EBARA CORPORATION Second Quarter of FY2022 Earnings Conference Q&A

Q&A during earnings conference held August 12, 2022

Participant 1: First, I would like to hear your comment on the Q2 results. Compared to the original plan for H1 of the year, I believe that operating profit of the FMS business exceeded the plan, that of the EP business fell below, and that of the PM exceeded.

Especially in the FMS business, I would like to know the factors that contributed to the higher performance, despite the impact of the lockdown on the pumps business and other factors.

Also, you mentioned earlier that the EP business has incurred additional costs. I would appreciate it if you could explain how much was the amount and whether there is any risk that it will continue in H2 of the year.

As for the PM business, while revenue is down considerably, profit was about JPY2 billion above plan. Can you tell us, in particular, what the factors are in this area?

Nagata: The main reason is that orders and revenue were stronger than expected in H1. Revenue, especially for standard pumps, came in considerably higher than planned, and based on this, revenue was also high.

Despite the lockdown and the sharp rise in raw material prices, the factors that boosted profitability included success of price increases and other measures. As a result, our overall impression is that H1 of the fiscal year has been somewhat better than expected.

Participant 1: Compressors and turbines (CT) business fell below a little. Why was operating profit not strong despite the increase in service and support (S&S) revenue?

Nagata: Operating profit was a little lower than the plan due in part to the problems in Russia and Ukraine, such as the inability to ship items that have already been ordered.

Ohi: For the EP business, first, maintenance was shifted from Q2 to Q3. Then, we incurred a loss of about JPY600 million due to problems during the commissioning. The additional cost was incurred because some equipment was damaged due to a problem at a plant under construction and had to be replaced, etc.

We have plant construction insurance on this and plan to have it insured back by the end of this fiscal year. Insurance will not cover everything, but we are making more progress than planned in lifespan extending renovation construction of the operation & maintenance business, which we expect will be able to cover it.

Togawa: On the PM business, because the utilization rate of our customers was very high, the S&S business grew in both the component business and the CMP business.

The operating profit margin for S&S is good, so we have been able to generate a large amount of profit, and the automated plant is now almost in full operation, which has been profitable for us. The main factor is that profit margins have improved in those areas.

Participant 2: Let me ask you about the free cash flow. I understand that you have changed your cash flow plan, and I would like to know how this relates to the dividend payout ratio, which has been revised upward.

First, what is the premise for the free cash flow plan? I think the revision is because of the change in operating cash flow, but can you give us a little more background on that?

Recently, the dividend payout ratio has often exceeded 35%, so I think it would have been possible to increase the dividend. It would be helpful if you could also comment on any relationship between the cash flow revision.

Hosoda: First, as you can see on the slide, cash flow from operating activities is lower than planned at the beginning of the fiscal year.

There are two main reasons for the decrease in cash flow from operating activities. The first is that overall working capital is increasing amid a trend of expanding revenue and business volumes.

Another factor is that the increase in working capital is not only due to revenue volume, but also to difficulties in procuring parts, etc., and inventories have increased more than business volume.

The increase in inventories is partly due to difficulties in procuring parts. One of the reasons is that we tend to counter the parts procurement difficulty by ordering parts early and actively increasing our inventories. This is primarily happening in the PM business.

Another factor is work-in-process inventory. We have a few precision equipment products that we are not able to ship at the time we would normally ship them because parts are not readily available.

In the standard pumps business, there are a few products that cannot be shipped because the construction work on the customer's side has not progressed well and the customer is not ready to accept them, although manufacturing has been completed to some extent, resulting in an increase in product inventories.

Inventories are increasing due to increases in parts inventory, work-in-process inventory, and product inventory for different reasons.

The increase in working capital due to these factors has had a negative impact on cash flow. Shipment of the PM business will proceed through H2 of the year. Since many projects of the PM business have relatively good deposit conditions, we expect that this situation will gradually be resolved.

These are the background circumstances of the current cash flow deterioration.

In relation to the dividend payout ratio, at the beginning of the fiscal year, we established a policy of a dividend payout ratio of 35% or more, and there has been no change in that policy.

However, even though net profit forecast has been revised upward this time, it is not a very large increase. Rather than changing the full-year dividend planned at the beginning of the fiscal year, we will take appropriate action at the appropriate time, following the appropriate decision-making process, while confirming the performance trend in H2 of the fiscal year.

