

FY2024 Third Quarter Earnings Conference held November 14, 2024

Summary of Q&A

Respondents:

Shugo Hosoda (Hosoda) Executive Officer, CFO

Questioner 1: I would like to ask three questions. First, I would like to know your assessment of the current results and your approach to the changes in the full-year forecast. On page 18, you have made changes to the various segments. Have these adjustments been made based on the actual performance observed so far, or have you revised your projections?

Hosoda: The revision for the full year is based on both our outlook and the actual results of Q3. In cases of upward revisions, these adjustments reflect the smooth progress in Q3 and the expectation that the final results will be higher.

Questioner 1: I would like to follow up on one point. On page 19, for the Energy Segment, you mentioned that you are factoring in gains on the sale of pension assets. I would like to know the size and whether the gains were recorded in Q3 or are expected in Q4.

Hosoda: They would come out in Q4. Please consider that a little less than half of the positive JPY4 billion upward revision in the Energy Segment is due to the gains from this sale.

Questioner 1: Second, I would like to ask you about the trend of orders in the Precision Machinery Segment, especially for CMPs. When we look at Q3 on a QoQ basis on page 15, there was a relatively large increase from JPY28.3 billion Q2 to JPY40.3 billion, and the forecast for Q4 is JPY71.8 billion, which is quite strong. What factors are driving the increase in demand and orders, and what kind of projects are you expecting in Q4?

Hosoda: In terms of CMP, while there is a slight lull in the Chinese market as a whole, we are seeing an increase in the area of generative AI for global customers.

We also expect to receive orders for service and support, which are expected to increase as the utilization rate of the factories of our customers who have already purchased CMP systems increases. It is difficult to say what the future prospects are for orders in this market, but based on the current momentum, we are thinking that the figure could go as far as this level.

Questioner 1: You haven't changed your original plan for orders for the full year, since Q2, but when you look at it from the perspective of inquiries, is the certainty of order volume higher than before?

Hosoda: That is correct. Regarding the certainty, it is difficult to say definitively as this industry often experiences sudden changes based on customer needs. However, given the current situation, we believe it is reasonable to expect this level of performance.

Questioner 1: When we look at the next fiscal year, is it likely that the momentum of Q4 will continue, or is it unlikely that this will continue? Can you give some additional information on orders progress for the next fiscal year?

Hosoda: We view the high order numbers for this 4Q as temporary. While we expect an overall upward trend and a high level of performance next fiscal year, we do not anticipate the momentum from Q3 and Q4 to continue at the same pace. Please consider the high numbers in 4Q as a temporary spike.

Questioner 1: Finally, my third question, I would like to ask what kind of positive or negative impact the Trump administration in the US would have on your business.

I think the Energy Segment, maybe, could receive a tailwind due to oil and gas investments, but won't the Precision Machinery Segment be affected negatively? What are your thoughts on this matter, including exports to China?

Hosoda: First of all, we do not expect immediate significant impacts from the change in the U.S. presidency. The effects of the US-China semiconductor friction are also not expected to change suddenly.

Regarding the energy segment, we have a base in the U.S. called Elliott, which could benefit from some tailwinds in our activities there. On the other hand, we are engaged in various initiatives toward future carbon neutrality. The Trump administration's policy stance on carbon neutrality has both positives and negatives, but overall, we do not foresee any immediate impact.

Questioner 2: My first question is about the operating profit ratio of the Precision Machinery Segment. The operating profit ratio for Q3 has been high, maintaining around 20% since Q2. Previously, it was mentioned that the high operating profit ratio was temporary and not sustainable. With the increase in the S&S ratio and CMP volumes, it seems the profit ratio has improved. How do you view this now?

Hosoda: We aim to maintain an operating profit ratio of about 20% in the Precision Machinery Segment, but we expect the full-year margin to be between 17% and 18%. While Q3's operating profit ratio is indeed good, fixed costs vary by quarter. For example, in Q4, R&D-related fixed costs are slightly higher. Therefore, we expect the full-year operating profit ratio to settle around 17%.

