

EBARA CORPORATION Third Quarter of FY2022 Earnings Conference Q&A

Q&A during earnings conference held November 14, 2022

Participant 1: First, operating profit for Q3 (Jul-Sep) was JPY15.5 billion. Can you tell us how this compares to the internal plan?

Hosoda: This also overlaps with the explanation of the Q1 to Q3 cumulative period, but the portion of the full-year forecast revision is consistent with the portion that deviates from the internal full-year forecast.

In Q3, we received more orders than expected for the PM and FMS businesses. Taking this into account, we have revised our full-year forecast upward, including the forecast for Q4. Revenue in the PM business were a little weak, but this was in line with our plan.

As for operating profit, there is a difference by segment, but operating profit was low in the EP business due to unexpected additional costs.

Operating profit in the PM business was slightly lower than expected. On the other hand, we have revised our plan for the FMS business, especially the compressors and turbines business, because operating profit has increased more than expected and is likely to increase in Q4 as well. We believe that the revised forecast is roughly in line with the deviation from the internal plan.

Participant 1: The full-year forecasts were revised upward by JPY500 million for the pump business and by JPY2 billion for the compressors and turbines business. Can you give us some more details on this?

Regarding the EP business, as of Q2, the explanation was that insurance would cover any additional costs. The downward revision was JPY1.5 billion this time. You mentioned earlier that there were three factors. Could you give us a breakdown of the JPY1.5 billion downward revision to the full-year forecast?

Also, is the JPY1 billion revision in the PM business due to postponement? Can you give us a little more detail on the full-year forecast for each segment?

Hosoda: First of all, you are right about the PM business. The main reason for the revenue delay is the difficulty in procuring parts. Some of planned revenue will be shifted to the next fiscal year.

In terms of production capacity, the fourth CMP line has been in operation since the summer, and in the component business, the full-scale operation of the automated plant is progressing smoothly. Therefore, production capacity is not a bottleneck at all, but we are still having difficulty procuring parts, which is the main reason for the delay.

As for the EP business, I explained the three reasons earlier. Again, this fiscal year was originally a low profit margin year due to the difference in the timing of revenue due to the ratio of EPC to O&M. Three factors specific to this quarter were added to that, some of which were unexpected, and we have a situation like this.

Additional cost factors resulting from equipment trouble in domestic EPC projects account for about one-third of the downward revision.

We have thoroughly analyzed the factors, and since the project was completed this quarter, there is no need to worry about incurring further additional costs for the same project. We are also in the process of taking action after a thorough analysis of the factors to avoid a similar situation in another case in the future.

The remaining portion is due to additional costs incurred by a Chinese subsidiary in outsourced equipment manufacturing and the postponement of revenue of highly profitable projects that were scheduled to be sold this fiscal year to the next fiscal year. Both of these combined have resulted in a loss of several hundred million yen in profit at the Chinese subsidiary.

The third is the electricity distribution business. We purchase the full amount of electricity generated at waste treatment facilities and sell it to municipalities and private companies as a new electricity seller business. Procurement costs for electricity revenue have been higher than expected due to recent inflationary trends. The effect of this has been to reduce profits by several hundred million yen, a factor that was not anticipated. These are the EP business.

The operating profit forecast for the FMS business was revised upward by JPY3 billion. Mainly, compressor turbines performed very well with favorable performance of service and support. Of the JPY3 billion, compressor turbines account for about JPY2 billion and pumps for JPY500 million. In the compressors and turbines business, as I mentioned several times, service and support has been very strong, and the upward revision to the profit forecast is partly the result of that. In the pump business, standard pumps overseas were particularly strong, resulting in a JPY0.5 billion increase.

Participant 2: First, please tell us about the profit margin for Q4 (Oct-Dec) of precision machinery. The plan is for the profit margin to decrease in comparison to Q3 (Jul-Sep). Am I to understand that this is primarily due to the exchange rate? Are there any factors that would worsen profitability, such as mixes, costs, fixed costs? Could you briefly tell us how you see the profitability of the remaining three months?

