May 14, 2021

# NSK Ltd. Q&A Summary - Fiscal 2020 Financial Conference (Year Ended March 31, 2021)

**Q1:**

In the fiscal 2021 forecast, while sales in the automotive business are expected to return to a level of over 500 billion yen, why is segment income only 14 billion yen and segment income margin in the low single digits? This number seems low compared to past results.

**A1:**

I think you are suggesting that segment income seems low compared to the results of the fourth quarter in fiscal 2020. Since the full-year fiscal 2021 sales forecast for the automotive business is 520 billion yen, if you use the income from the fourth quarter to estimate full-year income, segment income would be around 20 billion yen. However, here I think it is more appropriate to estimate using income from the second half of fiscal 2020, rather than just the fourth quarter. Looking at our forecast, however, you may think this number is still low, the reason being that, in the first half of fiscal 2021, we will not be able to fully recover from the impact of raw material cost increases. Another reason is that in the second half of fiscal 2020, we established a personnel structure to accommodate the increase in product volume, but product volume will slightly decline in the first half of fiscal 2021, and increase in the second half, so we are stuck in a situation in which we must operate while dealing with fixed costs in the first half. Another factor is that the profitability of the automotive components business is struggling somewhat compared to bearings. For the second half of the year, we expect a slight improvement in earnings in the automotive business compared to the same period in the previous year.

**Q2:**

You achieved fixed cost reductions of 17.6 billion yen in fiscal 2020. Why will about two-thirds of it return in fiscal 2021?

**A2:**

Variable labor costs are included in fixed costs, and the increase in these costs is having an effect as the volume of goods recovers. In terms of labor costs, in fiscal 2020, we believe that we were able to reduce labor costs and improve productivity by the equivalent of nearly 2,000 employees. The COVID-19 pandemic has changed the way we work, and we assume that we will be able to maintain the structure that has reduced travel expenses. Fixed costs also include investments for future growth, such as expenses related to design, development and digitalization, which we intentionally plan to increase as a necessary part of our long term efforts.

**Q3:**

You are planning to increase the weight of NSK's industrial machinery business to account for about 50% of sales. What is the reason for this?

**A3:**

As the automotive market becomes more electrified, we would like to increase sales in the industrial machinery business for stable growth, improved profitability, and a more stable business structure in the future. Of course, we will continue to grow our automotive business for the next five to ten years, so please take this to mean that we are aiming for growth in the industrial machinery business to exceed growth in the automotive business.

**Q4:**

Looking at the fiscal 2021 V-chart on page 11 of the financial presentation, could you explain your thoughts on the likelihood of sales price reductions, passing raw material cost increases through to sales prices, and external procurement cost reductions?

**A4:**

Sales price reductions are mainly in the automotive business. Although demand is recovering, the business environment under COVID-19 has not changed significantly and we will continue to negotiate to limit decline. We also aim to make up for reductions by passing on raw material cost increases in both the automotive business and the industrial machinery business. Looking at the V-chart, there is a 2 billion yen difference between the 6 billion yen increase in raw material costs and 4 billion yen increase in sales prices. This is due to a time lag between the timing of the raw material cost increases, which started from the first half of fiscal 2021, and the timing of price negotiations, and also because we are not sure if we can really secure 100% of our target sales price increases. As president my intention is to adopt a flexible sales price policy that takes into account raw materials and social environment. As for external procurement cost reductions, similar to how we have been limiting sales price reductions in the midst of volume fluctuations, our suppliers have been implementing measures as they incur increasing costs in various areas as well. Taking these factors into consideration, we estimate that the feasible level of external procurement cost reductions is about 4 billion yen.

**Q5:**

Isn't it necessary to carry out a more in-depth structural reform of the automotive components business?

**A5:**

Structural reforms have been underway for some time now, but sales are low at the moment due to the impact of COVID-19 and other factors. However, our manual column business has seen increasing volume. Therefore, if we take further steps to reduce fixed costs, we will be faced with the problem of responding to increasing production in this area and when volume rebounds in the business overall. Thinking about the future, we want to maintain the current level of R&D expenses.

