EBARA CORPORATION First Quarter of FY2022 Earnings Conference Q&A

Q&A during earnings conference held May 12, 2022

Participant 1: Regarding my first question, how do you evaluate the progress of overall operating income of JPY14.1 billion compared to the forecast of JPY24.6 billion at the first half of the fiscal year? As for the FMS business, I was told that construction was delayed in Japan, so is it slightly going down or not?

Also, the PM segment appears to be a bit low in sales volume. The backlog of orders is building up rapidly, but is this just a matter of shipment timing? Or are there some events in the supply chain that prevents shipments, which caused delay in shipping? Once again, could you please explain the overall first quarter and how profits were generated for each business segment?

Hosoda: I will discuss on how we are viewing the first quarter in comparison with the business forecast made in the first half.

First of all, sales are a little less than we had expected in terms of the FMS and PM segments. As I mentioned earlier, as for the FMS business, in Japan, there were cases where we could not ship even if we wanted to. There was also a slight delay from first quarter to second-quarter for the PM segment. In that sense, I would say that in terms of PM and FMS sales, they are about the same or slightly less.

Operating income, on the other hand, is in line with the original plan.

We also believe that the EP is roughly in line with our plan made at the beginning of the fiscal year.

Participant 1: Is this low sales of PM segment just a matter of timing or is it also affected by the supply chain?

Hosoda: It is mainly timing. The timing would be a little delayed because of the supply chain.

Participant 1: Also, on my second question, I believe you explained that orders for the PM segment are firm. Your assumption at the beginning of the period was that the PM business would be down about 12% for the full year. The first quarter is probably the lowest hurdle, but it is up 34%. With regard to these orders, can it be said that the PM segment is currently on an upward trend compared to the forecast given at the beginning of the fiscal year?

Hosoda: I believe that orders of the PM segment are steadily made. However, in some aspects, customers are placing orders early due to the difficulty of procurement. I think that the consequence may change depending on whether or not the early orders continue to be placed. At the moment, we view that things have been progressing steadily for the full-year targets.

Participant 1: My third and final question is about the exchange rate.

I wonder if sensitivities are not disclosed too clearly by your company. Since the exchange rate is moving quite a bit right now, I wonder how much a JPY1/USD1 change would affect the profit. For example, if you could give us a rough estimate of the scale of each positive and negative impact, such that there can be positive impacts of JPY3 billion to JPY4 billion from the yen's depreciation on the gross, but the prices of raw materials and other factors are carefully considered and they remain unchanged.

Hosoda: This is not changed from what we have always said, but in terms of the impact on annual operating income, JPY1 depreciation against the US dollar, whether depreciation or appreciation, would have an annual impact of JPY0.1 billion to JPY0.2 billion on operating income.

Also, the euro doesn't affect much. I have given an estimated value in euros, but I think the impact on operating income will be negligible.

In terms of the impact of JPY1 on Chinese yuan, we estimate that the impact on the annual operating income will be approximately JPY0.2 billion. I think it is usually around that level every year.

Participant 2: First, I would like to ask you about the trends in FMS and US oil and gas capital investments in the first quarter, or in the next quarter and beyond.

In the first place, are there any new projects under the current circumstances? Because of these hard times, will there be less new projects and more renewal projects?

Oil is going up, which makes it easier to invest in equipment, but interest rates are also going up, which I think is holding them back. I would like to get your comments on the trends in US oil and gas Capex, in the scope you can foresee.

Hosoda: In terms of US oil and gas, especially looking at the compressors and turbines business, the first quarter of this fiscal year has been characterized by the relatively strong performance of the after-sales segment.

However, it does not mean that new capital investment is not coming out; it is coming out as planned and after-sales are stronger than last fiscal year.

Last fiscal year, customer did not want people coming to their plants, they did not want service technicians either, due to the COVID-19. In the first place, we could not conduct after-sales activities. COVID-19 is still ongoing, but I think the more flexibility, more relaxed restrictions, is a big factor.