Hosoda: We have not changed the assumed exchange rate, so this is not the primary factor. Of course, if the exchange rate is in the direction of a weaker yen than the assumed rate, the profit margin will increase. As for the other points, the projects we have listed were originally planned to be recorded in H2, so it is due to their impact on the mix.

Participant 2: One more point, please tell us about the current plan for capital investment. As noted in the page 21, you are changing your investment plans. I think you have probably lowered your investment plan for the PM business significantly compared to the previous plan, and you have also lowered it slightly for the FMS business. Can you tell me if this is due to changes in the business environment or just a delay?

Hosoda: First, the large reduction in capital expenditures in the PM business is due to the delay of the new development building project planned in Fujisawa, which has been pushed back to the next fiscal year.

Capital expenditures in the FMS business will be slightly reduced. However, if you look at the cash flow on the page 20, cash flow from investing activities was revised from JPY48 billion to JPY46 billion, not much of a decrease. We have now completed the acquisition of Hayward Gordon through M&A. Part of the investment, which was originally planned as a capital investment, was realized through M&A. So, investment cash flow, including M&A, has not changed much, and capital expenditures are down a bit.

Participant 2: You have just given us three backgrounds on the EP business and how it compares to the Company's plan. Is it correct to understand that the domestic costs and the shift of the period to the next fiscal year are transitory? Should we assume that the profit margin of the EP business will improve in the next fiscal year if the measures taken in the power sale business are successful?

Hosoda: We believe that the three factors specific to this fiscal year that I mentioned earlier, which are responsible for the downward revision of the EP business, are transitory. We are taking steps to ensure that this will not recur in the next fiscal year.

However, as I mentioned at the beginning, this is a time when EPC projects, which are relatively unprofitable compared to O&M business, sell more than O&M projects. Taking this into account, we believe that the profit margin will be on par with the initial plan for this fiscal year until about next year or the year after. We are thinking in the long term that it will be around 2025, the final year of the next mid-term plan, before we return to the good profitability of the previous years. Therefore, for the next fiscal year, we currently expect conditions to be on par with our initial plan for the current fiscal year.

Participant 3: I would like to ask three questions. The first is about the investment utilization rate of customers for the PM business. Am I correct in understanding that, on a macro level, some customers are weakening, but all of your customers continue to operate at a high level?

Hosoda: Rather than the utilization rate of our customers, the implication is that orders to us are not losing momentum at the present time.

Participant 3: Is that the image which you have received orders for, customers are operating well enough?

Hosoda: Yes.

Participant 3: Is it correct to understand that not all of your company's customers continue to have high occupancy, and some of them appear to be weakening?

Hosoda: Yes. Our main customers are semiconductor manufacturers, so some of them are reviewing their capital investment plans.

Participant 3: The second point is about responding to changes in the business environment on page 12. I'd like to receive a confirmation. Are higher labor costs not yet the risk? Or is the increase in labor costs not a very big risk for your company?

Hosoda: By labor costs, do you mean not our internal labor costs, but labor costs for subcontracting in construction?

Participant 3: Especially about outsourcing.

Hosoda: We have already factored in the increase in personnel costs for our employees.

Labor costs related to outsourcing are, of course, included in the higher raw material prices. Indeed, I understand that the increase in the cost of electrical work, particularly in the EP business, is due to the rising cost of labor as well as materials. The assumption of raw material price hikes includes that area as well.

Participant 3: Finally, I would like to discuss the progress of the overseas strategy for standard pumps on page 13. I know that these bases won't go immediately into operation because you just acquired them, but in about five years, how do you think the global revenue composition of your standard pumps business will look like? What would be the rough balance if divided among Japan, Asia, the US, and Europe?

Hosoda: Osaki will answer.