Questioner 2: Second, I would like to check the data against the previous plan to confirm the details of the one-time costs. On page 19, there is a goodwill impairment of minus JPY6.4 billion and a gain on the sale of pension assets in the Energy Segment of just under JPY2 billion mentioned earlier in the Q&A. Is the 'Others' minus JPY2.5 billion not considered a one-time expense?

Hosoda: 'Others' includes costs related to the relocation of factories within the Fujisawa District. While these could be considered one-time expenses, they may also occur slightly from this fiscal year into the next. These are the main components of the JPY2.6 billion.

Questioner 2: Third, could you tell us about the order volume for components in the Precision Machinery Segment? Looking at page 15 of the earnings presentation, it was mentioned three months ago that the order volume for S&S was increasing as customer utilization rates were rising, and the levels were gradually improving. However, looking at the levels in Q3 and Q4, there does not seem to be a significant change from Q1. Is there any slowdown in the Chinese market, and is there any upside in Q4 when looking at the current factory utilization rates?

Hosoda: We expected the component orders to come up a bit more. As I mentioned earlier, not all global players are recovering simultaneously; there are some variations. Recovery is stronger in areas related to generative AI, but there are variations in the strength of capital investment.

CMP is currently strong in areas with active capital investment, and we are slightly optimistic. For components, we are stronger with customers of which capital investment is currently slow. That is the reason for the sluggish growth in this area.

Overall, I believe that the level is high, and as the recovery trend spreads globally, we expect components to follow.

Questioner 2: CMP looks very high at a glance in Q4, but for components, should we understand that the composition of customers related to generative AI among global players is causing this variation?

Hosoda: That is correct. While I can't go into details about individual customers, you can view it from that perspective.

Questioner 3: I have two questions about CMP. First, even without specific numbers, did orders for CMP and the overall Precision and Machinery Segment decrease in China QoQ from Q3 to Q4? Or were they flat?

Hosoda: They have increased.

Questioner 3: Earlier, when you said that you were taking it a little conservatively, did you mean that it might go down in Q4?

Hosoda: I mean, there is a lull in the momentum, but as for the increasing trend itself, it will still continue.

Questioner 3: It is going up, but the rate of increase is slowing down?

Hosoda: That's correct.

Questioner 3: My other question is about the old Fluid Machinery & Systems Business. Has competition with Chinese manufacturers intensified over the past six months? With the economic downturn in China, are cheaper products flowing into other regions in Asia, particularly affecting products of the old Fluid Machinery & Systems Business?

Hosoda: Competition with Chinese manufacturers can be seen in two areas: the domestic Chinese market and exports from China to other markets. In the domestic market, due to national policies, low-spec product competition from Chinese

manufacturers is particularly strong. However, our product range, whether pumps, compressors, or precision and electronic equipment, competes in the high-end segment, so we have not been significantly affected.

Rather than competition, the market for construction in China has deteriorated significantly, causing some struggle for pumps for that market. In the industrial sector, competition has not intensified noticeably.

Questioner 4: I have two questions. First, in the Q2 earnings presentation, there was a presentation on generative AI. Could you tell us the proportion of orders in new technology fields from a positive perspective?

Hosoda: There hasn't been a significant increase. We see increased demand for CMP used in HBM for generative AI and memory, but it is not a large amount. It is just starting to be visible.

Questioner 4: Second, the order volume for CMP equipment in Q3 was JPY40.3 billion, up from JPY28.3 billion in Q2, showing a recovery. What drove this increase?

For example, in Q2, it was mentioned that DRAM and NAND were lagging. Was the increase driven by previously delayed DRAM customers, China, or logic? The order plan assumes another increase in Q4. Which field or country will drive this increase?

Hosoda: For CMP orders in Q2 and Q3, growth in China is continuing. Additionally, from Q2 to Q3, we saw a significant increase in orders from major global customers related to generative AI, which is driving the growth.

Questioner 4: Do you expect that the trend will continue in Q4?

Hosoda: Yes, we expect it to continue.

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