May 13, 2022

NSK Ltd. Q&A Summary – Fiscal 2021 Financial Conference (Year Ended March 31, 2022)

Q1:

In the industrial machinery business, the fiscal 2026 sales target is 450 billion yen. Considering that the sales forecast for fiscal 2022 is 380 billion yen, isn't this number too low? Also, operating income margin is less than 10% even under the current busy operating conditions, what measures are you taking to improve it by over 3 percentage points to 13% by fiscal 2026?

A1:

The target for fiscal 2026 and fiscal 2022 are based on different currency exchange rate assumptions. Effectively, exchange rates aside, we expect growth of about 30% from fiscal 2021 to fiscal 2026.

The operating income margin did not reach 10% in fiscal 2021 and especially in E&E we did not reach our target operating income margin. Productivity has not been sufficient due to the impact of Omicron and other factors, and moving forward we will challenge ourselves to improve profitability. We will also grow in the automation sector for fiscal 2026, which is a highly margin segment for bearings and precision machinery products for machine tools. In addition, we believe that we can target 13% by improving our mix by expanding profitable areas such as the aftermarket.

Q2:

Is it correct to understand that the steering business has a higher probability of returning to profitability from two years from now, since new projects are in sight for fiscal 2023 onward and structural reforms are nearing completion? Also, what is in store for steering in the mid-term management plan and how do you envision cooperation with ThyssenKrupp?

A2:

As for the certainty of returning to profitability, your understanding is correct. Since we are still obtaining customer approval required for reorganizing production, we expect structural reforms to take until fiscal 2023. In addition, we believe that we will be able to return to profitability by the end of fiscal 2023 as volume return with new projects. This recovery scenario is based on NSK alone, and we have not incorporated or produced any estimate on the effects of potential future cooperation.

Q3:
A 50% reduction in Scope 1 and 2 carbon emissions in fiscal 2026 relative to fiscal 2017 seems difficult to achieve, how will you accomplish this? Also, how will your manufacturing methods change over the next five years?
A3:
The main targets for reduction are Scope 1 and 2, which for NSK mainly means to reduce carbon emissions from heat treatment, operation of machinery and equipment, and air conditioning at plants. The use of renewable energy will account for about half of the reduction, and energy-saving efforts, including improving production efficiency, are expected to account for the other half.
In particular, for heat treatment facilities, we will proactively shift to electric furnaces and efficiency improvement as well as equipment renewal. We are also pursuing new manufacturing methods as a theme for mid- to long-term technology development.

Q4:
We believe that the goals of the mid-term plan should focus on profitability rather than the top line, but what is the reason for your insistence on being a trillion yen company?
A4:
There is no doubt that profitability is important. On the other hand, when considering how to maintain a sustainable market presence, we believe it is important to have a policy of aiming for sales on the scale of a trillion yen. Further, we achieved 1 trillion yen sales in fiscal 2017. Using that sales composition as a benchmark as we look ahead to 2026 and beyond, and considering how to go beyond it, is also a shared goal in the mid-term plans of each of our businesses and divisions.

Q5:
How do you see the impact of the lockdown in China in terms of sales and operating income by business segment and around when do you expect a recovery?
A5:
On a preliminary basis, in April, we estimated a 10 billion yen impact on sales and the corresponding profits from the impact of the zero-COVID policy in the Shanghai area, which prevented plants and customers from operating and delivering products, and restricted shipments from warehouses.
The breakdown between the industrial machinery and automotive businesses is roughly 3:1. Although we are currently back to about 70% of plant operations, there are still disruptions in shipping, including the delivery of parts. We expect the situation to be resolved over the course of May.

Q6:

Looking at slide 5 of the financial results presentation. What is the reason for the widening gap between increasing raw material prices and passing these higher costs on to the market? Also, in the fiscal 2022 forecast on slide 10, how much of the raw material cost is assumed to be offset by reflecting it in sales prices?

A6:

The gap widened due to continuous procurement cost inflation and the typical 3-6 month delay in the timing of reflecting changes into sales prices. In the current fiscal year, we will proceed to add on top the amount not made up in the previous fiscal year. In addition, we expect to reap benefits from current procurement cost inflation by raising sales prices during the current fiscal year. In the case of OEMs, selling prices are not automatically revised but are subject to negotiation, and there is a risk that further inflation during the period may cause a gap in the timing of price reflections.

