EBARA CORPORATION Fiscal Year Ended 2023 Financial Results

Overview of Q&A at the Financial Results Briefing Held February 14, 2024

Respondents

Director, President, Representative Executive Officer, CEO & COO President, Precision Machinery Company	Masao Asami (Asami)
Executive Officer, President, Building & Industry Products Company	Shu Nagata (Nagata)
Executive Officer, President, Energy Company	Takanobu Miyaki (Miyaki)
Executive Officer, President, Infrastructure Company	Teruyuki Ota (Ota)
Executive Officer, President, Environmental Solutions Company	Hideki Yamada (Yamada)
Executive Officer, Chief Operating Officer, Precision Machinery Company	Masao Hodai (Hodai)
Executive Officer, CFO	Shugo Hosoda (Hosoda)

Questioner 1: First, in your explanation, you said the large increase in 2023 results over the plan was due to both one-time factors and ongoing positive factors, but there was a considerable difference, especially in the Energy Segment, where operating profit was JPY7.8 billion higher than the plan. What are the details about the differences from the plan in each of these businesses, separating them into one-time and other factors?

Miyaki: In Energy, one-time factors included emergency response requests from customers, particularly in the Middle East, one example being in response to a fire at a customer plant. This resulted in a higher-income project in 4Q as we responded to emergency arrangements. Another point was that sales to electric power and petrochemical markets, particularly in China, were much stronger than initially forecast, and steady in 4Q. These were the one-time factors in FY2023.

Concerning long-term factors, we are seeing the results of E-Plan 2022's efforts, particularly concerning improved profitability of products. This has increased profitability as a whole and will continue to have positive impacts on our business performance in the future.

Nagata: For the Building & Industrial Segment, the main factor behind our operating profit performance was the outstanding revenue results. Frankly, the market was difficult to read due to the ongoing Covid-19 pandemic and supply chain disruptions. In this situation, domestic and Chinese sales grew unexpectedly. We expect this to continue to some extent. In China, while the building equipment market is in a downturn, the industrial market remains robust. For example, investment in battery and semiconductor factories is very active, and we have found success in these areas, resulting in increased revenue. We believe that continued growth can be expected through sales expansion activities targeting growing industries.

Hodai: The Precision Machinery Segment outperformed forecasts due to higher-than-expected results of highly profitable Service & Support (S&S) in CMP business in 4Q of 2023 and lower-than-expected fixed costs and other expenses.

Yamada: Two upside factors contributed to the upswing in the Environmental Solutions Segment, one of which is the electricity sales business. In 2022, when the price of electricity became very high, reducing profitability. In 2023, we changed its contract structure so that electricity sales are linked to electricity prices in the market, which made a significant positive contribution.

In addition, an extremely profitable lifespan extending renovation project in Operations & Maintenance (O&M) that was planned to be recorded as revenue and operating profit for 2024, fell slightly forward to the 4Q, resulting in an upward swing in operating profit in 2023.

Ota: For the Infrastructure Segment, in its positioning as a core business, we are striving to steadily carry out selective orders and operating profit is trending up. One-off factors influencing results for this year is the recording of some highly profitable S&S projects, etc. awarded in the previous fiscal year and the year before that being recorded, pushing up revenue and operating profit.

In Infrastructure, we continue to see the effects of profit improvement efforts.

Participant 1: Please allow me to confirm further. What is the overall image of the upside impact on the operating profit from the Energy Segment's 4Q emergency response in the Middle East?

Miyaki: More than a billion yen.

Questioner 1: My second question is regarding the plan for the new fiscal year, specifically the plans for revenue in the Energy Segment. I would like to know the reasons why you indicated a plan for decreased operating profit despite a forecasted increase in revenue by ¥32.7 billion. While one-time factors that occurred in 2023 in the Middle East will certainly dissipate, there should still be positive effects such as the elimination of 2023 restructuring costs and significant growth in LNG, so please expand on that.

The Precision Machinery Segment is also forecasted to increase revenue by ¥20 billion, but operating profit will only increase by ¥3 billion. I understand that fixed costs will increase, but the increase in revenue will be a factor of about ¥10 billion in profit. Please explain why operating profit will increase so little in 2024 for these two businesses.

