EBARA CORPORATION

EBARA CORPORATION First Quarter of FY2023 Earnings Conference Q&A

Q&A during earnings conference held May 15, 2023

Participant 1: In the first point, in the precision machinery company, there was a certain degree of uncertainty in the semiconductor market from the beginning of the term, but the order plan was relatively stronger than the market's view. In the previous earning call’s Q&A session, you explained that you are using a new process and that your company's memory ratio is relatively small as well as taking consideration the bottom up from the relation with the costomers.

This time, especially in Q1, orders have fallen considerably, but could you explain in more detail how the view has changed from three months ago? In addition to that, the downward revision for H1 order taking. From Q1 to Q2, however, you are planning for precision and electronic orders to return, even if you say so quite a bit, so I am not sure if this is really okay or not. In particular, CMP received JPY9 billion orders in Q1, which will probably amount to JPY40.9 billion in Q2, so I would appreciate your explanation of the certainty of this area.

Hosoda: As I mentioned earlier, I do not expect the market to change much in the medium to long term, and I believe that the market will expand significantly toward 2030. As for the upcoming expansion phase, it is to be expected that it will come more rapidly, more rapidly than ever before.

In this rapidly expanding market, we believe that our precision machinery company will be in a position to demonstrate its strength in the relationships with our customers and increase our market share.

On the other hand, there has been a change in the view that the current adjustment phase has been pushed back slightly further than initially expected in terms of where the bottom will be reached and at what point the economy will enter a recovery phase.

One of the reasons we said that CMP revenue would not fall too much this fiscal year, on the contrary with weak Q1, was because we had a large backlog of orders at the beginning of the fiscal year, and we had an abundance of order backlogs.

The order backlog at the beginning of the period is selling well, but sales are slightly short of what we initially expected at the beginning of the period. The reason for this is that we have already shipped the products to the customer, but we have to have the customer perform acceptance testing in order to have the products shipped to the customer for process acceptance testing and acceptance inspection. However, the number of products that have been shipped but not yet accepted has been increasing.

To be more specific, there are more than 3 digits units which we have already shipped and installed at the customers’ site but have not yet been sold because the final Process Acceptance Test (PAT) has not been completed.

In terms of payment terms, we usually receive an advance payment when we ship, which is fine from a cash flow perspective, but in terms of sales standards, the sales are slightly weaker due in part to the impact of the relatively high sales in Q1 under the acceptance inspection standards.

However, since we are in such a situation, there is a high probability that the product will sell up relatively in Q2 or later. So we changed our forecast to Q2 rather than Q1 and H2 rather than H1, taking these factors into consideration.

Participant 1: I've heard that more and more of these process acceptance tests are not being completed. Is there a market factor that is leading to customers doing so? Are they already paying for them. Is it like this because there is no need to rush to get it up and running the equipments?

Hosoda: Well, I think there are various reasons on the customers' side, but sometimes production processes is completed only when all the equipment, not only our equipment, but also other equipment, is complete, so it may be due to those reasons. I think it's a situation where the customer doesn't have to rush to get an acceptance inspection, or something along those lines.

I think there are various reasons for this, but I understand that it is partly a reflection of the fact that, as a whole, there is no longer a need to hurry as much as anticipated in the last quarter.

Participant 1: I see. In such a situation, is it highly probable that orders, where they recover from Q1 to Q2 so far, are also highly probable?

Hosoda: Yes, this is also based on the assumption that we are looking at each individual order and when and how long it is expected to take, so to some extent, we are building up each order individually, so I think we are in good shape here.

Participant 1: The second point is also precision machinery business, but the service and support ratio of 28% was about 33% in the previous fiscal year, so the decline in service and support sales is a significant factor in the deterioration of profitability.

Hosoda: Yes, there is an impact. Q1 was a bit more neutral, with a precision service and support ratio of more than 30%, so compared to that, Q1 was still a bit low. I think this is due to the fact that our customers' factory utilization rates have been decreasing a little, and the number of dry pumps that are returned for overhaul has been decreasing. This is one of the reasons why the overall profit mix is deteriorating.