Osaki: Our forecast is that our standard pumps business will continue to be mainly in Europe and North America. It is conceivable that our presence will increase in such areas. However, we would like to take a closer look at the situation from now on for specific figures.

Participant 4: I would like to ask you two questions. First, you mentioned earlier that your company's orders in the PM business are not particularly affected by customer trends. Comparing the actual orders received in Q3 (Jul-Sep) with the order plan for Q4 (Oct-Dec), I think the plan is for orders to increase in Q4. What is the background behind the increase in orders against Q3?

Hosoda: Since the PM business is one in which customers can be identified individually, the plan is made by accumulating orders that could be received in Q4 by judging the status of orders from individual customers.

Some project orders were originally scheduled to be received in Q4 and will be postponed to the next year, and the details vary.

The general trend is a slight increase in orders from China. Other than that, we hope you understand that the plan is the result of accumulation of individual orders.

Participant 4: You have again revised upward your full-year order plan for the PM business. What is making the plan stronger while projects in China are being pushed back?

For example, is there some background such as a higher-than-expected volume of projects for factories to be launched in the US from about 2024 or so?

Hosoda: No, I cannot give you a specific customer, but the Chinese projects are not delayed.

Participant 4: So, you are saying that the projects outside of China were strong.

You have revised your full-year order plan upward, and if there is no periodic lag in orders from China and they are the same as you assumed three months ago, I was wondering if orders are getting stronger in some areas. I know that orders are strong in other areas and the weak yen is of course a factor, but if there are any other factors, please explain.

Hosoda: I mistakenly thought that the term shift you mean was from the current term to the next term. There is a slight lag in China from Q3 to Q4. There is a time lag, but regardless of whether there is a time lag or not, there is no doubt that orders from China are at a high level.

Other than that, I hope you can understand that, as a macro perspective, orders from China are increasing, rather than an increase in orders from one specific customer.

Participant 4: Second, under the circumstances where the FMS business is experiencing the effects of high costs, is the price pass-through progressing as your company had assumed three months ago? Or is the cost increasing a bit? Could you please provide some more additional information?

Hosoda: Progress is being made to some extent. Both overseas and in Japan, especially for pumps, we are raising prices. In Japan, we raised prices about twice in January and August, and several times overseas as well, and the impact is gradually being felt from H1 to H2.

As I mentioned earlier, we expect a negative impact of about JPY6 billion, but we have achieved an effect of about JPY2.5 billion through price increases and other measures. To some extent, we are beginning to see effects that minimize negative factors.

Participant 5: The new plan for orders at the end of this fiscal year in the PM business is JPY225.7 billion. The revenue forecast for the current fiscal year is JPY226 billion, partly due to the periodic shift, and this is about the same as a year's worth of orders backlog. Even if orders slow down next year due to the sluggish semiconductor market, can we expect revenue to grow more than this fiscal year? Of course, I think it depends on the extent of the slowdown in orders. If the market slumps, will the entire backlog of orders not be sold in the next fiscal year, and will it be extended to the fiscal year after next or later? Or is there a risk of cancellation, so you can't say for sure that revenue will increase next fiscal year?

Hosoda: We are now scrutinizing the next fiscal year. Basically, the order backlog is what customers want to be delivered as soon as possible, but the parts are not readily available, and we are under pressure to receive the order and make revenue as soon as possible.

Therefore, we believe that most of the backlog of orders will contribute to revenue in the next fiscal year. We do not think that the revenue base for the next fiscal year will be any lower than the current year.

Participant 6: Sorry for the very detailed question, but is it correct to understand that the cost increase in the power generation business is transitory? I think procurement prices are continuing to rise. If it is going down, it may be transient. I am not familiar with the characteristics of your business, so could you please reiterate them for me?

Hosoda: The cost increase is not transitory. However, in the electricity sale business, we are taking measures to prevent a similar situation from occurring in the next fiscal year and beyond by making contracts that allow us to hedge against cost increases by passing on them to customers.

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