Miyaki: First, in terms of overall sentiment for 2024, products will continue to show some weakening in the Chinese and LNG markets. In terms of market sentiment, this is not so different from 2023. S&S, on the other hand, was very good in 2023 compared to the plan, but compared to 2022 and in terms of the state of special demand, it has entered a phase of market slowdown, especially in the second half of 2023.

Given these factors, revenue in 2024 will increase significantly for products, in part because of the backlog of orders in 2023, but S&S will decline due to lower orders in 2023 compared to 2022, and lower orders in 2024. As you know, S&S has a higher profit margin than products, so overall profit will decline.

Meanwhile, we will continue to actively invest in the future. We will continue optimizing S&S bases which started in 2023. We will also actively spend money on R&D to develop products for decarbonization and sustainability.

Overall, the product mix and future investments from 2023 will continue, but despite the slowdown in the S&S market, our intention is to achieve an operating profit margin of 10%. The company intends to maintain a high operating profit margin.

Hodai: For Precision Machinery, we expect the semiconductor market we face to return to a growth trajectory in the second half of 2024. At present, however, there is no sense that customer factory utilization rates and the S&S business at large, which has relatively high profit margins, will return to an upward trend.

Against this backdrop, we expect and are taking action to improve our results from last year. At the same time, we would like to make this a year of steady investments in increased production, investment in human resources, and ERP systems, etc. for greater growth in the future, resulting in our plans for 2024.

Asami: For Precision Machinery, we plan to increase revenue by ¥18 billion and increase operating profit by ¥3 billion, increasing operating profit margin by 0.2%. As Hodai said, we will also invest in R&D, and the current ¥250 billion level of revenue will double to ¥500 billion by 2030. If this does not happen, we must consider our business to be in a recession, and we must make investments to develop products that will continue to answer the needs of our customers, as well as maintain and prepare production capacity in line with the growth in demand for such products. We plan to increase investment while maintaining our operating profit margin.

Participant 2: My first question concerns the profitability of the Precision Machinery Segment. Your plan for 2024 indicates a lower operating profit margin in 1H and a higher operating profit margin in 2H.

From the previous question, I assume this difference is due to the full-scale operation of S&S. In addition to confirming this assumption, please explain whether the 2H of 2024 shows the actual value of EBARA and the income potential of the Precision Machinery Segment, which has been rising. I think this shows that the operating profit margin is on an upward trend toward overperforming against the E-Plan 2025 target, but what do you think?

Hodai: As you commented, in the 1H of the year, we expect the situation to remain a little tough continuing from 2023. 1Q tends to start slow every year, especially since there are relatively few operating days for S&S overhauls and other major sources of revenue.

Therefore, we expect the situation to improve in the 2H. Adding on to that, although we have been able to absorb the steep rise in material and labor costs since 2022 through price increases, internal management efforts, and increased efficiency, we are still in the process of improving our performance this year. We are taking measures looking to achieve both E-Plan 2025 and increase profitability past 2025.

Asami: Like other industries, the Precision Machinery Segment also suffered from rising raw material and labor costs in 2023. EBARA has also accepted rising prices from suppliers, explained that situation to customers and gotten their understanding, the Precision Machinery Segment is also proceeding with price revisions similar to those taken in the Building & Industrial Segment. However, there is a small lag before we see an effect on profitability.

Revenue in the Precision Machinery Segment is growing, mostly due to product sales in 2023. The low utilization rate of customers led to sluggish revenue growth in S&S and there is a time lag between product orders and when those lead to S&S orders.

In this sense, we expect that customer factory utilization rates will not really pick up until the 2H of 2024. It is at this point that customers will make their capital investment decisions.

Participant 2: My second question is regarding the outlook for orders received for the Precision Machinery Segment. When divided into components, CMP, and so on, there are some differences in growth rates, with CMP growth being the strongest. I would like to know more background information regarding this.

Additionally, over the past one to two years revenue has increased across the board, I would like to ask what kinds of products are emerging as buds and how much China has contributed compared to before.

Hodai: First, regarding orders, there is no significant difference in the ratio of CMP to components. Both are weighted toward the second half of the year.

As for the Chinese market, investment is brisk, especially in the mature generation of legacy nodes. Since we have been providing products to these customers since last year and again this year, we have a certain level of presence in China.

Asami: We hope you understand that the growth in orders, revenue, and profitability in 2023 reflects the fact that our customers in China have accelerated their investments, and we are no exception, and we expect this to continue in our 2024 plan.