Participant 2: First of all, regarding the electronics, I wonder if there was any amount of cancellations on the Q1 orders.

Hosoda: We have seen some cancellations. However, it is my understanding that the cancellations include the meaning of postponing the event to a future date, and we are also receiving appropriate cancellation fees, so while the majority of cancellations are postponements, it is true that there are some cancellations.

Participant 2: I see. If there are a lot of cancellations and the orders come in later, I think it is no wonder that the orders for Q1 are so low, but I understand that the current orders are mainly due to actual demand. In short, if, for example, there were JPY10 billion or 20 billion cancellations, this drop would not be a significant difference, but if there are not many cancellations, this difference in the actual value of orders alone would seem to indicate that the drop in orders is quite large, is that not so?

Hosoda: It is not on the order of JPY10 billion or 20 billion, but there have been cancellations in the order of billions.

Participant 2: But this is just a temporary situation, and I imagine that the cancelled customers will come out somewhere when they see the investment plan.

Hosoda: Yes, the medium- to long-term perspective has not changed at all, and I think that the customers' decision of whether to pay the cancellation fee now or to postpone it will be determined by the relationship with the customer, and that is all.

In essence, the understanding that this is something that will come up in the future has not changed.

Participant 2: The other point is about China. In your explanation, I thought maybe you mentioned that China was good in the building service & industrial segment, and also in energy. I know it's January to March, so the period may be a little too short, but I thought that China would increase capital investment after the Chinese New Year, but surprisingly nothing came out of it, and looking at GDP growth rates and economic trends, I thought that it could not be said to be a recovery.

In spite of this, I see a recovery in your company's sales to China, so I wonder if this difference is driven by a macro story, or by pumps, or other individual businesses, or if it is unique to your company. Could you please explain again your response to China's move?

Hosoda: We would like to hear opinions from various people to determine whether this is a macro trend or not, but from the perspective of our business, considering that Q1 of the last fiscal year was relatively quiet due to the COVID-19 lockdown, etc., and that business activities were suspended and plants were shut down, it is a numerical fact that Q1 has increased significantly compared to Q1 of the previous year.

In building service & industrial business, especially in the old segment, we hear that coal-fired power is growing a little in standard pumps and chiller systems, and we also hear that coal-fired power is growing in custom pumps.

We have heard that the overall recovery in China has been weaker than expected on the macroeconomic level, but as a comparison with Q1 of the previous fiscal year, we have seen a comparative increase.

Participant 2: I see. For example, when I look at the market for building service & industrial business, there has been absolutely no movement at all, and I thought it was negative, but from your company's point of view, I guess that had nothing to do with it.

Hosoda: Yes, looking at the resulting figures, it doesn't seem to matter much.

Participant 3: I would like to ask you two major questions.

First, I would like to confirm the CMP order. Is it my understanding that the JPY9 billion figure for this time is the amount that would be obtained if there were cancellations by your company, or is it correct that the amount of cancellations was subtracted from the original order from this Q1 to JPY9 billion? If it is possible, I would like to know the amount of orders received in Q1 if this cancellation was not made.

Hosoda: The first way to account for this is that we record negative orders for cancellations. Therefore, please understand that we are netting with respect to that part.

I can't explain the exact figures, but if you understand that the billions of yen of orders and cancellations mentioned earlier are in addition to the above, I think you can get an approximate idea of what we are talking about.

Participant 3: In addition to this, in your explanation earlier, I think you mentioned something about a delay in the period, but regarding the JPY41 billion in orders received in Q2, are you saying that there were some projects that were slightly off in Q1 and that this figure for Q2 will be fine? I am sorry, but I would like to ask you what you see as the basis for this. What do you think?

Hosoda: Yes, some orders that were originally scheduled to be placed in Q1 have been postponed to Q2 due to the extension of negotiations, and some orders that have already been placed in Q2 and are likely to be confirmed to some extent are included.

Participant 3: Regarding precision machinery business, while the Company lowered its full-year sales plan by approximately JPY10 billion, it lowered its profit plan by only JPY1.5 billion, I think.

