September 5, 2023

FY 2023 1Q Results Briefing: Gist of Questions and Answers Session

Questioner [Q]: What is the reason for the significant growth of maintenance services for BP in the first quarter? Is it likely to continue into the second quarter and onwards? What is the reason for the decline in operating income even though maintenance services increased in the first quarter?

Fujii [A]: Regarding BP, sales of maintenance services have continued to grow smoothly for the past two years. This is on account of the steady expansion of our BP plant market share for each fiscal year.

In Japan, the market share of Nikko-made plants is about 30%, which is the smallest among the three companies. Compared to this, our sales share for a single fiscal year has constantly exceeded 40% for the past several years.

The situation is that we are replacing plants made by other companies with Nikko-made ones because we have been constantly above the two competitors.

Maintenance services are a recurring revenue business and since more and more plants are replaced with Nikko-made ones, demand for maintenance services is growing. There seems to be no issue regarding continuity into the second quarter and onwards, and we expect sales of BP maintenance services to continue to increase year on year.

Operating income declined despite the increase in maintenance services because the profitability of products was poor compared with last year. Profitability was worse than last year when sales for the three months this year are compared to those for the same period a year earlier.

Questioner [Q]: What is the reason for the shifting of 2,000 million yen in first-half AP sales into the second half? Is it in Japan or overseas?

Fujii [A]: Overseas, I think there were almost 1,000 million yen in sales that were postponed in China. The rest is in Japan. Regarding China, the timing of orders got slightly delayed and the sales were pushed to the second half.

Questioner [Q]: Have you been making progress in the rollout of the price increases of products? Could you give us quantitative explanation as to its impact on the first quarter business results and that on full year?

Fujii [A]: It is difficult to answer the question regarding the progress of implementing price increases for products because we are not selling the exact same products, whether it is AP or BP.

Price hikes of raw materials, especially steel, had serious negative impacts on our earnings in the previous fiscal year and the fiscal year before that.

We sign contracts for product prices with customers based on the raw material prices as of the signing of the contract, but there are cases where it takes one or two years or even longer from the purchase of materials and manufacture of the product to its sales. We cannot pass through costs to customers while raw material costs are climbing, so it had a significantly negative impact on profit.

Starting April last year, we have been signing contracts with customers after major price revisions for all the various materials and parts as of that point.

Since April of the current fiscal year, raw material prices, especially steel prices, have more or less peaked and have not risen. Rather, they are showing signs of a declining trend, so I think our price revisions have addressed those changes.

As a rule, we have been strictly managing gross profit ratio and have been requesting customers to shoulder price increases. We had a hard time getting customers to accept price increases of products, but more recently customers have gradually started accepting them.

It is difficult for us to explain it quantitatively at this point, so I would like to refrain from answering that part.

Questioner [Q]: What is the level of contributions by Matsuda Kiko on business results for the current fiscal year? Is my understanding correct that it was not included in the initial plan? What is the reason for Matsuda Kiko's margin being higher than that of Ube Kohki?

Fujii [A]: Matsuda Kiko's contribution to the business results of the current fiscal year will be for the half year, or six months, and this was not included in the initial plan. The figures for Matsuda Kiko's contribution are not included in the current full-year forecast, either.

The figures for Matsuda Kiko are 250 to 300 million yen in sales as it is for six months for the current fiscal year. It might be slightly difficult for it to achieve a profit margin similar to the past three years in the current fiscal year. Having said that, we expect it to contribute more than 50 million yen for six months.

As for the reason behind the very high margin of Matsuda Kiko compared to Ube Kohki, we believe it is because of Matsuda Kiko's high technological prowess and flexible handling of delivery time. It is receiving orders without having price competition with other companies, and that is leading to the high margin rate.

Questioner [Q]: Other SG&A expenses in analysis of factors contributing to changes in ordinary income had a positive impact in the first quarter but it says minus 500 million yen for the full year. Do you plan to have this much expenses?

Fujii [A]: The expression was not very good, which might have generated a misunderstanding. There was a very high positive impact on other SG&A expenses in the first quarter from an increase in dividends income while there also were increases in other components of SG&A expenses. It is not that other SG&A expenses declined in the first quarter compared with last year.

To be honest, the 500 million yen increase in SG&A expenses for the full year may be slightly on the higher side, but increases in expenses cannot be helped because we are actively hiring.

Questioner [Q]: Are there no changes to the budget plan for capital investment from what was detailed in the Medium-Term Management Plan?

Fujii [A]: We plan to implement the medium-term plan of 6,000 million yen and the plan formulated at the beginning of the term, as this three-year period is for making active investment. So, we will be proceeding as planned and there are no changes.

Questioner [Q]: It says that there are many business negotiations related to the World Expo in Osaka and IR-related projects in the environment- and conveyor-related business. What kind of margin are you expecting from them?

Fujii [A]: Regarding the related sales for the current fiscal year, sales of orders we received in the first quarter, which were explained earlier, will be definitely recorded in the current fiscal year.

They are slightly below 200 million yen for two projects for the disposal of removed soil.

I would like to refrain from discussing the margin as it is a business-related matter.

Questioner [Q]: It appears that the environment surrounding AP in Thailand is more severe than expected. Is the timing of it turning profitable expected to be delayed?

Fujii [A]: The biggest factor causing the delay in the starting up of AP in Thailand is that we could not provide any support from Japan, as the factory was launched right in middle of the COVID-19 period. We think we probably lost one and a half to two years compared with the initial plan.

We consider fiscal 2025 as a possible timing to turn it profitable. We want to improve the production ratio of Thailand, procure at low prices and manufacture at low costs, complete design of new models with local specs within the current fiscal year and primarily start selling new types of plants from the next year. This would further lower manufacturing costs and improve profitability.

Questioner [Q]: What is your view on improving PBR? You have high PER and net assets do not increase, so my recognition is that you can easily achieve a PBR of 1 through a rise in ROE as far as net profit increases. If you have an ROE of 5%, your PBR will reach 1. In what time frame do you think you can achieve this?

Fujii [A]: You are right and we also think that there is no need at all to lower the denominator, that is equity or net assets, for improving our PBR. Payout ratio is 60% and net assets would not increase significantly in the future. So, it all boils down to how soon we can increase the numerator.

Currently, we are actively making investments towards the goal of generating profits in the future even if our equity ratio of sixty-plus percent slightly declines.

To this end, we can still sufficiently accumulate a lot more assets, although we would like to think of an equity ratio of 50% as the bottom limit going forward. If these assets properly generate profits, as you have mentioned, we can easily achieve 5% in ROE if we have 50,000 million yen in sales, for example.

It is easily possible if we are at a level where we have sales of 50,000 million yen, operating margin of 6%, operating income of 3,000 million yen, and after-tax profit of 1,700 to 1,800 million yen.

This time frame also involves making the Thailand business profitable as I mentioned earlier, and one benchmark is the fiscal year ending March 2026, so we would like to consider the fiscal year in two years as a target.

Fujii [M]: We appreciate that many really good, tough questions were asked today. Thank you very much.

The management team, including myself, will work as one to respond to your expectations especially in the second half, as we strongly believe in achieving what we planned in order to meet your expectations. We look forward to your continued support.

Thank you very much for attending the meeting today.

Note: This summary of the question and answer session was created in part to provide information to those who did not attend the results briefing. Please note that parts of the text have been edited to improve clarity and enhance understanding.

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