Q7:

I would like to know what changes are included in the plan for the "volume/mix" in the factors for change in operating income between the previous year and the current year, especially quantity of goods and other factors.

A7:

The 42.3 billion yen of volume/mix in the v-chart showing change in fiscal 2021 operating income on slide 5 includes 33.0 billion yen from volume, and the rest from the mix of business units, regions, and so on. The 13.5 billion yen of volume/mix in the fiscal 2022 forecast v-chart on slide 10 is almost entirely due to volume.

Q8:

In each business unit, did you succeed the initiatives planned in the sixth mid-term management plan? Based on your results, how will your approach change in the new mid-term plan spanning until 2026?

A8:

In the industrial machinery business, the first half of the sixth mid-term plan focused on wind power, railcars, and other infrastructure-related business, while in fiscal 2021, we emphasized growth in the recovering markets of machine tools, semiconductor equipment, and E&E, resulting in record sales. Growth in these sectors is expected to continue over the medium term and we will continue to expand sales. Sales in the aftermarket also reached a record high at the end of fiscal 2021. With the addition of B&K Vibro, we expect to generate even more synergy in this field moving forward.

With regard to the automotive business, there was a failure to receive new orders in steering systems. Although bearing products were affected by the decline in automotive production, we have been focusing our efforts on orders for EVs and HEVs, and our evaluation is that we were able to make up for the decline in ICE vehicles by fiscal 2026 (final year of the new mid-term plan) by focused efforts on electric vehicles.

Q9:

Based on current free cash flow and future capital investment plans, what, if any, management targets do you have for free cash flow?

A9:

At present, we do not have a target for free cash flow itself. Operating cash flow is targeted at 500 billion yen for the five-year cumulative total, and working capital is being put to increasing inventories to address COVID risk and supply chain issues, but we will continue to monitor the situation and start making adjustments toward normalization this fiscal year. 70% of operating cash flow will be used for capital investment, and 20% will be put toward shareholder returns. If we use the cash flow over the next five years, it will amount to about 100 billion yen.

Q10:

Regarding the new mid-term management plan, will it still take about five years to return to the level of 1 trillion yen in sales and 100 billion yen in operating income? Why?

A10:

The fixed cost burden of facilities and equipment is heavy, and this will require a recovery in the volume of goods. In addition, we want investment to increase supply capacity to realize growth as well as invest in IT and technology development looking ahead to 2026. Another reason is that global labor costs are rising and it will take time to reap the benefits of productivity improvements and labor savings. We have many mid-term themes to tackle, and we want to make the best use of the resources we have.

Q11:

What was the amount of one-time expense related to Russia in the fourth quarter, and how much was the actual operating income for fourth quarter excluding that expense? Also, after excluding the one-time costs, isn't the 11 billion yen operating income in first half of fiscal 2022 plan low?

A11:

We posted about 2 billion yen operating income in fourth quarter, and excluding this, operating income was over 10 billion yen. The forecast for the first half of fiscal 2022 takes into account the impact of the Shanghai lockdown and the impact of Russia and Ukraine.

Q12:

What are you looking to do with ThyssenKrupp? Will it be an equity method affiliate joint venture?

A12:

Since it will be a steering business company, we are evaluating cooperation in production, sales and development, but this will be decided in the course of further discussions. If ThyssenKrupp takes majority ownership, it will become an equity method affiliate. However, even in that case, if our sales channels are utilized, sales and profits will be generated by NSK, so these and other factors will be discussed moving forward.

Q13:

On slide 20, the value of NSK sales per electric vehicle in the automotive bearings business unit is slightly lower than for internal combustion vehicles. How will you achieve the same level of sales for EV as for ICE? Also, what strengths have you capitalized on to secure your current share in EV?

A13:

Demand for bearings for electric vehicles will mainly be for e-axle and HUB bearings, and through fiscal 2026 we will maintain our share of the hybrid vehicle market, where Japanese companies are strong. In the EV market we will expand our sales in all directions, including capturing the development of new demand in markets where we currently have a low market share, such as in automakers based in Europe, China, and emerging countries.