**Q6:**

The fiscal 2021 forecast has a sales growth rate of 13% in the automotive components business, which is generally in line with the return of demand, so is it correct to assume that the impact of End Of Production (EOP) of certain vehicle models is decreasing compared to the previous fiscal year? Also, from now through the start of mass production in 2023 of the single-pinion electric power steering product jointly developed with a European car maker, will the top line of automotive components grow at the same rate as demand, or will it be able to grow even more?

**A6:**

The 13% is mostly linked to automotive production volume, so the EOP will not have much of an impact this fiscal year. Our current intake of orders and sales efforts will result in business in three or four years, so we have a relatively clear picture of the projects we will be working on over the next three years. We now see that we will be able to recover from next year in fiscal 2022, and even further after that in fiscal 2023, with recovery basically in line with recovery in automotive production volume. We are striving to make further improvements, including by capitalizing on the single-pinion electric power steering project.

**Q7:**

In your fiscal 2021 forecast for the industrial machinery business, you expect demand in wind turbine and railcar sectors to settle down as they were strong last year. However, in the mid-term, do you expect that NSK's growth in these sectors will outperform growth in demand by leveraging tribology technology and Condition Monitoring Systems (CMS)?

**A7:**

The wind turbine sector was very strong last year, so we expect a slight lull in demand, but in the long run, renewable energy fields are growth fields, and we will continue to invest in them. Likewise, with China's declining birthrate becoming an issue not only for Japan but also for the rest of the world, the trend toward automation and robotization of machine tools will continue. In addition, in wind turbine, railcar and other infrastructure sectors, as well as in the machine tool sector, bearings have very high technological requirements, and there is strong demand for bearing-related support for rotating equipment. Moving forward, how we differentiate ourselves in terms of technology and quality will affect our capacity to increase market share in these sectors over the mid-term.

**Q8:**

What is the scale of sales in the E&E business in the fiscal 2021 forecast? Also, what is the progress of your plan to increase the number of manufacturing facilities?

**A8:**

The fiscal 2020 result was just over 80 billion yen, and in fiscal 2021, we expect demand to increase by about 15% due to the acceleration of electrification and so called stay-at-home demand, which we estimate to be around 90 billion yen. We can handle this level of growth by adding personnel to our existing production infrastructure, but we need to go one step further and expand our manufacturing facilities in anticipation of growth. However, at this time we cannot disclose details on our plans for new facilities.

**Q9:**

What is the status of the Brüel & Kjær Vibro (BKV) business (condition monitoring system specialist) that you acquired last year?

**A9:**

The business has maintained its originally planned earnings, and we have included about 1 billion yen from BKV in our EBIT in the fiscal 2021 forecast. As part of post-merger integration, we have started to collaborate on sales channels and infrastructure, and new projects for the future are beginning to emerge. Although the scale of this project is not large enough to have a direct impact on our business performance right now, we feel that we are steadily moving ahead.

**Q10:**

How do you plan to catch up with competitors in the US and Europe, including the gap in ROE levels? I would like to hear your thoughts as the new president.

**A10:**

One difference between us and our competitors in the US and Europe is our business structure, which has an impact on our earnings. If we look at the automotive bearing business alone, we do not believe that our competitiveness in terms of earnings has deteriorated. However, if we look at our earnings from the perspective of industrial machinery and automotive bearings together, operating income margin is hovering around 7%, which means that we are about 4-5% lower than the 10-12% operating income margin of our overseas competitors. We believe that this is due to differences in fixed costs and procurement strategies, especially in the areas of limiting fixed asset costs such as facility costs, and in the use of scrap-and-build style strategies.

Over the long term we must strengthen our ability to systematically reallocate production and plant utilization, and our ability to do so more regularly. We must also strengthen our procurement strategy, and enhance our capacity to reduce fixed costs by utilizing outside forces. In addition to steadily addressing these issues, we would like to further develop our quality and technological capabilities over the period of the next mid-term management plan so that we can effectively sell on value in terms of sales price policy.