Please understand that cash flow and dividend payout ratio are not linked this time.

Participant 2: And one more point, please. What is your view on the current performance plan for the PM business? I am looking at the appendix on page 16 or 17. I believe that the full-year plans for components and CMP in the PM business have changed this time.

In terms of orders, the H1 forecast for components has been raised significantly. In terms of revenue, on the contrary, the revenue forecast for CMP has been lowered and that for components has been raised. I would appreciate your explanation of what changes have been seen in this area.

At the same time, the full-year plan for operating profit in the PM business has not changed, but your current explanation suggests that H1 of the year was slightly above the plan. I would like to know if there is room for an upward swing in H2 of the fiscal year.

Togawa: Orders are very strong at the moment, so the plan reflect the results. As for revenue, both businesses are currently struggling to obtain parts.

However, the time from production to revenue is relatively short for components, and we have many orders, so we believe that we can increase production as long as we can obtain parts.

In particular, the automated plant is getting off to a good start, and we are considering two-shift, 24-hour operation starting in Q4, and we would like to increase production in such areas.

On the other hand, for CMPs systems, the production lead time and the period between shipment and revenue are very long. The availability of parts is improving slightly, but it is expected to be too late to contribute to revenue for the current fiscal year.

Therefore, we have planned for an increase in revenue for the components and a decrease for the CMP. As for operating profit, revenue of CMP systems will decrease, which will be covered by other sources.

However, the plan was left unchanged to take into account the rising costs of raw materials and other items.

Participant 3: I would like to ask one question each about the CT business and the PM business.

First, I would like to talk about the CT business. We have received statements both in your comments and in the financial statements that inflation has made your customers more cautious in their investment decisions. Is this a global-wide trend, or is it a US-centric one? Are customers making their investments to some extent, albeit cautiously, due to the high price of oil?

Secondly, regarding LNG, there was a comment at the Q1 financial statements that cryopump projects are moving forward. Am I correct in understanding that the situation hasn't changed much in Q2?

Nagata: It is true that the number of projects for new products has decreased a little due to the fact that investment decisions are becoming more cautious.

On the other hand, S&S have been receiving strong orders, and revenue have been strong as well. Although there are some concerns about the future outlook, we believe that earnings will be stable this fiscal year due to the strong performance of the S&S.

Also, as for the cryopump, there is no change in the situation. The movement has not changed much from Q1.

Participant 3: By the way, since it is inflation, is it safe to assume that this will recover, or orders will be taken if interest rates fall? Or will it take a bit of time for recovery, even if interest rates drop?

Nagata: Of course, it is not just the effect of interest rates, so it is not something that changes immediately with an increase or decrease in interest rates. Basically, since the price of crude oil has remained stable at a high level, we expect that projects will start moving in the future, but I hope you understand that there is a slight delay.

Participant 3: The second point is about the PM business. On page nine, bottom left, we can see the YoY changes in revenue by region. This is revenue, but is there a similar trend for orders?

Togawa: Yes. Revenue and orders received move in essentially the same way.

Participant 3: Is it correct to understand that orders in Japan are down in H1 of the year?

Togawa: I don't think that the supply-demand relationship is getting worse. We believe the timing of our customers' investments is in H2 of the year, not H1, as it happens.

Participant 3: Is it your understanding that the YoY drop in revenue in Japan is a timing issue?

Togawa: Yes, I see it that way.

Participant 4: Let me ask you two questions.

The first point is the background of the upward swing in orders in the PM business. The full-year plan has been revised upward because the H1 results exceeded the plan.

With the recent bad news coming out of the semiconductor market in general, is the reason behind the upward revision of your order plan just because your customers want to place orders earlier?

Are there any other factors, such as market share gains in CMP, exhaust systems for EUV lithography systems, or other areas, or expansion of new business opportunities?

Togawa: Basically, we believe that most cases are because orders are placed early in consideration of delivery dates. Our client has announced some fairly bold investments, such as building a new fab, and we believe that plan is being implemented.

Participant 4: What is the situation if this is divided between memory and logic foundry systems? Also, if they are building a new fab, do you receive quite a few orders for the US?

Togawa: If anything, foundries are stronger. Compared to last year, inquiries and orders from the US are increasing.

