions while steadfastly communicating Companywide policies to divisions through those engaged in personnel and accounting in each division and functional division. The aim of this system is to strengthen cooperation between CXOs and business divisions. We have introduced the same arrangement for other CXOs as well, although the degree of corporate governance differs according to function.

In addition, we have begun tackling the development of human resources with high potential. While it had been common for employees to build a career in the division to which they were assigned after joining Showa Denko, the Company is now expanding the promotion of transfers across divisions and job rotations, including at the head office, which will enable management teams to identify and develop human resources with high potential.

**■ Maoka** Beginning in 2022, Showa Denko has been holding town hall meetings at various locations. At these meetings, Mr. Somemiya touched on the ranking of business divisions in terms of ROIC. At first, I was concerned that we would receive negative feedback from those in the business field about being ranked in such a way. However, many responded that they were grateful, as no one had ever discussed such an issue with them before and it was enlightening. All those present expressed their understanding of the explanations provided on portfolio management and ROIC, which helped them to gain an appreciation of the rationale behind the Company's decisions. Speaking personally, I was greatly heartened to learn that employees felt this way on the occasion of the meeting.

**■ Yamada** Your experience makes clear that sharing information is the first step. I believe that making an issue visible facilitates the establishment of a shared language, which further enhances the importance of working together.

**■ Maoka** As horizontal cooperation progresses between businesses, situations will arise in which—for example—a business supplying raw materials commits funds to product development expenses or capital expenditures, which might put Business A at something of a disadvantage but result in a positive outcome for the Company as a whole. At such times, I intend to rate the efforts of Business A as valuable and demonstrate that assessment resolutely in terms of my actions. Since focusing only on numbers would ultimately result in failure, I believe it is crucial that we move forward while placing due importance on both individual businesses and the Company as a whole.

**■ Somemiya** The greater the number of employees who understand and implement Showa Denko's purpose and values\*, the better we can establish a virtuous cycle that improves not only the Company's financial but also its nonfinancial value. President and CEO Takahashi has frequently pointed out that tomorrow will not be better than today unless we change what we do, the way we do it, and the people who do it. Therefore, I hope that Showa Denko's Values will become a deeply ingrained part of its guiding precepts.

\* Values: This is the value system we hold dear. It entails being Passionate & Results-Driven, Agile & Flexible, having Open Minds & Open Connections, and maintaining a Solid Vision & Solid Integrity.

**■ Yamada** Although it may not be appropriate for an analyst who basically focuses on business results to say so, I believe that around only half of a company's value may be found in its numbers. To convert value that is not expressed in numbers into that which is visible in the numbers over the long term, it is important for employees to move in the same direction while remaining confident that they are being evaluated properly in both quantitative and qualitative terms.

Roadmap for Realizing Our Long-Term Vision as a "Co-creative Chemical Company"

**■ Yamada** As implied in Showa Denko's purpose—"Change society through the power of chemistry"—society will not be transformed without the power of chemistry. It is my belief that the power of chemistry is indispensable to maintaining the types of value that we currently enjoy, to the maximum possible extent. At the same time, the power of chemistry has an integral role to play in helping society progress toward the resolution of environmental issues, such as carbon neutrality, and the achievement of the United Nations Sustainable Development Goals (SDGs), including the goals related to

social inequality and hunger, in a way that leads to greater affluence. With that said, the fact remains that the SDGs cannot be achieved through chemistry alone. This is why shifting to a co-creation model that reflects current circumstances is the correct direction for Showa Denko to take. The way in which it makes this shift will be of the utmost importance, and I have high expectations of the Company in this regard. Co-creation increases the number of stakeholders with whom Showa Denko engages. As such stakeholders each have stakeholders with a host of interests of their own, I believe that Showa Denko can make a more persuasive case for convincing stakeholders to join it in realizing co-creation, if it can demonstrate in specific terms the way in which it will distribute the value created with internal and external parties.

People's attitudes do not change readily. I believe that it is only when people first change their actions and achieve results and experience success that their attitudes change.

