August 3, 2023

NSK Ltd. Q&A Summary – Fiscal 2023 Q1 Financial Conference (Year Ending March 31, 2024)

◆Industrial Machinery Business

Q1

The performance of the industrial machinery business has been declining. What is the status of the E&E, industrial machinery bearings, and precision machinery businesses, respectively? Are there any signs of recovery and what is the current level of the BB ratio?

A1

E&E is in a difficult situation as volume has been declining since the second half of FY22. In general industrial machinery, the situation varies by industry, with growth focused in infrastructure-related sectors, especially wind power generation and railroads, and we expect this to continue. In the Precision Machinery business, the ratio of machine tool and semiconductor manufacturing equipment applications is high, and the present situation is rather tough. The BB ratio of the industrial machinery business has not reached 1, but we do not expect it to fall further.

Q2

What are you counting on in the second half of FY23 and beyond for the Precision Equipment business? We would also like to ask how the profit margin at the order level as of Q1 FY23 compares with the same level of orders in the past, and whether the bottom has been reached in this economic cycle.

A2

Although capital investment is weak right now due to the stagnant Chinese economy, we believe it is true that semiconductor-related capital investment will continue to advance worldwide. It is also important to prepare for an increase in EV-related capex. When demand fell sharply in the past, we overly tightened our belt, but this made it difficult to return to form when demand recovered. At this point, our margins may appear weak, partly because we have only tightened our operating structure to a level
ready for a potential recovery in the second half of the year.

◆**Automotive business**

Q3

Please tell us about the situation in China and the status of your automatic transmission (AT) products. And also, what do you think is the next step for AT products?

A3

Demand in China is increasing due to the rebound after the end of the lockdowns in the previous fiscal year, but is not growing as fast as expected. In addition, AT product production is not increasing as much as the increase in automotive production at this point, but we expect a return in the second quarter and beyond. We do not expect any major changes in the AT product market through 2026, and beyond that, we believe the challenge is to respond appropriately to further progress in the shift to EVs.

Q4

Regarding the profit margin of the automotive business, the FY23 full-year target and the profit margin for the first quarter appear low when compared to past results and the targets of the current mid-term management plan. What are the reasons for this and how do you intend to improve it?

A4

In the past, as global automobile production volume increased toward 100 million units, the profit margin of our automotive business was close to double digits. Currently, overall volume is falling, but we are aiming for a profit margin in the low single digits, including increasing profitability with products for EVs in the future, and we will increase our profit margin with a different portfolio of products and production compared to the past. In addition, we have not been able to pass on all of the cost increases due to inflation to date to sales prices, so we will continue to steadily negotiate toward this.

Q5

What kind of reaction have you received from customers regarding the JV in the steering business? Have there been any changes in business dealings or relationships with customers in the bearing business, or have there been any reactions or developments from other companies in the same or different fields?

A5

There has been no change in the relationship as we have carefully explained the situation to our customers and they have understood. In addition, there has been no specific reactions from other companies at this time.

◆Overall situation (inflation/transferring increasing costs to sales prices, etc.)

Q6

How did sales and operating income in the first quarter of FY23 compare to the plan at the beginning of the period? Has there been any weakening in demand or the business environment?

A6

Progress in terms of operating income or profits against the original plan is in line with expectations. As for the details, sales in the industrial machinery business decreased, sales in the automobile business increased, and inflation costs did not increase as much as expected. In addition, we were able to slightly accelerate the shift of transferring increasing costs to sales prices, and the effect of foreign exchange rates, including the impact of the yen's depreciation, were within the expected range as a result.

Q7

With inflationary pressure weakening in some areas and the volume of industrial machinery falling, will you be able to effectively transfer increased costs to sales prices as planned for the second half of the year? I would like to know the progress of the 24.5 billion yen transfer of costs to sales prices plan noted on page 8 of the financial results presentation.

A7

This fiscal year, we are negotiating with our customers to gain their understanding that they must also bear a certain amount of the labor cost increases, excluding the portion to be covered by our own cost reduction efforts. Although cost increases have subsided in some areas, we believe that we have communicated to our customers the reality that the cost level is high from a historical perspective. Although it will be a tough negotiation, we believe that we must achieve this with the understanding of our customers, based on the premise that we will move toward a society with sustainable wage growth and sustainable growth.

◆**Financial**

Q8

Has the company decided how it will use the 20 billion yen in cash that will come in as a result of the JV in the steering business? Also, how is the gain from the sale being handled in the revised earnings forecast?

A8

Although we cannot specify a single use for the 20 billion yen, we are considering M&A and share buy-backs while checking the situation, focusing on what we have considered as measures for "growth with profitability" in our mid-term management plan. With regard to gains on sales, we assume that there will be an impact on our business performance, but we are not at a stage where we can discuss specifics, as we are currently examining the situation closely.

Q9

Why will the conversion of the steering business into a JV reduce sales by 182.0 billion yen, but only 95.7 billion yen in assets? What is the impact on ROE?

A9

Assets held for sale on the balance sheet in the first quarter of FY23 represent the figures after consolidation and elimination of inter-group transactions, and do not represent all assets of the steering business. Therefore, 95.7 billion yen is not the actual total assets of the steering business, which is estimated to be more than 100 billion yen. We believe that ROE excluding the steering business will improve.

Q10

I think the situation has changed significantly since the mid-term business plan announced in May 2022, and I wonder if the goals for FY2026 will change now that the steering business has become an equity method affiliate. Do you plan to announce a new plan in the future?

A10

We believe it is necessary to present our mid-term management plan again at an appropriate time in the future, as there will be a significant change in the figures even just looking at a single fiscal year as the steering business becomes an equity-method affiliate.

◆Other

Q11

Deteriorating demand for capital investment and the rise of EVs in China have been factors in the deteriorating performance of Japanese companies. What is the status of NSK's industrial machinery and automotive businesses in China? What percentage of the automotive business in China is accounted for by local Chinese automakers?

A11

Both capital investment and automotive business in China are in a difficult situation; although the EV market has lost a little momentum, we will continue to grow our business for EV vehicles. Currently, the percentage of sales to local automakers in our automotive business in China is about 20~30%.

Q12

What percentage of total operating income is accounted for by China, and will China continue to be the most important market for NSK in the future? Also, how will NSK respond to a future shift in manufacturing to the United States?

A12

China accounts for about 40% of our total profits. The Chinese market is important to us, and we will continue to respond to Chinese demand through local production for local consumption, but we have decided to strengthen R&D in order to further respond to Chinese customer's need for speed moving forward. As for shifting manufacturing to the U.S., for example, many products in the market are exported from Japan, but we are now considering local production. In addition, since U.S. production will increase due to the shift to EVs, we will respond to this trend including by utilizing our production base in Mexico.