The background of the small difference in profit in relation to the drop in sales, and the question of whether the Company will be able to maintain profit even if the sales inspection continues to be delayed and sales fall short of the plan in the future, can you give us your view on this?

Hosoda: Precision machinery business's operating margin is 15% or something like that. It is a little above 15%. Therefore, I think the JPY1.5 billion decrease in operating income compared to JPY10 billion is not such a strange figure.

On the other hand, depending on the situation, we cannot say that there will not be further delays in posting sales, but we have made a number of assumptions about the relationship with existing customers and future customer movements and have come up with what we believe to be the most probable figure at this point in time.

Participant 3: Considering the marginal profit margin of the precision business, perhaps a little more profit to sales would not be out of place. As a background, your company originally planned to spend development expenses and other costs in response to the decrease in sales. Therefore, I would like to ask you if you intend to control the decrease in sales and make a profit when sales decrease.

Hosoda: I understand that the marginal profit is a bit higher, so JPY1.5 billion is not much compared to JPY10 billion, and I thought that the profit margin is low because of the calculation that sales will decrease by this amount and operating profit will decrease by this amount in the mix relationship to which specific projects will decrease.

As for whether or not we will secure profits, I am not sure if we will reduce fixed costs, but we will of course make efforts to secure profits through various measures. On the other hand, I believe that it is no good if we only maintain profits for the current term by reducing investments for the future or other areas.

In this sense, I believe that we will move in the direction of securing the profit target for the current term to the maximum extent possible by using what we have to use under the situation where our medium- to long-term business assumption will remain unchanged.

Participant 4: First of all, I would like to ask you about your assumptions for H1 and H2 in terms of operating profit. Especially in the building service & industrial business and energy business, I believe that the operating profit for H1 of the fiscal year was revised upward from the initial plan, but if we subtract the operating profit for H2 of the fiscal year, we can see how H2 will look like.

If the current situation is favorable, I was thinking that the H2 plan for building service & industrial and energy could be higher than at the beginning of the period, but if you have any thoughts on the background of this, do you mean that you have only revised the H1 forecast since you know what the H1 forecast was? I would appreciate it if you could tell me the nuances of the situation.

Hosoda: In building service & industrial business and energy business, we have increased profits in H1. It is my understanding that they are making upward revisions for the full year as well.

As for building service & industrial, H1 was JPY1.5 billion, and the full year is JPY1.2 billion, so that means H2 is down JPY0.3 billion. In that area, we calculate how profits are generated in H1 and H2.

The reason for the upward swing in profits in H1 of the fiscal year is that H1 of the fiscal year saw a greater-than-expected effect of higher prices in building service & industrial. The reason for this is that since we are raising prices, the selling price to the customer will increase, but we assumed that the timing of the price increase on the supplier side and the timing of the selling price when selling to the customer will increase in the same way.

As for Q1 of this fiscal year, the effect of the price increase on the customer side has been stronger, while the price increase from the supplier side has been delayed a little. The effect of the price hikes has been positive for Q1.

In H2, it is expected that these effects will fade, and suppliers will raise their prices more and more, so we have taken these factors into consideration in determining the profit margin for H1 and H2. These are building service & industrial, and I guess energy is similar.

There are many specifics, but let's take a look at the energy profit in H1 and H2. Energy profit was up seven in H1 and down four in H2. The fact that profits will be slightly lower in H2 of the fiscal year is due to the fact that the various measures we are planning to implement this fiscal year, such as the consolidation and elimination of service bases, will be more prevalent in H2 of the fiscal year than in H1. We have judged that the probability of this is the highest at this stage.

Participant 4: I understand. I heard that the consolidation of service bases started in Q2 but was brought forward, so I was wondering if the cost side of the energy company will become lighter in H2.

Hosoda: Some of the items that will be released in H2 will be released in H1, but we originally had a lot of work to do in H2, so we are considering H2 to be a little weaker than H1.

Participant 4: Next, this may be an overall point, but I would like to know how the cost of personnel expenses came out for this Q1. In terms of your company, I am wondering if it could be a onetime bonus or some other expense that could be paid out in personnel costs, since your company had a higher profit in the last fiscal year compared to past levels of performance.

