

July 29, 2010

(4112 TSE1st)

Hodogaya Chemical Co., Ltd.

Advancing Aspirations through Chemistry: Creating Greater Value and Functionality

Hodogaya Chemical Co., Ltd. (hereinafter Hodogaya Chemical or the Company) is a specialty chemical company that develops and markets a broad range of functional material offerings, based on unique technologies related to organic chemical synthesis and polymeric materials. The following is a summary of Trias Corporation's recent visit to Hodogaya Chemical and an interview with Taito Muraoka of the Corporate Planning Department.

[Corporate History and Overview]

Hodogaya Chemical was established in 1915 as the Hodogaya Soda Manufacturing Co., a private enterprise producing electrolytic soda from industrial salt. In 1926, it began manufacturing phosgene, which is created from the chlorine generated by the electrolyzation of industrial salt. Despite being highly toxic, phosgene is used in numerous applications.

A year later, the Company began producing dyestuffs, signifying its move into the field of organic chemicals. In 1939, it was renamed as Hodogaya Chemical and started production of agrichemicals in 1950. In 1960, it established Nippon Polyurethane Industry Co., Ltd., which was the first in Japan to manufacture MDI, a key component in making polyurethane products. Three years later, the Company founded Nipponperoxide Co., Ltd., a maker of hydrogen peroxide and the largest Hodogaya Chemical subsidiary today. The Company concurrently began producing PTG, an elastic textile material. In 1978, it started production of CCA (Charge Control Agent, an additive used in photocopier and printer toners)—which has become Hodogaya Chemical's largest source of revenue today—and CTM (Charge Transport Material, an organic photoconductor material for use in photocopiers and printers) in 1984. It then began production of OLED (Organic Light Emitting Diode) materials from 2001.

In order to reinforce productivity on a consolidated basis, Hodogaya Chemical restructured its Group of companies on two occasions, first in 2006 and then in 2008. One example of this move was the staggered selloff of Nippon Polyurethane Industry (NPI) shares. Although the polyurethane subsidiary generated considerable net sales, its capital investment burden was equally large and its business model had become incompatible with Hodogaya Chemical's management policy of achieving high profitability in niche markets of high-growth markets. For these reasons, the Company sold NPI to Tosoh Corporation, which served as a supplier to the polyurethane subsidiary, which then was repositioned as a nonconsolidated subsidiary of Hodogaya Chemical in 2008.

[Status of Main Business Segments]

Hodogaya Chemical's operations are currently divided into four segments: Fine Chemicals; Specialty Polymers; Basic Chemicals; and Others. The ratio of consolidated sales for each segment and their main products for FY3/10 are listed in Table 1 shown below:

Table 1: Consolidated Sales and Major Products by Segment for FY3/10

Segment	% of sales	Operation	Main Products
Fine Chemicals	40%	Imaging Materials	Used in photocopiers/printers (CCA, CTM, CGM)
		OLED materials	OLED materials
		Dyestuffs	Dyes & coloring, food additives
		Specialty Chemicals	Phosgene derivatives, Intermediates for medical/resin and electronics materials
		Agro-science	Agrichemicals, herbicides
Specialty Polymers	27%	Functional polymers	Urethane materials, adhesives, removers, hardeners
		Construction materials	Polyurethane waterproof materials
Basic Chemicals	27%	Industrial chemicals	Hydrogen peroxide
Others	6%		Hazardous materials storage; carbon nanotube

NOTE: Data supplied by Hodogaya Chemical and compiled by Trias Corp.

Consolidated sales in FY3/10 declined by 2% on a year-on-year basis despite a modest recovery posted from Q2 (see Table 2). Operating profits, however, rose to ¥1.52 billion, a y/y increase of 64.3%, buoyed by such factors as cost cuts in fixed expenses and a price recovery in basic chemical products. The status of each segment is profiled below, with particular focus on the Fine Chemicals division.

