Management's Discussion and Analysis of Financial Position, Results of Operations and Cash Flows

1 Overview of the Year Ended March 31, 2018

Business performance in each business segment remained strong amid the gradual recovering trend of the world economy, enabling the NSK Group to set new record-highs for both sales and operating income.

Looking at global economic conditions during the year ended March 31, 2018, the Japanese economy underwent a gradual recovery, mainly driven by a pick-up in consumption and steady improvement in employment. The U.S. economy continued to see solid growth due to stronger employment and capital expenditures. The European economy trended toward recovery, primarily in the Eurozone, on the back of growth in consumption and a moderate increase in capital expenditures. Meanwhile, the Chinese economy enjoyed steady growth, boosted by a range of government policies, while other Asian economies exhibited a gradual recovery.

In this economic environment, consolidated net sales for the year ended March 31, 2018 totaled ¥1,020,338 million, a year-on-year increase of 7.5%, and operating income totaled ¥97,875 million, a year-on-year increase of 49.8%. Income before income taxes was ¥97,248 million, a year-on-year increase of 52.9%. Net income attributable to owners of the parent was ¥69,312 million, a year-on-year increase of 52.1%.

2 Business Segment Information

Details regarding the market environment and results by business segment are as follows.

Industrial Machinery Business segment

The Industrial Machinery Business has continued to recover. Looking at the NSK Group's results by geographic breakdown, sales in Japan increased, primarily in the machine tool and electrical sectors. In the Americas, sales in the semiconductor and general machinery sectors rose. In Europe, sales increased, primarily in the machine tool and aftermarket sectors. Sales in China also grew steadily due to strength in the electrical, and aftermarket sectors. In other Asian countries, sales increased due to a continuing recovery in demand, primarily in the semiconductor sector.

As a result, net sales in the industrial machinery business totaled ¥266,249 million, a year-on-year increase of 17.3%. Operating income was ¥28,333 million, a year-on-year increase of 93.3%.

In the Industrial Machinery Business, sales to such sectors as machine tools, semiconductors, and electrical equipment were strong, and both sales and operating income could be significantly increased against a backdrop of expansion in production volume associated with robust demand. In addition to strengthening our productivity by investing in capacity increase, we are improving our portfolio by concentrating on high-value-added products and high-profit sectors while improving profitability. Going forward, to expand the Industrial Machinery Business's presence in the market over the medium to long term, we will continue to focus on growth areas and work to expand profit-generating business.

Automotive Business segment

The global automotive business continued its gradual expansion. Looking at the Company's results by geographic breakdown, sales in Japan increased, primarily in products for transmission systems. In the Americas, sales declined due to slowdown in the U.S. automotive market. In Europe, sales increased due to solid vehicle sales. In China, the increase in sales was slight, partially due to a change in product mix. Meanwhile, sales in other Asian countries rose, primarily in India.

As a result, net sales in the automotive business totaled ¥723,564 million, a year-on-year increase of 3.9%. Operating income totaled ¥65,963 million, a year-on-year increase of 2.1%.

In the Automotive Business, the gradual expansion of global automobile production volumes continued, and we achieved record-high sales as the Japanese powertrain business in particular performed well. Although there were cost hike factors, such as increases in the prices of raw materials, we were able to maintain operating income in the 9% range due to improvements in productivity and other cost reductions. Going forward, we will aim for continued growth from the powertrain business and to contribute to new automotive technologies, such as EVs and autonomous driving, by means of the elemental technologies accumulated up to now and new technological initiatives.

3 Analysis of Financial Position

Total assets were ¥1,092,310 million, an increase of ¥48,355 million compared to total assets on March 31, 2017. The main reasons for this were increases of ¥16,245 million in trade receivables and other receivables, ¥11,242 million in inventories, ¥22,691 million in property, plant and equipment, and ¥9,202 million in net defined benefit assets, which offset a decrease of ¥10,330 million in other financial assets (current).