So, even in the precision and electronics segments, there is an increase in fixed costs and some other segments, but I would like you to focus on the precision and electronics segments in particular. The increase in personnel expenses this time, if you look at it on a quarterly basis, Q1 was the kind of quarter that tends to show a negative impact. Can we take the view that this was a quarter where Q1 was more likely to have a negative impact?

Hosoda: I can't give you a specific quantitative explanation, but I think it can be assumed that Q1 is relatively high due in part to the provision for bonuses in H2.

Participant 4: I understand. So, when looking at Q1 and Q2, can I take it that Q1 is more likely to have an impact on labor costs in terms of increase or decrease factors?

Hosoda: Yes.

Participant 5: I would like to ask about energy. In your explanation, you mentioned that there was active activity in the LNG industry and in North America, and that you had received some orders. Can you give details, like what kind of plant-related orders were received, whether energy or LNG, for example? I would like to hear more details, for example, that it was a cryogenic pump.

Especially in North America, there is a lot of activity in LNG plants right now, so I would like to understand the trends in that area and how they relate to your orders.

Hosoda: In the North American oil and gas sector, there was no movement at all from H1 to the middle of the last fiscal year. The price of oil was rising, but due to the growing uncertainty over various geopolitical risks, it was difficult for customers to make final investment decisions, and last fiscal year, investment decisions were pretty much at a standstill. We are beginning to see movement in H2 of the last fiscal year, just before the end of the term.

In North America, several LNG plants in the central area of the Gulf Coast have begun to be quite active, and we have heard that orders have been received for both compressors and cryogenic pumps for LNG liquefaction plants.

Some years ago, we transferred our cryopump business to Elliott, a company that handles compressors and turbines, and together we have been taking orders for both compressors and cryogenic pumps for the oil and gas market. One of our achievements is that we were able to deliver compressors, turbines, and cryogenic pumps together to LNG-related plants, which is similar to providing solutions to customers.

Specifically, we have received orders for compressors, compressors for auxiliary equipment, and cryogenic pumps for liquefied natural gas in the Gulf Coast.

Participant 6: I would like to sort out the negative factors of profitability of precision and electronics. I understand from your earlier exchange with the participant 1 that there was a decline in service and support, but it says that this project mix deteriorated, could you please explain this?

I've been hearing about this recently, but what is it? Is it something that has continuity? Looking at the recovery in Q2 results, I am not sure if that is the case.

Hosoda: The mix of projects in the precision machinery company is difficult to explain, but the profitability of each project varies depending on the customer and the processes used by the customer.

As I mentioned earlier, in the equipment business of the precision machinery company, we make future earnings forecasts by accumulating microscopic data on how and when sales of each piece of equipment are expected. The mix of projects sold this time or the timing of bad sales can be attributed to the customer, the way the customer uses the equipment, or various other factors, but from this perspective, sales were mainly for relatively low-profit items.

As for Q2 and beyond, it is difficult to explain other than to say that they are planned based on the high profit margin projects that are currently being accumulated by the customers and the way they are being used. It's something like that.

The reason why the profit margin is high or low is, of course, due to various negotiations with each customer, and also because the industry is characterized by the fact that customers are asked to install evaluation equipment, and if the results are satisfactory, they are asked to start full-scale work. If the results are good, then the client can start the full-scale work.

The timing of the entry of the evaluation machine may cause the product mix to deteriorate. However, the product mix is determined by the totality of such factors.

Participant 6: Which is a bigger factor, the service and support factor or the case mix factor?

Hosoda: In Q1, you can see both. I think it is about the same.

Participant 6: I am not sure if this is due to the automated plant or the effect of increased production in Kumamoto, but I think profitability continued to improve in those areas. It is hard to say since demand has been declining a bit, but I guess you are saying that the Q1 results were minus 45 after such effects?

Hosoda: Yes, you are right. The improvement in profitability in terms of productivity that we enjoyed last year remains unchanged as a manufacturing process in the current situation. Of course, there are some aspects that cannot be enjoyed 100%, such as a decrease in production volume and a decline in capacity utilization, but these figures remain unchanged.