Table 2: Sales and Profit Breakdown for FY3/10

(¥ million)	FY3/09		FY3/10		
Sales	Actual	y/y change	Actual	y/y change	
Fine Chemicals	12,724	-6.5%	12,586	-1.1%	
Specialty Polymers	8,917	-21.0%	8,529	-4.4%	
Basic Chemicals	8,179	-7.0%	8,357	2.2%	
Others	2,277	-4.4%	1,990	-12.6%	
Total	32,097	-11.0%	31,462	-2.0%	
Operating Income	Actual	Margin	Actual	Margin	y/y change
Fine Chemicals	623	4.9%	161	1.3%	-74.2%
Specialty Polymers	63	0.7%	448	5.3%	611.1%
Basic Chemicals	233	2.8%	662	7.9%	184.1%
Others	7	0.3%	250	12.6%	3471.4%
Total	926	2.9%	1,521	4.8%	64.3%

Fine Chemicals: This division consists, in descending order of sales, of the following: 1) imaging materials; 2) dyestuffs; 3) specialty chemicals; 4) agro-science products; and 5) OLED materials. Imaging materials account for some 50% of fine chemical products, of which CCA (Charge Control Agent) used in toners for photocopiers and printers is the top seller. Adding a small portion of CCA not only generates static electricity but also provides optimal control over the discharge, allowing for a clearer image to be created. Roughly 90% of the global CCA market belongs to Hodogaya Chemical and Orient Chemicals Industries in Osaka, Japan. Given that the market is susceptible to economic fluctuations, in which downturns adversely impact copy volume, the Company experienced a tough operating environment in FY3/10—but demand has been recovering ever since.

CTM (Charge Transport Material) and CGM (Charge Generation Material) used in OPCs (Organic Photo Conductor) are also imaging materials. OPC is central to photocopiers and printers, converting optical signals (letters and images) into electrical signals. CGM absorbs light and generates an electric charge, while CTM serves to transport the charge. While many manufacturers of photocopiers and printers produce OPC drums in-house, Hodogaya Chemical is the leading maker with a global market share of 30-40%. The sales recovery of CTM and CGM, given that they are hardware materials, are slower than CCA, which used in toners.

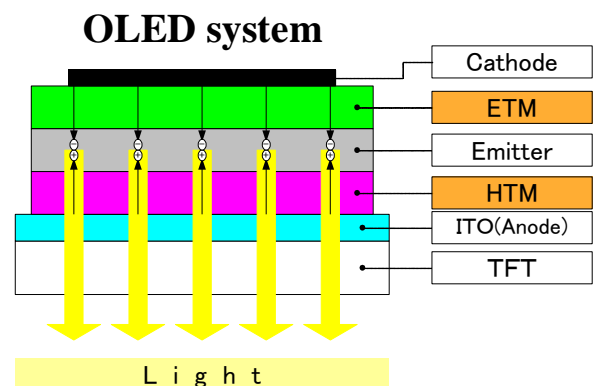
Meanwhile, the Company's dyestuffs are used in aluminum coloring, while spilon dye is used in stationery applications, cathion dye for car sheets, and so on. Dyestuff sales have been recovering since the latter half of FY09. Specialty chemicals include various intermediate materials that owe their roots to phosgene, and demand is recovering in the areas of plastic materials and medical products. In agro-science, the Company offers non-farming herbicides for home garden use, in which it has some 60% share of the domestic market. The market serves as a stable source of revenue that is less susceptible to economic downturns, and is relatively difficult for competitors to enter as it is subject to strict regulatory administration.

Given that OLED materials are representative of the Company's activities in high growth markets, it will be discussed later in this company memo.