There has been no decrease in both new projects and the new equipment, but the after-sales business in particular has increased compared to the previous fiscal year. Given that, when asked if the capital investments have been increasing along with the soring oil prices, no, it has not reached to that point yet. I am sure that customers would like to wait and see how oil prices are rising this time around. When oil prices rise too high, customers want to wait and see what happens.

Participant 2: My other question is to confirm one point about this first quarter’s order in the PM segment. There is a bigger growth in components compared to CMP, but is that just because CMP grew last fiscal year and this quarter's growth rate is a bit weak?

Hosoda: Both have grown. I think it just happens that the growth rate of Component was bigger in the first quarter. We see both as growing rather than components doing better than CMP in particular.

Participant 2: Yes, it's 27 and 53. I understand.

Participant 3: I have two questions, and the first is to confirm the FMS business.

If we look at the plan for the first half of this fiscal year and the actual results for the first quarter of this fiscal year, by subtracting them, we can see that profits for the second quarter will be lower. What is the background of it?

I would appreciate it if you could give me more background on whether you are considering some aspects, raw materials, or the situation you mentioned at the beginning, where shipments are not going so well domestically. This is the first point.

Hosoda: Especially in the domestic standard pump business, it is difficult to foresee the effects of soaring raw material prices. There are some opaque areas. We are also considering the possibility of passing on the cost of the product to the customer, but we are not sure if the effect of the price pass-on will be realized in time for the second quarter.

This may seem a bit weak, depending on your point of view, but it is safe to say that this is a numerical plan that takes these factors into consideration.

Participant 3: Just as a supplementary confirmation, is it correct to take this as the impact of domestic raw material prices or shipments, regardless of the impact of China, etc.?

Hosoda: For the raw material prices, China is included. As for China, raw material prices and the effects of the lockdown are slowly emerging. Including that, we forecast it will be a little weak.

Participant 3: Does that mean that China's influence may be slowly emerging, or is it emerging already?

Hosoda: It is emerging.

Participant 3: Regarding the other question, I believe you mentioned earlier where I asked you a question, that it seems that the domestic price increase will not be completed in time. In your company's product line, which one must be watched closely the ones that are likely to receive large impacts from the increase in raw material prices? Maybe you're talking about all of them, but do we need to watch for the standard pumps or compressor and turbine?

First of all, for which products do you consider the risk in your company's initial plan for the impact of this raw material price?

I remember that raising the prices was done to some extent last fiscal year, but does that mean that it is not up to speed on price pass-on? The question is when to raise it to another level, and will it take effect to some extent in the second half of the year? I would appreciate it if you could tell me about these current pricing policies in terms of products and regions.

Hosoda: Our product line can be broadly divided into standard products, mass-produced standard products, and custom products, each of which is made to order.

In terms of which businesses are affected by the rising prices of parts and materials, all of them are. For example, in the case of custom pumps, compressors and turbines, it is possible to reflect price hikes to a certain extent from the quotation stage.

The estimation period should not be too long after providing an estimate reflecting that. The quotation is usually valid for six months, but by making it valid for three months or one month, we are responding with a pricing policy that devises ways for us not to take on this kind of risk.

On the other hand, if there is an unexpected price increase after one quotation, we will establish an escalation clause that will reflect the price. Some long-term construction projects are handled in this way.

We talk about price increases and price pass-on mainly for these standard products. In that area, with the cost of each material going up and up, we think we need to adjust the price this time around.

Of course, we have been doing this since last fiscal year, but it is not a one time thing, and there is a possibility that we may have to do it several times depending on the market environment while keeping an eye on the situation, which causes lapse in timing or delays. It is safe to say that there are some uncertainties in our future business plan in terms of how we will absorb these issues.

Participant 3: The custom products area is under control to a certain extent due to the policy that has been in effect up to now. However, since there are raw material price increases and uncertainty for the standard pumps, the current plan is based on the idea of having a certain degree of risk buffer with the exchange rate. Is this correct?

Hosoda: Yes, that's right. With regard to custom products, we will reflect the price increase in materials in each and every quotation. There is no doubt that custom pumps will be impacted too, but in terms of how we will be impacted, I think it will be in the form you just mentioned.

Participant 4: I would like to confirm two points regarding the raw material prices.

