President & CEO
Chihiro Kanagawa

In 1991,
Shin-Etsu Chemical Co., Ltd. was among the first companies in Japan to embark on a comprehensive program to raise productivity and profitability throughout its worldwide operations. This program was accompanied by a heightened concentration of strategic investments in core businesses and an emphasis on utilization of the most suitable locations in which to manufacture the company's key products. Together, these strategies have given the company a powerful earnings base. Net income has reached a record high in each of the past two years. This interview focuses on how Shin-Etsu plans to build on these strengths for even greater achievements.

Would you briefly list the highlights of consolidated results for the fiscal year that ended on March 31, 1997?

Net sales rose 8.6 percent to ¥624,405 million. Much of this excellent sales performance was due to increases in sales of semiconductor silicon and other products in the electronics materials business. The share of the company's total sales contributed by the electronics materials business segment rose from 37.3 to 41.0 percent. Net income was up 7.4 percent to ¥40,614 million, another record high. Naturally, sales growth was a major reason for this excellent business performance. Equally important was the progress we have made in recent years in strengthening our multi-regional business structure. We have continuously sought ways to cut costs, flatten and simplify our organization, and to utilize our management resources in the most productive manner.

Other than the record-setting sales and earnings, what do you regard as the most important achievements of the past fiscal year?

I am constantly trying to envision what our operating environment will be like five or ten years from now. Based on the projections we make in our mid- and long-term planning, we attempt to anticipate problems that must be solved, and then take the actions necessary to effectively cope with these challenges. At present, our business strategy consists of four key policies. One is to further integrate production activities to extend from raw materials through finished products. The second is to avoid an over-reliance on demand from any single market to generate future growth in sales and net income. We must diversify thirdly to sustain stability. The fourth strategic policy is to make our business structure more global so that we manufacture products at the most profitable locations. During the past year, Shin-Etsu made considerable progress in implementing all four of these strategic policies, while, at the same time, managing to raise earnings to an all-time high. I regard this as our most important achievement.

Can you be more specific about accomplishments involving these core policies?

Backward integration of production is an excellent example. We are the world's largest supplier of semiconductor silicon and synthetic quartz. We are also one of the world's largest producers of silicon based chemicals. Silicon metal is the basic raw material for all of these product lines. In the past, we have relied entirely on other companies for this important raw material, which made us very susceptible to supply shortages. In February 1996, we acquired Simcoa Operations Pty. Ltd., an Australian company that manufactures silicon metal from quartz. This acquisition, in addition, gives us a quartz mine of outstanding quality. With a secure, inhouse supply of silicon metal, we have helped to stabilize the future availability and cost of this vital material for all of our silicon related products. It is one of the steps towards our goal of controlling our own destiny.

We are working hard to diversify our sales bases and to expand our product lines so as to reduce the impact of business cycles on our sales and profitability.

Sales in our electronics materials business have been growing rapidly as a proportion of our total business. This is due to the strong expansion of the electronics industry and especially the semiconductor industry. Demand in the semiconductor industry, historically, has been very cyclical in nature. This means Shin-Etsu must structure itself so that performance of the whole company does not decline when conditions decline in such an important individual market.

In our chemicals business, we produce polyvinyl chloride, silicone and cellulose derivatives. Among these, polyvinyl chloride is currently a very important product. Demand for it from housing, construction and other civil engineering industries has been excellent. Silicone chemicals are another major source of revenue. These products are sold to an extremely diverse range of customers including, among others, the pulp and paper, cosmetics, automobile, construction and electrical industries. Similarly our cellulose derivative business serves a vast variety of industries, and so it and the silicone chemical parts of our business are well insulated from the cycles in individual markets.

Our goal is to structure all of our businesses for this kind of stability. This is why we are using our technologies in silicon chemistry, and other fields where we have a technical edge, to develop products outside the field of semiconductors. Two examples of newer fields for which I have high hopes for future growth are synthetic quartz and rare earth magnets.