Specialty Polymers / Basic Chemicals: Both being commodity businesses, sales volume for the two segments began recovering in Q2 of FY3/10, which was faster than the recovery in fine chemicals sales. Moreover, the production capacity utilization ratios for these two have returned to normal levels at this time, while that of electronic materials have been 80-90% of normal. The specialty polymer segment includes functional polymers such as PTG, which is a basic polyurethane material, and construction materials like waterproof urethane offerings. The basic chemical segment primarily provides hydrogen peroxide, which is environmentally friendly and used in pulp bleaching, semiconductor cleaning and other applications. The two segments' operating profits improved substantially in FY3/10, led by greater profit margins resulting from lower materials costs—which had previously spiked in the latter half of FY3/09, thereby widening the margins in the following fiscal year.

[Keys for Future Growth: OLED Materials and Carbon Nanotubes]

Over the next several years, the OLED Materials segment has the potential to lead the Company's earnings growth. OLEDs are self-emitting devices with high luminosity and energy efficient. Demand for these devices is expected to soar, especially as next-generation flat displays for mobile phones, PC monitors and so on, while applications as a lighting source are also being developed.



Note: Illustration from information made public by Hodogaya Chemical

This Memo is for reference purposes only and is not intended as a solicitation for investment. The contents contained herein are prepared based on reliable information that already exists in the public domain. The Company, however, does not guarantee complete accuracy. Any opinion or information contained in the Memo is relevant as of the day of the Information Meeting and/or Company Visit, although the views and/or facts may be altered without prior notification. Final investment decisions shall be made by investors themselves based solely on their own judgment and responsibility.

Hodogaya Chemical offers a low-molecular OLED, which is built up by laying one upon another micro-thin membranes, which are created by evaporating organic materials. The device's light-emitting process works when an electron from a cathode (-) and a proton (hole) from an anode (+) are channeled through a transporting layer (electron transporting material, or ETM, and hole transporting material, HTM), the electron and proton combine in an emitter layer and generate electric energy, which is then converted into light. The ETM, HTM and emitter are all made from organic materials as well.

While Hodogaya Chemical is mainly involved in the production of HTM to date, it is also in the process of securing a user's approval to produce ETM as well. Because the OLED market is an emerging market, it is difficult to get a firm grasp on such data as market share and so forth. However, the Company was the top producer of HTM before the onset of the economic crisis of 2008, but a competitor affiliated with a large flat-panel maker in Korea has been gaining market share since then. In Japan, Idemitsu Kosan, Toyo Ink Manufacturing and Nippon Steel Chemical produce HTM, while Toray and Chisso Corporation make ETM, and Idemitsu and Nippon Steel Chemical produce emitters. Idemitsu is the only domestic company that supplies all three materials. Hodogaya Chemical has not pursued emitters because the basic technology is different from that of HTM, but is seeking to secure the technology through an alliance with a Korean maker in a bid to become a comprehensive provider of OLED materials in the future. Towards this end, the Company announced on June 14 that it will be acquiring a 34% share in SFC Co., Ltd. (Korea), a fine chemicals maker of emitting OLED and other materials, by late-July 2010.

It should be noted here that HTM has a similar chemical structure with CTM, which is used in photocopiers and printers, in that both rely on a benzene series aromatic compound as a raw material. This characteristic thus allows the production facilities of CTM to be used to produce HTM. While CTM is manufactured by the ton, HTM is made by the kilogram or even gram. That means even if the OLED market should suddenly expand in the near-future, the Company could readily increase HTM production without need of major capital outlays. Facilities to improve purity would be necessary because OLED materials require higher purity levels than CTM, but the investment should not exceed ¥1 billion. Current OLED materials sales are too modest and R&D costs too high to generate profit, but the expectations are that a significant increase in sales volume will lead to robust profitability. Hodogaya Chemical aims to reach the break-even point, which includes development costs, in this segment in FY3/11.