First of all, in the first quarter that ended, although raw material prices had a more negative impact on operating income than expected, the operating income was in line with the expectation. Is this correct?

Hosoda: Yes. There are some fluctuations among business, but yes, what you said is correct.

Participant 4: So, the impact of high raw material prices was more than expected in the first quarter, is that correct?

Hosoda: It was high, but it was absorbed and controlled through various measures in a way that it is not too high, that's what I meant.

Participant 4: Also, on the second point, the sensitivity of exchange rates was disclosed. If we simply calculate on a full-year basis, the annual effect on operating income would be JPY3 billion.

On the other hand, the full-year operating income forecast remains unchanged. Is it correct to say that there is a downside risk of about JPY3 billion for the full year due to the impact of the sharp rise in raw material prices?

Hosoda: Yes, that is correct. We assume that the impact of the JPY2 billion to JPY3 billion level of raw material price hikes may not be fully covered, and so, it can be offset by the impact of the exchange rate.

Participant 5: What changed your cash flow projections for the year?

Hosoda: Basically, it's because working capital is increasing as the business expands.

What's different compared to last fiscal year is that sales of trade receivables and inventories are increasing at a mostly good pace as the business expands, but accounts payable is not increasing as much as expected.

This is because the conditions for procurement of parts and materials and payments to suppliers are worsening. We are also seeing some negative trends on the procurement side that are not good for our cash flow. I analyze that is the cause of the problem, especially with regard to the PM business.

Participant 5: Do you mean that there is a difficulty in procuring for the PM segment or that it is largely related to purchase obligations?

Hosoda: It's not just the PM segment, but it is large in that segment due to the impact of sales expansion this time.

Participant 6: In the three areas of fixed costs, there was a considerable increase compared to the previous fiscal year, with the FMS business at JPY3.1 billion and the PM segment at about JPY2.6 billion, but is this within or outside of expectations?

Hosoda: As for fixed costs, there are quite high personnel expenses, and as planned, the number of employees is increasing in line with business expansion. Also, we have introduced a performance-linked bonus system, and in line with the strong performance of the previous fiscal year, bonuses increased slightly compared to the previous fiscal year.

Also, there will be an increase in depreciation, but we are planning for that as well, so in that sense, it is within the scope of our planning assumptions.

Participant 6: On a different note, as for the stock market, I would like to ask once again about Ebara’s situation in China, as there is this investor that draws attention.

Just recently, with the Chinese lockdown and such, logistics and various shipments have been halted or stalled. The Company has both factories and suppliers there, but to the extent that you can say, can you tell us what is going on in China at the moment? I'm particularly interested to see if any improvement trends are emerging.

Hosoda: There are some different aspects depending on the product group and the market, but as far as the oil and gas market is concerned, the companies related to our business, in China, do not seem to be affected that much at this time.

As for the pump plants, the impact of the lockdown varies from region to region. In some areas, such as the Shanghai region, where lockdowns are more pronounced, there may be a slight impact on production.

However, I don't think the current situation has any impact on the current full-year plan. We cannot ignore the scale of the PM segment in China, which has been slightly affected by the large number of customers in the Shanghai area. However, compared to the previous fiscal year, it is not that the level has been significantly lowered. We understand that we are affected, but not to the extent that we have to make major changes to our planning assumptions.

However, there are uncertainties about the impact of the lockdown, the impact of logistics, and the impact of the sharp rise in the cost of materials. We are looking at JPY2-3 billion, and we will have to keep a close eye on whether or not we can control the situation within that range.

Participant 6: What is the figure of JPY2 billion to JPY3 billion?

Hosoda: It's not just China. JPY2 billion to JPY3 billion means the amount of impact from the sharp rise in the price of parts and materials, and I meant that for the upside risk in the exchange rate mentioned earlier and the level of offsetting that also covers China.

Participant 6: In general, people think that maybe Ebara is relatively more dependent on China in the stock market, but from your company's standpoint, is it correct to say that there is no concern that the Chinese base is so far below the plan as of today?

Hosoda: Yes. We do not believe that this is a major reversal of the current plan or assumptions.

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