**■ Maoka** I believe that efforts toward carbon neutrality cannot progress without the consent of consumers. To this end, we must involve not only companies but also a variety of stakeholders, such as governments. Showa Denko carries out two sets of activities under the Jisso Open Innovation Network of Tops (JOINT) and JOINT2 (➡ P.45), consortiums engaged in the development of semiconductor packaging materials, substrates, and equipment that are prime examples of activities involving stakeholders. As materials alone cannot create products of value, co-creation initiatives with a range of parties are indispensable. Also important is highlighting the significance of such initiatives to the world. Even if Showa Denko does something of value, ultimately it will see no returns and create no incentives if no one knows that the Company was responsible for the achievement. Establishing a system to address this point will be a challenge for us as we go forward. Although we have focused on in-house collaboration between divisions and departments thus far, I believe that it is vital to create a foundation to create value by pursuing co-creation, without being constrained by company or corporate frameworks.

**■ Yamada** Providing an environment for creating such a foundation is of crucial importance. Meanwhile, I feel that the chemical industry is lagging behind other industries in making use of digitization. Although Showa Denko is making great strides in terms of streamlining production and other matters, I hope that it will leverage digital technology to connect directly with customers, academia, and society to create new value. I think that connecting directly with a variety of stakeholders will invigorate communication and increase the sharing of information, which will contribute to the overall optimization of companies and of the industry.

**■ Somemiya** Utilizing digital technology to connect directly with a variety of stakeholders certainly holds the key. I also hope that we can create a platform in which more people with open minds can participate, and construct an ecosystem that enables not only Showa Denko but all parties to enjoy the advantages.

Similarly, achieving carbon neutrality requires the involvement of all parties, including the industry as a whole and governments, rather than the efforts of a single company. To this end, we must create a movement that is committed to fundamentally realizing carbon neutrality.

**■ Yamada** If companies only invest at their own convenience and at a time that suits them, the fundamental issue will remain unsolved. Instead, I believe that it is crucial for co-creation partners to build systems by reconciling their respective viewpoints and objectives. Although Showa Denko is prepared to do what it can to realize carbon neutrality, making investments in carbon neutrality on its own would not produce the returns demanded by investors, who would



not tolerate such investment. I believe that progress can only be made by improving co-creation to a stage where all parties know the actions that they must take in order to work together.

Promoting Dialogue with Investors and Other Stakeholders

**■ Yamada** This year marks the 20th year since I began covering Showa Denko, and I have been truly impressed with the progress it has made. Again, as Showa Denko's purpose sets out, society will not change without the power of chemistry. The chemical industry appeals to me. I sincerely hope that Showa Denko will become one of the world's leading chemical companies. To achieve this status, it must actively communicate information to customers and the various stakeholders with whom it engages in co-creation, including communicating more information to society and stakeholders.

**■ Somemiya** The reason we have not communicated information to an adequate extent lies in the fact that we have not been sufficiently active. Through my communication with investors as CFO, I have come to realize very keenly that Showa Denko has not sufficiently met the trust and expectations of its stakeholders. We have not necessarily been negligent in any way, and I do appreciate that we have worked to engage with stakeholders to the best of our ability. Nevertheless, given that we have not met such trust and expectations while remaining unaware of changes in the external environment due to our long history and past connections, we must make a fresh start. On this basis, the two companies will become a new company called Resonac\*, rather than two companies coming together. Accordingly, the new company will be aware of the need to create a vision and new value.

\* Resonac is the name of the newly integrated company to be established in 2023 (subject to approval at the extraordinary shareholders' meetings scheduled to be held for both companies in September 2022).

**■ Maoka** When Mr. Yamada spoke at a study session held for the management team at Showa Denko, his answer to a question on why the chemical industry was not fairly evaluated—despite the value it produced—was that chemistry was basically the name of a process and that the activities of the chemical industry were not widely known. This reply made a strong impression on me. It made me aware once again that it is important to objectively analyze how our business affects a variety of people and to develop methods of improvement. Ultimately, we deliver value to people, rather than companies or investors. We must devote ourselves to implementing a way of co-creating that captures people's hearts, unshackled by the past conventions of the chemical industry.