Despite being even smaller than the OLED market, carbon nanotubes (or CNT) have the potential of delivering high growth and high profitability. The Company established Nano Carbon Technologies Co., Ltd., a joint venture with Mitsui & Co., in 2006. While the JV was dissolved in 2009, Hodogaya Chemical set up a CNT development unit internally to push forward research into the new material. CNT offers a variety of beneficial features: It is lighter than aluminum, becomes stronger than steel when mixed with plastics, can be heated with only a modest amount of electricity, and absorbs electromagnetic radiation. How such features are exploited for commercial applications will determine CNT's growth as a market.

A number of applications are already being examined, including using CNT to counter static electricity, as a preventive measure for ETC (Electronic Toll Collection) system malfunctions, and as a sheet heating element.

[FY3/11 Forecast and New Mid-Term Management Plan]

Hodogaya Chemical projects consolidated sales to reach ¥33 billion, up 4.9% y/y, while posting an operating profit of ¥2 billion, an increase of 31.4% y/y, in FY3/11 (see Key Financial Data and Business Results on page 6). A recovery in the fine chemicals segment, particularly in imaging materials, is expected to contribute to earnings growth. On the other hand, earnings from basic chemicals are likely to remain flat y/y, as profit margins—which posted substantial gains in FY3/10—should contract slightly despite an increase in sales volume.

Under the previous mid-term plan, issued in FY3/07 and dubbed “Innovation 90,” the Company fortified the foundations of management by improving its balance sheet, reorganizing businesses and upgraded its operating infrastructure in FY3/07-3/08, or Phase 1. Phase 2, covering FY3/09-3/11, aimed at a dramatic expansion of business, with the ultimate goal of achieving ¥50 billion in sales and an operating profit margin of 13%. Strengthening the Company’s management foundations and balance sheet improvement were to some extent completed through restructurings, including the divestiture of Nippon Polyurethane. However, the sales and operating profit margin goals are now quite difficult to achieve due to the economic crisis that struck worldwide in Phase 2.

Under these circumstances, Hodogaya Chemical will be issuing a new management plan that spans FY3/12-3/14 in the spring of 2011. There will no change in its management policy of developing products through advanced technologies that are high in added value and target niche markets and high profitability. Meanwhile, the Company aims to raise the ratio of sales generated overseas, which current stands at some 12% of net sales. Although Hodogaya Chemical will have no choice but to revise downward the net sales target of the previous plan, management believes that it will be possible—as long as the underlying demand returns to a certain level—to achieve a double-digit operating profit margin by focusing on highly profitable businesses.

