August 3, 2022

NSK Ltd. Q&A Summary – Fiscal 2022 Q1 Financial Conference (Year Ending March 31, 2023)

Q1:

What specific aspects of the Q1 results were better or worse by business segment compared to the assumptions made at the beginning of the fiscal year?

A1:

Although the impact of China's zero-COVID policy was factored into the plan, the industrial machinery business was less affected than expected, and machine tools and semiconductor manufacturing equipment maintained high levels of demand, resulting in positive results. On the other hand, the automotive business was expected to be affected only in China, but the automobile production volume outside of China, especially in Japan and the U.S., was also affected.

Q2:

Although the full-year plan remains unchanged, what are the concerns going forward?

A2:

As shown on slide 6, risks include a further delay in the recovery of automobile production volume due to prolonged supply chain disruptions and a slowdown in either the European or U.S. economy. We are also facing higher-than-expected cost increases and other risks, but we will continue to manage the business while taking countermeasures, and at this point we believe that there will be almost no impact on overall performance, so we have left our plan unchanged.

Q3:

What is the impact of the lockdown on the China business, when looking at each business, and production and sales? What is the situation for automotive, industrial machinery, and especially precision machinery products in China, and are there any signs of a slowdown or a sharp drop in orders?

A3:

The production base and warehouse are located in the suburbs of Shanghai, and both production and sales in the automotive and industrial machinery businesses were significantly affected in April; since mid-May, the lockdown in the Shanghai area has been lifted, and both production and sales have almost recovered. So far, there are no signs of a sharp drop in orders in precision machinery and industrial machinery.

Q4:

What is the breakdown of inflation and transfer of costs slide 3 of the financial statement? To what extent have you been able to catch up on transfer of costs, and what is the background to this? What is the status of cost increases and price increases for energy and logistics costs other than steel compared to assumptions?

A4:

There was virtually no price decline, and much of the 3.5 billion yen has been passed on to prices. We were able to make up for 70-80% of the height of increased costs by Q4 last year, which reflects what we have gained. In addition, industrial machinery prices reflect the portion we negotiated during the period. As for steel costs, we have been able to transfer higher costs to our customers as we have worked out our approach to reflecting such cost increases in our prices to a certain extent. We are continuing to negotiate with our customers on transportation and electricity rates, which have never risen this high so suddenly before.

Q5:

You said that there was almost no impact of the selling price reduction in the Q1, but how much impact do you expect in the Q2?

A5:

We believe that selling prices down will be less than in a normal year.

Q6:

With the profit margin of the industrial machinery business exceeding 10% in Q1, what is the background to the improvement in the difficult external environment, and do you see further profit improvement?

A6:

Foreign exchange rates had a large impact on the industrial machinery business, with over 2 billion yen in profit also affected by exchange rates. In addition, we were able to increase sales to the aftermarket, where profit margins are high, and productivity in areas where we had deployed personnel ahead of time in preparation for future increases in volume last fiscal year has increased, enabling a recovery to double-digit profit margins. In E&E, we believe that there is room for volume growth and profit improvement.

Q7:

Are there any signs of a change in demand trends for semiconductor manufacturing equipment and machine tools, or will they remain strong for some time? What is the demand environment and outlook for precision machinery products and precision bearings? Also, what should we watch out for in the Q2 and beyond by industry and by region?

A7:

The increase in orders remained high but stayed flat compared to the steady increase in the past, and we will continue to operate with the assumption that there is a risk of a slight slowdown in the future. We expect that the current business conditions, especially in Europe and the U.S., will become clearer after the summer vacation in July and August. Many of our customers manufacture machine tools and semiconductor manufacturing equipment in Japan and export them to overseas markets, so if there is any change, it will affect sales in Japan ~~as a region~~.

Q8:

What is the aim of your new plant in Southeast Asia to manufacture bearings for small motors at a cost of about 20 billion yen, aiming at EV demand, and what is the status of bearings for small motors from April to June?

A8:

For bearings for small motors, we are considering the need for one plant to produce high value-added products by increasing production capacity, including demand for industrial machinery, in response to increasing demand amid the shift to electrification. On the other hand, demand is currently falling due to the impact of lockdowns in China and automobile production, and we will improve the profitability of industrial machinery by implementing various measures in conjunction with the return of demand.

Q9:

What is the scale of E&E sales in Q1 and how profitable is it?

A9:

E&E sales in Q1 was 25 billion yen, half of which is for automobiles, so we are in a difficult situation right now, and the results were a bit unsatisfactory. Profitability is in the single digits, which is pulling our profitability down since the overall industrial machinery business is now over 10% of the total, and as E&E volume recovers, we can expect sufficient earnings to go along with it, which will boost the profitability of the industrial machinery business as a whole.

Q10:

Are you in a situation where you have to take additional measures to improve profitability in the automotive business with bearings and steering technology?

A10:

As part of the steering business structural reform, we decided to see our decisions through to the end. One of the pillars of the steering business structural reform was the plan to transfer production to regions where we can make cost reductions but with the current depreciation of the yen, we may have to be a little flexible and make some adjustments in anticipation of further depreciation.

Rather than taking major measures for automobile bearings, we will operate on the assumption that the current growth in automobile production will continue. In Europe, we are aware that we must take measures with an eye to the future, as a cooling down of the overall European economy is becoming apparent, triggered by the problems in Russia and Ukraine.

Q11:

Please tell us about the progress on the earnings improvement effect of the steering (full-year forecast of 3 billion yen plus, Q1 results of 500 million yen plus over the previous year). Although the volume of goods itself is a headwind, are there any areas that need to be corrected from Q2 onward, and how will they be corrected?

A11:

The 2 billion yen is a decrease in amortization expense, so it will be effective. The production system change/transfer is planned for the second half of this fiscal year, and we believe it is necessary to re-examine the plan, taking into account the impact of yen depreciation.

Q12:

There are concerns that the economic situation in Europe will become more difficult due to the Russian gas supply problem and rising energy costs. Are there any concerns that this will delay the negotiations for the joint venture for the steering business?

A12:

The European market itself is cooling down more than we are feeling in Tokyo, but it could be that negotiations will take longer or proceed more quickly, and we can't say either way.

Q13:

There are concerns about the macroeconomic environment in Europe. How is the recent BKV situation?

A13:

The main focus of BKV is for wind power generation, but looking at Q1, the momentum is a little slower than last year due to some projects being shifted back. However, we believe that the projects that have been shifted back will come back to normal over time.

Q14:

Regarding inventory reduction, what inventory level do you think is appropriate for next March from the more than 200 billion at the end of June? Also, what is the projected cash flow at the end of March?

A14:

We expect inventories to be at or below the level at the end of March at the very least. Q1 inventory is higher than expected in the automobile business, and we need to closely monitor the automobile production volume. Sales in the industrial machinery business are increasing, and we do not see any problem in terms of inventory efficiency even if inventories increase slightly. As for cash flow, we expect that profits and depreciation will probably amount to about 100 billion yen per year, and since investment is 70 billion yen, we believe that dividends and other payments can be covered within the scope of free cash flow.

Q15:

How much of an impact did the elimination of unrealized profits, etc. have on operating income because of the significant change in inventory volumes and exchange rates compared to three months ago?

A15:

The elimination of unrealized profits resulted in almost no overall impact compared to the same period last year due to inventory and foreign exchange effects, as well as profit trends.