Participant 3: I have two questions. First, regarding the outlook for orders in the Precision Machinery Segment. The plan is to recover in 2H 2024, if possible, could you provide some additional information on the outlook for order recovery, such as current trends and what will contribute to recovery, broken down into memory and logic.

Hodai: Memory has not really changed since last year, and customers are still showing restraint in investment. Nevertheless, as is often reported in the news, we are anticipating that investment in DRAM may start soon. We expect to see the buds of DRAM investment in 2H 2024.

We do not think there will be a big difference in Logic from last year. Continuous large investments are not happening as in the past, but business is steady.

As for China, 2023's strong performance in legacy nodes, and emerging customers, has continued into 2024, and we will capitalize on that.

Participant 3: For my second question, I would like to ask about the current thinking on cash and cash equivalents and their efficiency. In 2023, EBARA's performance was fairly good, and I think free cash flow is well above the assumptions of the medium-term business plan E-Plan 2025. What are your thoughts for how to allocate this cash? Please comment on whether the Company will use the excess cash to invest in growth, or whether there is a view to strengthen shareholder returns, including through share buybacks.

Asami: The increase in free cash is because of not doing M&A last year, unlike the year before last, although we raised funds last year with the intention to do so. Hosoda will discuss future uses.

Hosoda: The E-Plan 2025 three-year plan for cash allocation is shown on page 24 of the material. The first and most important issue for these three years is to invest in growth and infrastructure.

In terms of shareholder returns, there are two types, capital gains and dividend income. Regarding dividend income, we will maintain our basic policy of a consolidated dividend payout ratio of 35% and increase the amount of shareholder returns as the amount of overall profits increases.

As for capital gains, you mentioned share buybacks, we will continue to compare and act on investment opportunities, such as in growth and infrastructure or others, and the use of cash, including share buybacks, from the perspective of which will increase future medium- to long-term EPS and shareholder value.

Basically, however, we believe that there are various investment opportunities on the business side, including investment for expansion into new business areas, such as in hydrogen, or as in other businesses such as Precision Machinery Segment, where we must consider how to increase capacity in response to growth at a slightly different pace from other businesses. We will consider the best options at the time, while properly identifying opportunities.

Cash on hand has increased by ¥31.9 billion this time, but we generally want to keep about two months' worth of consolidated revenue on hand. We ended the term with a little more than two- or three-months' worth of cash on hand. However, early in 2024, we plan to make cash outflows for capital investments that could not be made in 2023, and this will return cash on hand to its normal levels of about two months' worth.

¥31.9 billion is only a temporary increase and will return to its normal level soon.

Participant 3: As an additional question, what is the scale of M&A that you envision, roughly say ¥10 billion or so?

Asami: I am sorry, but we cannot answer that.

Participant 4: I have two questions. The first is regarding the Precision and Machinery Segment. I believe that there is test equipment, or equipment that is loaned out to customers, to promote sales. Has the amount of such equipment increased or decreased compared to last year?

Hodai: We call it evaluation equipment, but it is an ongoing activity to lead to the next opportunity. This question is difficult to answer by cutting out a specific cross section. Our policy is to continue such activities as long as there are ongoing opportunities for evaluation.

Participant 4: Probably, since many Chinese customers are relatively new, I think there are many cases where evaluation equipment is provided, is that correct? Also, other customers in Asia, Taiwan, and South Korea still have low utilization rates, so is it fair to say they are not the ones getting this equipment?

Asami: It is case-by-case. In particular, looking at China, there are sometimes customers who have received loans and decided to build a factory, but due to a variety of uncertain factors, stop midway and then disappear. We would like you to understand that EBARA's approach to China is to do business in cash as much as possible.

Participant 4: My other question regards progress about E-Plan 2025, as shown on page 26 of the material. It says there were improvements in productivity due to the start of operation of the ERP system at domestic and overseas group companies and the automation of designs. Specifically, what kind of contribution to profit was made in 2023? Also, if the automated designs are going well, does that mean that the accuracy of cost estimates at the time of order receipt and shipment has improved considerably? This may still be partial, but I would appreciate any quantitative information on the effectiveness of the system, if there is any.

Asami: First of all, regarding the ERP system, at this point please assume that there is no contribution to improved profitability in 2023.

