Sanyo Special Steel Co., Ltd.
IR Briefing Regarding the Business Results for the FY2019 1Q
Q&A Summary

Date: Tuesday, July 30, 2019

Speaker: Director, Member of the Board and Managing Executive Officer;
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** Please be noted that the actual Q&A session was in Japanese and this English translation is prepared for reference purpose only.*

Q. Sanyo's performance is expected to recover in the second half of the fiscal year in the revised forecast. Please tell us the reasons for this.

A. The price of iron scrap declined from April to June and remains at a lower level than originally expected. We consider that ; 1) the time lag of iron scrap surcharge mechanism, which is applied to 60% of our sales, and 2) the possibility of margin expansion in sales outside the scope of surcharge mechanism will contribute to its recovery. The same applies to iron alloys.
For electrodes, we reflected our recent negotiations with suppliers to the revised forecast. The prices of small-diameter electrode made in China have declined, and we think that the prices of large-diameter electrode have also reached its peak. We are expecting further positive movements for the negotiations of the second half of the year.

Q. In the revised forecast, sales volume has been lowered. Please tell us how you think about the domestic sales environment and demand in the second half of the year.

A. In our previous forecast, we thought that inventory adjustments would be completed in the first half of the fiscal year and sales environment would recover in the second half of the fiscal year. We still think that most of inventory adjustments will be completed during the first half of this fiscal year because inventory adjustments related to machine tools, robots, and semiconductor manufacturing equipment have already continued for a while.
On the other hand, it is difficult to forecast whether actual demand will recover in the second half now. So we think it is reasonable to set the sales volume in the second half at the same level as in the first quarter and to decrease the sales volume from the previous forecast.

Q. Ovako has seasonal differences, and it is regarded to be difficult to generate more profits in the second half than that in the first half. In the revised forecast of FY 2019, the operating profit of the second half is almost the same level with that of first half. Could you explain the rationality of this forecast?

A. The term of Ovako’s second half is from July to December. Since production declines in July due to the regular plant repairs in summer season, there is a seasonal difference between the first half and the second half. We expect sales volume in the second half of fiscal 2019 to be on par with the second half of fiscal 2018. We are executing profit improvement measures such as sales expansion activities and cost reductions in fixed and variable costs to achieve this revised second half forecast.Ovako and our management have already started in many ways to collaborate together to improve Ovako’s earnings.

Q. In the operating income variance analysis from FY2018 to FY2019 forecasts, the revised forecast shows that consumable, outsourcing, and logistics cost have decreased by -1.5 billion yen. In the previous forecast, this figure was -2.7 billion yen. What is the cause of this change?

A. In the previous forecast, we supposed electrode prices would continue to be at the similar levels of the second half of FY 2018. But electrode prices are expected to decline in our revised forecast. Outsourcing costs are expected to decline due to an outsourcing volume decrease which reflects sales volume decrease. The logistics costs have not increased so much as we initially expected. These are the main factors for this change.

Q. How is Ovako's forecasted volume and profits for FY 2019 compared to FY 2018? What is intense competition in general-purpose products? Is it a future risk factor?

A. In the first half of FY 2018, Ovako's sales volume and operating profits were at a high level due to a rush in demand prior to WLTP. In the second half of FY2018, Ovako's operating income declined because sales orders declined, and costs became higher due to shift increase on the premise that demand in the second half of FY2018 would be as vigorous as that in the first half of FY2018. We assume sales volume in the second half of FY 2019 is at the same level as in the second half of FY 2018, but we think that our revised forecast profit is quite feasible, because the impact of the shift increase has been eliminated and cost reductions including procurement costs is expected. Regarding the competition of general-purpose products, competition with steel mills of Czech Republic etc. has intensified since June and we renewed our sales prices in order to defend our orders. We believe this situation may continue for a while. We will secure expected revenues by promoting activities to expand sales for existing bearing manufacturers and sales of high-value-added products such as steel tubes, pipes and rings in fields other than general-purpose products.

Q. Quarterly sales volume of MSSS has declined. Does the market share of MSSS decline? Impairment loss of power usage rights is a temporary impact, but is it likely that power costs will increase in the future?

A. We think that the decline in sales volume of MSSS is mainly due to inventory adjustments. For example, forging manufacturers have made inventory adjustments which makes volume reduce to 50 to 70%. As a result, MSSS has suffered a significant volume decrease. In addition, orders for National Railway, which are relatively large in lots, have been decreasing until this June depending on economic circumstances. The impairment loss of power usage rights is a temporary decrease in profits. Power costs will rise because inexpensive electricity cannot be purchased in future, but this impact is already included in the revised forecast.

Q. Please tell us the background that depreciation expense increase from 14.5 to 16.0 billion JPY in the FY2019 revised forecast.

A. We adjusted depreciation expenses, checking the status of acceptance inspections of facilities at the end of the first quarter. For example, depreciation expenses increased in Ovako due to the application of IFRS16 Leases.

Q. Please tell us if there are any updates and changes in schedules about the synergies among Sanyo and Nippon Steel and Ovako.

A. We think that improvement of operating and procurement costs of Ovako can be realized in the short term to some extent. We have dispatched four engineers to Imatra plant in Finland and we are working to improve operations of Imatra as soon as possible. Sanyo and Nippon Steel have begun discussions on decreasing procurement costs jointly. We believe that the implementations of synergies are on schedule. We have also begun considerations on the optimal production structure across Nippon Steel Group.