Total liabilities were ¥531,296 million, a decrease of ¥27,647 million compared to total liabilities as of March 31, 2017. The main reasons for this were decreases of ¥8,415 million in trade payables and other payables, ¥2,072 million in other financial liabilities (current), ¥14,230 million in financial liabilities (non-current), ¥5,817 million in net defined benefit liabilities, and ¥3,210 million in provisions (non-current), which offset an increase of ¥5,823 million in deferred tax liabilities.

Total equity totaled ¥561,014 million, an increase of ¥76,003 million compared to total equity as of March 31, 2017. The main reasons for this were increases of ¥69,312 million in net income attributable to owners of the parent, and ¥20,649 million in other components of equity.

Total current assets increased ¥5,061 million compared with the previous fiscal year-end, to ¥511,346 million. Total current liabilities decreased ¥10,642 million compared with the previous fiscal year-end to ¥307,960 million. As a result, the current ratio increased from 1.59 times as of the previous fiscal year-end to 1.66 times. Gross interest-bearing debt decreased ¥16,491 million compared with the end of the previous fiscal year-end to ¥250,908 million. Net interest-bearing debt (interest-bearing debt net of cash and cash equivalents) was down ¥8,202 million compared with the previous fiscal year-end to ¥119,624 million. The net D/E ratio decreased from 0.28 in the previous fiscal year to 0.22. Equity per share attributable to owners of the parent increased from ¥873.11 to ¥1,016.30. The equity ratio attributable to owners of the parent increased from 44.2% as of the previous fiscal year-end to 49.2%.

4 Cash Flows

Total cash and cash equivalents at the end of the period were ¥131,283 million, a year-on-year decrease of ¥8,289 million. Cash flows for the fiscal year under review are presented as follows.

Net cash flow provided by operating activities

Net cash flow provided by operating activities totaled ¥83,746 million, an increase of ¥15,810 million, compared to the same period of the previous year. The main cash inflows were ¥97,248 million in income before income taxes, and ¥46,785 million in depreciation and amortisation. Meanwhile, the main cash outflows were a ¥12,464 million increase in trade receivables, a ¥10,382 million increase in inventories, a ¥11,116 million decrease in trade payables, and ¥18,835 million in income tax paid.

Net cash flow used in investing activities

Net cash flow used in investing activities totaled ¥53,001 million, a decrease of ¥1,241 million compared to the same period of the previous year. The main cash outflow was ¥61,397 million in purchases of property, plant and equipment. Meanwhile, the main cash inflow was ¥16,941 million in proceeds from sale and redemption of other financial assets.

Net cash flow used in financing activities

Net cash flow used in financing activities totaled ¥39,804 million, a decrease of ¥8,609 million compared to the same period of the previous year. The main outflows were ¥48,687 million in repayments of long-term loans and ¥17,438 million in dividends paid. Meanwhile, the main cash inflows were ¥12,000 million in proceeds from long-term loans and ¥20,000 million in proceeds from issuance of corporate bonds.

5 Fiscal Policy

The NSK Group's financing is currently derived from its own funds and borrowings, etc. With regard to working capital, in the case of financing through borrowing, it is common to obtain short-term loans with a term of less than one year in the local currency used by each consolidated company. As of March 31, 2018, the outstanding balance of short-term loans was ¥62,039 million. Long-term funds, such as those for machinery and equipment for production, are financed primarily through long-term loans and corporate bonds. As of March 31, 2018, the outstanding balance of long-term loans and corporate bonds was ¥188,868 million, the breakdown of which was loans from financial institutions of ¥108,868 million and unsecured corporate bonds of ¥80,000 million.

Going forward, we aim to reduce our interest-bearing debt by strengthening our financial and earnings structure. The NSK Group believes that it is possible to finance the working capital and capital expenditures necessary to maintain growth through its sound financial situation, ability to generate cash flow from operating activities, commitment line contracts totaling ¥15,000 million and the issuance of commercial paper amounting to ¥50,000 million.