Sanyo Special Steel Co., Ltd.
IR Briefing Regarding the Business Results for the FY2020 1Q
Presentation from the President and Q&A Summary

Date: Friday, July 31, 2020

Speaker: Representative Director and President; Shinya Higuchi
Director, Member of the Board and Managing Executive Officer; Kozo Takahashi

** Please be noted that the actual presentation and Q&A session was in Japanese and this English translation is prepared for reference purpose only.*

[Opening comment from President Higuchi]

I would like to briefly touch upon the following topics;
a) Impact of COVID-19, b) Overview of business result for the first quarter, c) Forecast for FY2020, d) Current situation and outlook of Ovako, e) Views and Ideas with regards to the post COVID-19 era.

[Impact of COVID-19]

Due to the turbulent global economic situation and the standstill of some of our customer business activities caused by COVID-19, Sanyo's sales orders and shipments have dropped significantly since April. As a result, the utilization rate of all of the facilities at Sanyo, Ovako and MSSS, has declined significantly.

As you well know, almost all of our customers are in the manufacturing industry such as automotive, industrial machinery, construction machinery. Even though some analysts mention that the COVID-19 impact on the manufacturing industry would not be as severe compared to other industries, and may be less austere than that during the financial crisis in 2008, we are quite cautious and careful about viewing on and preparing for the coming post COVID-19 age.

The economic stagnation in emerging countries, where demand for special steels should have grown, would surely be prolonged because of the relatively low standard of medical care and less vigorous fiscal capacity compared to developed countries. Taking the change of lifestyle on global basis triggered by COVID-19 into account as well, we consider time frame needed for recovery back to pre-corona levels to be substantially long.

After summer of 2019, when there was no sign of COVID-19, we have pursued an optimum production and a cost minimum operation in response to the decline in sales orders and shipments due to customer's destocking. Since January 2020, we furthermore have practiced the following "emergency profit improvement measures and actions"; a) voluntary partial return of executive compensation and manager's salary, b) application of the unemployment insurance for temporary leave program, c) reduction of overtime, d) cutback of repair and maintenance expenses, and e) added saving of other miscellaneous expenses.

Facing the serious impact of COVID-19 after April 2020, we have accelerated the depth and velocity of implementing and applying all of the "emergency profit improvement measures and actions" mentioned above.

[Overview of business result for the first quarter]

Despite all of the endeavor and to our regret, we could not avoid to record an ordinary loss of 1.8 billion yen (consolidated basis) in the first quarter of fiscal 2020, although we consider that we were able to offset the negative impact caused by the huge decline in earnings relatively better than during the analogous period of the financial crisis in 2008, by means of and positive effects from the “emergency profit improvement measures and actions”, Ovako’s positive ordinary income of 0.5 billion yen (Jan. to March 2020) and reduction of depreciation expenses by change in depreciation methods from declining balance method to straight-line method.

[Forecast for FY2020]

Simultaneously, we disclosed our business forecasts for the first half and the full year of fiscal 2020. Based on the current business trends and forecasts, and from our interaction with customers and market, we view and assess that the drop of sales volume will bottom out in July-September and then gradually recover, though some of COVID-19 impact will linger until December 2020.

For Sanyo (non-consolidated basis), the ordinary income of the 2nd half fiscal 2020 is expected to be back to positive, mainly due to gradual recovery of sales volume.

For Ovako, the COVID-19 impact will peak in 3Q; July-September 2020, and together with the effect of regular maintenance outage in July and December, the sales volume for the 2nd half; July-December 2020 will drop significantly, resulting in an ordinary loss of 4.1 billion yen in the 2nd half fiscal 2020.

Consequently we could not avoid presenting a negative business forecast (consolidated basis) for the fiscal 2020. The ordinary loss of the first half of fiscal 2020 will be 5.4 billion yen, and the ordinary loss for the second half of fiscal 2020 will be 2.6 billion yen, resulting into an ordinary loss of 8.0 billion yen for the full year of fiscal 2020.