Participant 4: Second, please allow me to confirm your approach to planning profits for H2 of the year. In your presentation, you mentioned that the risk factors, such as rising material prices and material procurement problems, occur throughout the year but can be basically offset throughout the year by foreign exchange effects.

On the other hand, the revenue and profit plans for the FMS and PM businesses for H2 of the year seemed lower than usual. Is there any other reason why profits are sluggish?

Nagata: There are no factors that would cause profitability to deteriorate significantly in H2 of the year compared to H1. However, one point is that we have decided to record as an expense a project that was originally intended to be capitalized, so operating profit will be several hundred million yen less than planned. But other than that, I don't think there is a factor that caused operating profit to decrease.

Togawa: As for the PM business, in H2 of the year, we expect to see the impact of material price hikes. We have not included the impact of foreign exchange in our plans.

Participant 4: Let me just confirm one additional point. You just mentioned that the impact of material price hikes will be felt in the PM business, but that the impact of foreign exchange rates is not included. The material says that the impact of material costs and other factors will be offset by foreign exchange rates.

For this, are you thinking mainly of the FMS and EP business?

Togawa: I think the impact of the exchange rate will come into play if the yen depreciates more than the latest planned figures.

Participant 5: I think that the change in the way you disclose your FMS business is probably a pretty big decision. Will the organization change as well? Even if you divide the products into separate categories by customer, total revenue and profit will naturally remain the same. I wonder if there will be some kind of synergy by changing that classification.

Can you tell us what you were thinking about when you made the decision to do this, if you can?

Asami: As I mentioned earlier, we still have a way to go in terms of profitability, but I think it is true that we have improved a lot with custom pumps and compressors and turbines.

EBARA, on the other hand, has always done business through completely different business entities with insufficient synergy, despite being in the same market, centered around large product-oriented segments: the pumps business for custom pumps, and the compressors and turbines business for compressors and turbines.

In such a situation, the market environment is changing as the mega-trend in the market is toward decarbonization and carbon neutrality, and we felt that we had to consider our response based on the market axis, not on the product axis. The decision to change the axis was based on the need to further strengthen the market-in approach.

With regard to the organization, we will continue to study specifics for the mid-term management plan 2025, which will start next year.

We made the announcement in August, and the Board of Directors has made a decision. We have made this announcement in order to promote understanding within the Company and to those outside of the Company that we will be conducting a thorough study during the remaining months of August and September through the end of the year in preparation for the new medium-term management plan that will begin in January of next year.

Participant 5: It would be better to wait for the next mid-term plan for numerical targets.

Asami: Yes. We will be able to explain in the future what the current numerical targets will be next year, both for the current FMS business and the three new segments.

Participant 5: After dividing the business into three parts, Mr. Nagata will take over the top position, right?

Asami: We will be discussing that as well. We can't say that much at this point. I hope you understand.

Participant 5: I understand. Looking forward to next year.

Participant 6: Let me check one additional point.

I believe that three months ago, you commented that in the FMS business for the domestic market, price pass-on was not keeping pace with the increase in raw material prices. You told us that you would catch up by passing on prices from Q3 onward.

Is it my understanding that there has been no change, and your plan is currently progressing well?

Nagata: As for the price pass-on, we have already raised prices, and the effects will be seen in the future. Although there is a slight time lag after the price pass-on, we expect to see the effects by the end of this fiscal year.

Participant 6: Am I correct in understanding that there is no change in the plan?

Nagata: Yes.

Participant 7: I just want to confirm two things.

Revenue of CMP in the PM business had a large swing from the forecast of three months ago. Could the only cause be a delay in procurement of parts?

Three months ago, there was also talk of delays in shipments for some projects, although this may have been also due to delays in procurement of parts. Can you tell me if it is all due to parts?

Also, in H2 of the year, revenue is expected to decrease slightly compared to Q2. If there are any other elements besides the parts, please provide additional explanations.

Togawa: Basically, I think the main reason was that parts were unavailable. This was especially true around the time of the lockdown in China. The situation still remains.

However, we are increasing production capacity as planned, and we believe that we will be able to catch up as parts become available.

Participant 7: One more thing about the FMS business. In the energy area, whether it is cryogenics or CT, some equipment and materials companies are starting to receive orders. I don't think there were any particular comments at today's briefing about how the competitive environment is affecting the Company. I would appreciate your comments on the current situation and changes, whether they are tailwinds or headwinds.

Nagata: There is no particular change in the competitive environment.

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