August 6, 2021

NSK Ltd. Q&A Summary – Fiscal 2021 Q1 Financial Conference (Year Ending March 31, 2022)

Q1:

Slide 2 shows the cost of raw materials has increased more than expected and the progress rate for increase in costs seems more than the forecast for the fiscal year. Labor costs increased ¥5.0 billion in the first quarter compared with ¥7.0 billion in the forecast for the fiscal year, which is high, considering there is ¥2.0 billion for the remaining three quarters. The same is true for depreciation and amortisation, equipment, and selling, general and administrative expenses. What factors are causing costs to increase above the initial expectations?

A1:

We are paying particular attention to raw material costs in the current fiscal year. ¥1.2 billion in the first quarter is in line with our forecast of ¥6.0 billion. At present, raw material prices are on the rise, and there is a risk that raw material costs could be around ¥9.0 billion for the year.

Excluding subsidies, labor costs increased ¥1.5 billion in the quarter, of which around ¥0.5 billion was for the introduction of personnel to handle the increase in volume, and this is within the scope of the forecasts. We believe we will be able to handle the increase in volume with as lean a structure as possible to increase productivity and achieve profitability. Depreciation and amortisation is in line with the forecasts, and cost of equipment reflects actual current activity, so that accounts for the increase year on year. Transportation costs have increased due to the current rise in unit prices and switch to air transport, and we may have to anticipate an increase in the forecast of approximately ¥1.0 billion. We are managing operations with increasing attention, bearing in mind the need to handle an expected further increase in volume, and cost pressures in raw material costs and transportation costs.

Q2:

Are there any changes in the environment that are behind the increase in raw material costs, such as stronger demands for price increases from specialty steel manufacturers and steelmakers, or the transfer of increases in raw material costs to sale prices being unacceptable? I understand that there are currently challenges in supply and demand, but is the impact temporary, or, if there are any changes in the underlying environment, will it continue next fiscal year as well?

A2:

At present, we believe the main factors are market conditions and the balance of supply and demand. However, bearing the future in mind, I think we have to consider the possibility of stronger demands for price increases from specialty steel manufacturers over the medium-to-long term. Another factor that we need to consider over the medium-to-long term is environmental issues. For example, it is possible that hydrogen-related activity will increase, but it will require enormous investment in research and development and capital expenditure. We are watching closely the issues of how this will be done and who will pay for this investment.

Q3:

Recently, there have been frequent discussions about a global shift to EVs. We also hear from machine tool manufacturers that they are postponing or reviewing their scheduled projects although it is not clear whether this is true. What about any changes in NSK's bearing business? Are there any changes in expectations, outlook, or anything else?

A3:

Currently, there are no structural changes or any other specific changes that are likely to have any impact on increasing or decreasing our business. However, the discussion is moving forward on a daily basis, not only among European OEMs, but also Japanese OEMs. At present, we have yet not reached the point of having concrete discussions about changing the direction of our business, but we are making various assumptions and pressing on with preparations.

Q4:

Please explain the impact of semiconductor shortages, including the outlook for the second quarter and beyond. There is also talk of a global shortage of nylon resin among other materials. Could you tell us if there are any supply issues other than semiconductors?

A4:

At the beginning of the fiscal year, we estimated that the impact of semiconductor shortages would be around 1.0 million units in the first quarter, and we thought OEMs would revise their forecasts for the second and third quarters upward by that amount, and global production volume would reach the 86.5 million-unit level for the year. In fact, production was 2.2 million units lower than the initial forecast, and the impact on our business is believed to be around ¥9.0 billion greater than expected in the first quarter. We are still in the process of gathering information from customers on how much automotive production volume is expected to recover, but at present we believe it will rebound to 86.5 million units. The second quarter has actually been trending slightly positive compared to the initial forecast, and the current outlook is that production will be slightly higher

than initially expected. Heading into the third and fourth quarters, I think we can expect to see production and sales exceed the negative results in the first quarter.
In addition, we believe we can secure adequate supplies of resin and other raw materials that we procure directly. However, we are diversifying suppliers in preparation for any unforeseen circumstances.

Q5:

What is the supply and demand situation for precision machinery and parts? Is there any risk of supply shortages, and what is the situation for production lead times?

A5:

At the moment, demand is rising, but without reaching the 2017 peak level overall, so we have not reached the point of having problems with production capacity. However, as the number of orders trends even higher, we are adjusting order delivery dates individually, but we do have the capacity to supply products with a certain lead time. In addition, we believe that we can offset cost pressures, including materials, by exceeding the initial sales forecasts for the current fiscal year.

Q6:

You mentioned that there is strong demand for industrial machinery bearings in the machine tool sector. In which markets is demand strong?

A6:

The increase in demand in the machine tool sector was characterized by sharp growth in demand for precision bearings for use in ball screws and spindles, driven by EMS demand due to NC conversion in China. Capital expenditure in the automotive area, which had cooled, has subsequently rebounded sharply, and replacement demand and equipment upgrades are clearly beginning to take off, including at SMEs. This can be understood to show that customers are beginning to see a brighter future outlook.

Q7:

How did the results for sales and profit in the first quarter compare to the forecast? What are your thoughts on cost increases in bearings and the factors for sales and profit growth in the second quarter? How do you see the upside and downside factors?

A7:

In relation to our internal plan, the result was negative in the automotive segment, factoring in the

impact of semiconductor shortages. The industrial machinery segment was positive, and we expect to make up for the overall shortfall in the full-year period. In particular, the positive factors are capital investment related to machine tools, semiconductor manufacturing equipment, pumps and compressors, and related capital investment. On the other hand, wind power generation and railway rolling stock appear to have entered an adjustment phase, but we believe investment will move forward over the medium-to-long term.

Q8:

Profit for industrial machinery bearings has rebounded, and further recovery is expected in the second quarter and beyond. What is the status of mix and production?

A8:

Industrial machinery bearings are at a stage where we can expect double-digit profit. However, we believe we must now lock-in productivity improvements and profitability by ongoing capital investment, transferring production, and adopting new production methods. On the other hand, we are continuing to incur costs and expenses with the transfer from the Fujisawa Plant, and as the burden of depreciation and amortisation will also start up, we believe we need to achieve our original goal of improving productivity as soon as possible.

Q9:

The Others segment produced segment income of ¥1.0 billion in the first quarter. What are the details? How does this compare with the forecast?

A9:

Results were in line with the forecast in both the BKV and the steel ball businesses. Over the medium-to-long term, we want to make the BKV business successful as a new business by creating fully-fledged synergies with NSK.