Automations of design has been basically done for years, especially for compressors and turbines, so there is some effect on profit at the time of estimation. At this stage, custom pumps and other businesses are using that as a reference while finding the best processes for automation for their respective businesses. It is better to think that it is not contributing much to profitability of the previous term. Of course, there is a decline in design man-hours, and some contribution is made, but a large part is still front-loading. We have improved profitability by making sure that at the time of order receipt the margin, delivery time, and specifications are appropriate, and then that after receiving the order there are no mishaps with shipping or logistics.

Participant 5: I have two questions. First, I believe there should be some movement on a plant in Kyushu that is scheduled for completion at the end of the year. I would like to hear any updates on the progress of this project.

My second question is regarding the 2023 results, I understand that orders for products in the Building & Industrial Segment were strong. If you could expand upon which areas were strong, I would like to know more details.

Hodai: In regard to the status of the production building for equipment including CMP, which is being constructed by the Precision Machinery Segment in Kumamoto, the groundbreaking ceremony was held last year, and construction is progressing on schedule for completion in December of this year. Operations are planned to start from next year, expanding our production capacity.

Nagata: For the Building & Industrial Segment, revenue in domestic and overseas markets are growing. In the domestic market, water supply units used in condominiums and other facilities performed well. Overseas, revenue was strong in China, where demand was particularly strong for batteries, semiconductors, and drainage systems for public subway systems.

Participant 6: Please tell us the highlights of last year, and how you view the financial results, with a focus on the Precision Machinery Segment.

Asami: 2023 was a very good financial result overall. In terms of the overall plan for 2024, the Company plans to generate operating profit that exceeds this target while steadily investing in growth.

As for the 2023 financial results of the Precision Machinery Segment, I will ask Hodai to explain.

Hodai: As you may be able to tell from last year's results, the semiconductor industry has reached a plateau, or rather, it was a year which was quite sluggish, however, our business was able to generate sales mainly in CMP in the first half of the year, in part because of the sizeable order backlog from two years ago.

Although there was some struggle, we trimmed the S&S business and moved ahead with efforts to cultivate business outside of our main customers. The Chinese market was also steady, and while we were unable to reach our targets for either the semiconductor or non-semiconductor fields, we were able to achieve revenue and operating profit higher than the previous year.

Participant 6: If that is the case, as for the outlook for this year for the Precision Machinery Segment, do you see any cause for concern, given the active talk in China, as you just mentioned, and the fact that demand for semiconductors will continue to expand in the long term? On page 14 of the material, there was talk of investment to increase production, but I would like to ask you a little more about concerns you may have regarding that.

Hodai: Although there are many causes for concern, the semiconductor industry is not yet at a point where it can be said to have revived, but we have decided to set our targets to surpass last year in the assumption that it will be better in the second half of the year.

We expect business and other areas to remain steady as in the previous year in regard to the area of China, which you pointed out.

As we conduct business on a global scale, we will always pay attention to geopolitical risks, and will continue to do business with the best judgment at the time. We think that unexpected things should also be assumed as a cause for concern.

Participant 7: I would like to ask about the Precision Machinery Segment. We understand that demand for equipment for legacy nodes is growing among Chinese semiconductor manufacturers. Do you expect it to continue over the medium- and long-term, please tell us about your outlook for the future.

During a previous question, the President mentioned cash payments, and it seemed representative of the briskness and growth that is the current situation. I would like to know if you are also considering initiatives to penetrate more into mainland China, for example, by expanding your offices or bases in China, and if so, what are the possibilities for this?

Hodai: We think the boom in the Chinese market last year will continue this fiscal year, at least in the calendar year. However, it is frank that it is difficult to forecast from the next fiscal year onward.

We currently have two bases in China, and we are advancing overhaul and other businesses accordingly. While there is still some leeway in terms of capacity, we are constantly considering whether it is sufficient when looking ahead to the future, and although it is not yet at the stage where decisions have been made, I believe that we must continue to make optimal judgments from various aspects.

Participant 7: When you say that you cannot predict China well for the next fiscal year and beyond, do you actually have examples of cases where you have been doing business there but have suddenly lost it due to unprofitability? Or do you simply mean in general terms that the market is truly unpredictable?

Hodai: It is more of a general observation. To be honest, it is not easy to tell if it is going to get better or worse, because the movements are a little different from the other areas and trends we are used to. However, as it is undoubtedly a market with great potential, we intend to continue to monitor it closely.