Main Q&A from Ebara Corporation FY2019 Conference on Earnings, Long-term Vision, and New Medium-term Management Plan

<Summary of Q&A during conference held on February 13, 2020>

Forecast for Full Year FY2020

Q: Tell us the factors behind the decline in income in Pumps Business.

Previous fiscal year, we began to see the benefits from ongoing initiatives, resulting in earnings that outperformed plans. This fiscal year, conditions changed and the Pumps Business will factor into a forecast of 2.5 billion yen decrease in income.

A: Our forecast for decreased income this fiscal year reflects the following three points.
-These last few years, earnings grew on sales of standard pumps on the domestic market boosted by Olympics-driven demand. We gradually began to see a reactionary decline in earnings since October of last year.

-We will see an increase in expenses related to ongoing initiatives, including the depreciation and amortization of growth investments (automated line construction, etc.), the integration of AI, and expenses related to the implementation of IoT. We expect to cover approximately half of this increase by enhancing service & support (S&S) but we do forecast a year-on-year decline.

-In the custom pumps business, there was a problem with some products, particularly those from our Japan plant. These problems did not entail complaint response but rather required specifications changes to the designs of ordered products and subsequent problems related to procurement. We incorporated expenses related to resolving these problems during the current fiscal year and implementing fundamental revisions to our domestic production structure.

Q: Please tell us the impact of the Pumps Business on operating income. Are you forecasting a negative impact of around 1.0 billion yen for each factor above?

A: Approximately the same amount for each factor.

Q: This fiscal year, are you forecasting the FMS Business will be weighted more towards the second half?

A: The difference between the first half and second half will be minimal.

Q: Why have you set low operating income targets for the PM Business?

A: We forecast depreciation and amortization expenses will increase by approximately 4.0 billion yen (including initial expenses and fixed asset taxes) due to the previous fiscal year's construction of an automated plant. The plant will launch operations in May so we are assuming the benefits of operations startup, including a decrease in variable costs, will amount to approximately half. Depreciation and amortization are a fixed amount but next year this amount will increase because the depreciation and amortization expense amount will be for a full year of operation.

FY2020 Capital Expenditures Plan

Q: Please tell us the reason cash flows from investing activities will increase this fiscal year.

A: A major reason is that we are forecasting approximately 6.0 billion yen in expenditures for the construction of a cryogenic pump test stand.

Q: Why is a test stand necessary?

A: The increase in demand for cryogenic pumps since last year will result in an increase in shipments two to three years from now. We need to expand existing facilities to conduct testing. To increase productivity, we will concentrate on a single location by constructing a new facility approximately double the size of existing facilities.

Looking Back on Previous Medium-term Management Plan: E-Plan 2019

Q: Tell us which factors led to inability to achieve plan goals.

Further assessment is required regarding the fact that you achieved the net sales goal of 500.0 billion yen but you did not reach operating income goals. It is difficult to feel confident about the next three years.

A: Sales increased but lack of increase in income was due to numerous orders received for projects with low profitability. We think this is largely due to compressors and turbines as well as custom pumps in Japan. In our new medium-term management plan, we will promote a focus on profitable orders. At the same time, we are advancing scenarios for growth and will work to combine these efforts.

Q: Will improvements be slow considering it will take time for the revised stance towards orders received to affect sales?

A: Yes, that is the case.

New Medium-term Management Plan: E-Plan 2022 Goal Figures

Q: At 6.5%, the operating income ratio for the Pumps Business, in which you have made investments thus far, is largely unchanged from the previous fiscal year. Is there a possibility this could swing higher?

You have developed sites thus far but Pump S&S sales have not increased much in the past three years. Why is that?

A: For custom pumps, we developed sites during the period of the previous medium-term management plan and are beginning to see positive results at certain sites. During the new medium-term management plan period, we will promote local production and use of parts and strengthen links with the CT Business to produce results.

To increase sales for standard pumps, we will add 10 or more overseas sites. The overseas operating income margin is higher than 6.5% so there is the possibility that results will outperform this goal. Also, we have reflected a portion of expected benefits from restructuring the domestic custom pumps business. Positive results would factor into results outperforming goals.

Q: Tell us about the scope of sales required for each business assumed required to achieve operating income margin goals?

Since you are focusing on profitability, I presume you have not set specific sales goals but investor impressions will change significantly depending on the scope of sales.

A: The presumed scope is consolidated sales of approximately 600.0 billion yen overall. The PM Business has a strong rate of growth. In the Pumps Business, we will increase sales of standard pumps. With custom pumps, we will focus on profitability. The CT Business and Chillers Business will be largely unchanged.

Q: During the previous medium-term management plan period, CT Business profitability improvements did not reach goals. The biggest problem appears to be the profitability of products. Specifically, what are you referring to in your new medium-term management plan measure to "optimize sales scope and production structure"?

A: In addition to initiatives conducted during the previous medium-term management plan period, such as design automation, product downsizing, and the integration of an International Procurement Office to achieve cost reductions, we will promote order receipt focused on profitability more than plant operations. As a result, if our production structure becomes excessive, we will adjust the number of manufactured products and reduce fixed costs.

Q: The ROIC goal outlined in the new medium-term management plan is the same as the "8.0% or higher" of the previous plan yet all operating income margin goals are lower than the goals from the previous plan. Why is this?

A: We reviewed the previous medium-term management plan based on three perspectives (market factors, strategy adequacy, and strategy progress). While there was the impact of the decline of crude oil prices, our conclusion was that our strategies themselves were insufficient.

In particular, for the Pumps Business and the CT Business, we conducted a thorough evaluation of realistic strategies and to what extent improvements were actually possible. While we want to strive for goals that were higher than the previous plan period, we focused on setting achievable goals.

Q: You are maintaining the ROIC goal of "8.0% or higher" but is there a difference in the strategies and initiatives you have outlined to achieve these goals? Are these goal figures based on the identification of the problems facing each business and points of improvement for capital efficiency?

A: Rather than pursue sales scope, we will focus on profitability while also increasing efforts to reduce operating costs. We will aim to achieve ROIC goals by conducting investments clearly divided into investments for profitability improvements and investments into growth businesses. Our main strategy will be to enhance existing efforts and be more focused in our decision-making.

About Donation to The Ebara Hatakeyama Memorial Foundation

Q: The donation amount of 4.0 billion yen represents nearly 10% of the previous fiscal year's operating income and approximately half of income decline factors. Did the Board of Directors deliberate the intended use of the 4.0 billion yen and the appropriateness of the accounting treatment?

A: The Hatakeyama Memorial Museum of Fine Art curates a collection of 1,300 pieces, including six designated National Treasures and 33 Important Cultural Properties. We deemed the timing of this donation to be appropriate based on the fact that the curation of the collection during museum closure due to issues related to seismic resistance was becoming a problem. This donation was evaluated by the independent directors and we investigated an accounting treatment that would have a limited impact on short-term gains and losses. Furthermore, this decision was made by management after consulting with an external auditing firm.