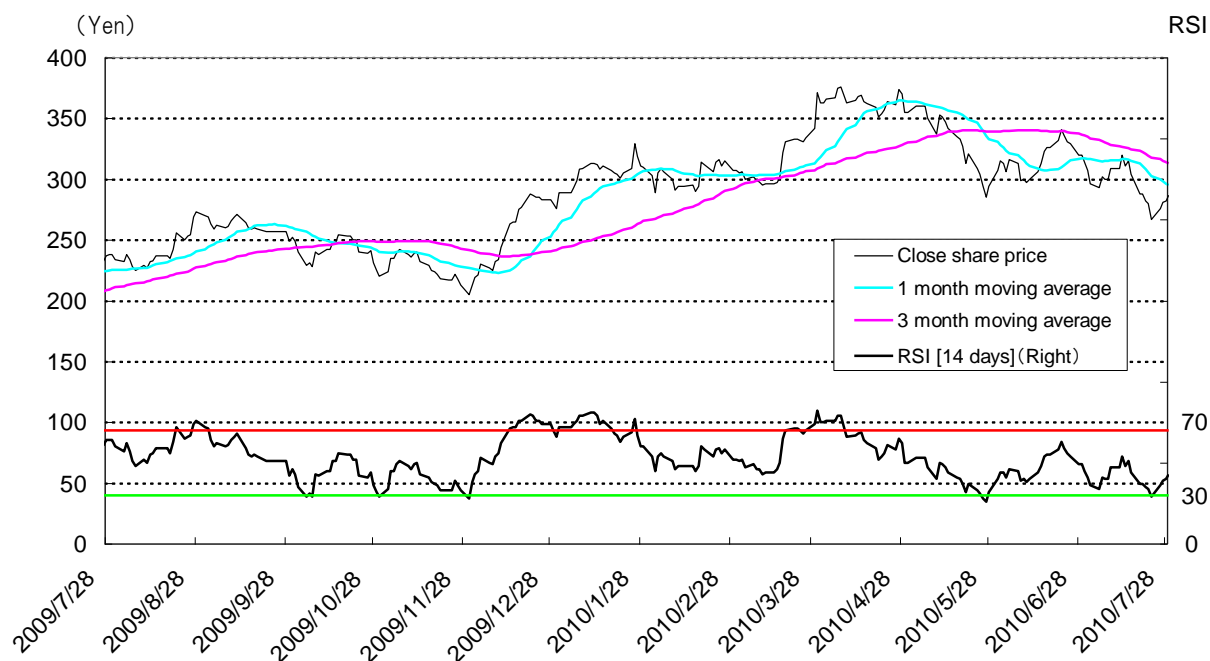


[Reference] Hodogaya Chemical Co., Ltd. (Securities Code: 4112)
Key Financial Data and Business Results (Consolidated)

Key Stock Indicators (Consolidated)			Key Financial Data (Consolidated)		
No. of Shares Issued	Mar.2010	84,137,261	Total Assets (¥million)	Mar.2010	50,585
No. of Treasury Stock	Mar.2010	5,018,455	Shareholders' Equity (¥million)	Mar.2010	26,491
Market Value (¥million)	Jul. 29, 2010	24,147	Interest-Bearing Debt (¥million)	Mar.2010	12,651
BPS (¥)	Mar.2010	691.7	Equity Ratio (%)	Mar.2010	52.4
ROE (%) ※1	Mar.2010	△ 1.6	Ratio of Interest-Bearing Debt (%) ※5	Mar.2010	47.8
ROA (%) ※2	Mar.2010	△ 0.8	Free Cash Flows (¥million) ※6	Mar.2010	2,600
PER (times)	FY3/11 est.	25.2	※1 ROE=Current Net Income÷Averaged Shareholders' Equity of beginning of term and term end ※2 ROA=Current Net Income÷Averaged Total Assets of beginning of term and term end ※3 PCFR=Market Value÷(Current Net Income+Depreciation) ※4 Average Daily Volume=Average Daily Volume for previous 12months ※5 Ratio=Interest-Bearing Debts÷Shareholders' Equity ※6 Free Cash Flows=Operating CF+Investment CF		
PCFR (times) ※3	Mar.2010	23.9			
PBR (times)	Mar.2010	0.4			
Share Price (¥)	Jul. 29, 2010	287			
Unit Share (shares)	Jul. 29, 2010	1,000			
Average Daily Volume (shares) ※4	Jul. 29, 2010	183,510			

Consolidated (¥million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend per Share (¥)
FY3/07	37,033	2,863	2,620	4,198	63.30	5.0
FY3/08	36,070	2,715	2,462	1,135	51.30	8.0
FY3/09	32,099	927	367	△ 3,943	△ 49.71	8.0
FY3/10	31,463	1,521	734	△ 429	△ 5.42	8.0
FY3/11 2Q fcst.	15,300	500	200	0	0.00	4.0
FY3/11 fcst.	33,000	2,000	1,200	900	11.37	8.0

Note: FY3/11 forecasts announced on May 10, 2010

Share Price Charts and RSI


Source: Prepared by Trias Corp. with Bloomberg L.P. data.

Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices. In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.

$RSI = \frac{\text{averaged share price appreciation for N days} - (\text{averaged share price appreciation for N days} + \text{averaged share price decline for N days}) \times 100}{\text{averaged share price appreciation for N days} - (\text{averaged share price appreciation for N days} + \text{averaged share price decline for N days})}$