Synthetic quartz is sold primarily as preforms to fiber optic cable manufacturers. Demand for this material is growing very rapidly. Shin-Etsu is the only producer of optical fiber preform outside the electric wire industry. We are expanding our production capability and expect to maintain our superiority in terms of both quality and cost.

Rare earth magnets are widely used in voice-coil motors for hard-disk drives. We rank among the world's leading suppliers of magnets for these motors. The products are leading candidates for such promising applications as electric car motors, linear motors, medical equipment and compressors for air-conditioners and refrigerators. Shin-Etsu is in an excellent position to achieve leadership in this business field. We are the world's only company that handles everything from the refinement of rare earth ores through the final products. This integration provides valuable advantages in terms of raw-material procurement and quality control.

What is Shin-Etsu's basic strategy for its PVC business?

I have no doubt that we will see steady future growth in the PVC market. We are aiming to become even more global, and align our production network to make us as cost competitive as possible. In 1996, PVC sales in Canada and the United States were about 6 million tons. That's more than 10 percent higher than in 1995. Our most important objective in the PVC business is to raise capacity in the United States, where we can manufacture PVC at the lowest cost. Plans are moving ahead for a second plant at Shintech on the U.S. Gulf Coast. The new production facility will become a key global strategic base supplying not only the U.S. market, but also targeting markets in Canada, Latin America, the Middle East, Africa and Asia—where a particularly large potential demand exists.

Japan is another key PVC market for us. Here, intense competition is creating an extremely difficult business environment for all suppliers. However, there still exists a large and high-quality market for PVC in Japan. We are working hard to improve our performance here.

What is the outlook for Shin-Etsu's semiconductor operations?

The Shin-Etsu Handotai group of companies account for about 25 percent of global output of semiconductor silicon, the primary material used in our electronics materials business. We have production bases in Japan, Malaysia, the United States and the United Kingdom. This diversification means that no single semiconductor producer accounts for an inordinately large share of our sales. In fact, we supply almost all of the world's producers of semiconductor devices. Recently, Shin-Etsu Handotai again demonstrated its technological leadership by being first in the world to succeed in making a prototype 12-inch wafer suitable for mass production.

We are determined to maintain our position as the world leader in technology, production capacity, and sales volume of semiconductor silicon. We are increasing our semiconductor silicon capacity even though some semiconductor device producers are restricting their capital investment programs. We believe that this is necessary in order to keep up with the rapid pace of change in electronics. The needs of our customers change very rapidly. Currently, for example, the major demand is for 8-inch diameter wafers, because the larger wafer makes possible lower fabrication costs for our customers. Because of this development, our mid-term business projections foresee excellent growth in demand for semiconductor silicon. To provide for this growth, we began operations in July 1997 at new plants for 8-inch wafers in the United Kingdom and Taiwan.

Can you summarize current plans for capital spending at Shin-Etsu in Japan and overseas?

We give priority to investments that will contribute the most growth in sales over the mid- and long-terms. To fund these investments, in 1996 we conducted our first equity-related financing initiative in about six and a half years. This consisted of the August sales of ¥50 billion of convertible debentures in Japan and US$500 million of notes with warrants in Europe. Altogether, we raised more than ¥100 billion. We plan to use these funds to strengthen and increase production capacity for major products, such as PVC, silicone and semiconductor silicon.

We estimate that over the next five years our capital spending will be between ¥450 billion and ¥600 billion. This estimate includes approximately ¥150 billion to ¥200 billion for the parent company, and ¥300 billion to ¥400 billion at our subsidiaries. We expect these expenditures to be funded from the above-mentioned debt plus retained cash flow.

What is the outlook for Shin-Etsu's business performance over the next few years?

Our capital program is expected to assure increased sales and earnings over the next several years. In terms of both sales and margins on sales, Japanese chemical companies fall behind the large U.S. and European chemical producers. Our aim is to rank among the world's leaders in terms of profitability. We will do this by enhancing our global technical superiority in markets where those strengths are the most valuable. As we seek to achieve higher goals in the years to come, we ask for the continued support of our stockholders, employees and business associates.

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