To our deepest regret, we have no choice but to cease the dividend payment for fiscal 2020 in accordance with our negative business forecast of a net loss. Please accept our apologies for not being able to pay out any dividends from fiscal 2019 year-end. We definitely will accelerate profit improvement measures, and simultaneously monitor the market trend closely to capture the recovery of demand promptly to regain profitability. We sincerely ask for your kind understanding.

[Current situation and outlook of Ovako]

Next, I would like to highlight the current situation and outlook about Ovako briefly.

Ovako has been consolidated to Sanyo in profit and loss since the first quarter of fiscal 2019, just after Ovako became our affiliated company in March 2019. At that time, the demand for special steel in Europe has been stagnant mainly due to U.S.-China trade dispute and automobile sales plunge prompted by WLTP, and the destocking process of our customers continued until December 2019. As a result, sales volume in fiscal 2019 (January to December 2019) decreased by 15% compared to fiscal 2018, resulting in an operating loss of 0.6 billion yen and ordinary loss of 0.9 billion yen in 2019.

In the first quarter of fiscal 2020, the sales volume increased by 23% from the previous quarter. In addition, Ovako continuously decreased its fixed costs, including personnel rationalization.
Consequently ordinary income recovered to positive 0.5 billion yen.

Unfortunately, the COVID-19 impact started to materialize from April 2020 and may linger until December 2020, hence the sales volume in fiscal 2020 (January to December) will decrease by 14% compared to fiscal 2019, resulting in an operating loss of 3.5 billion yen, and ordinary loss of 3.7 billion yen, as stated in the business forecast. To regain profitability and increase competitiveness, Ovako will vigorously continue to pursue the followings; a) additional reduction of fixed cost, b) utilizing the unemployment compensation scheme for temporary layoff.

According to the accounting standard for impairment of fixed assets in Japan, it would be regarded as “Indicators of impairment” in case Ovako fails to achieve an positive EBIT of more than 2.5 billion yen in fiscal 2021 to exceed the amount of annual goodwill amortization, since Ovako is expected to be negative in EBIT for two consecutive years in fiscal 2019 and in fiscal 2020.

"Indicators of impairment" will not immediately lead to an actual impairment loss, and even if Ovako’s goodwill amount would be fully impaired, Sanyo continues to maintain its financial robustness, with an equity ratio nearly to 50% and D/E ratio around 0.3 to 0.4. As a matter of course, we have carried out and will definitely continue to implement profit improvement measures in order to upgrade the financial performance of Ovako.

The first focus will be on reinforcing Ovako’s downside elasticity. Ovako's marginal profit per unit is higher than Sanyo’s, and therefore its profit will deteriorate more than that of Sanyo in case sales volume would decline. Ovako has already reduced fixed costs by around 10% to date, excluding the effects from unemployment compensation, and Ovako will accelerate to implement profit improvement measures to seek a lower break-even point.

The second focus will be on swiftly accelerating the synergy among Sanyo, Ovako, and Nippon Steel. We already have realized positive results in reducing operating costs at Ovako’s manufacturing sites with the support of dispatched technical staffs from Sanyo. Adding to that, we will strive to proceed in streamlining the manufacturing site on global basis, and to reduce sourcing costs by collective procurement.

[Views and Ideas with regards to the post COVID-19 era]

Finally, I would like to explain about the views, ideas and policies in the post corona era.

As mentioned at the beginning, the global economy is in a serious situation due to the COVID-19 impact, and we are cautious to anticipate a swift recovery. In addition, the global industrial structure may change significantly due to changes in lifestyle and the widening economic disparities between developed and emerging countries.

Based on these premises, the whole Sanyo group must fortify the corporate robustness enabling to be profitable even if production and sales may not return to a desired level. We will pursue additional reduction of fixed and variable cost and improvement of product mix to secure enhanced margins and increase profitability. We will reinforce our global business entities and enrich our global network, responding to the rising need of local production for local consumption. We will further strengthen our R&D capabilities of products and technologies, building on our advanced and innovative technology of manufacturing high-cleanliness steel, to meet new demands of each region and customer. In addition, we will continue to push the progress of synergies among Sanyo, Ovako, and Nippon Steel.

Through these activities, the whole Sanyo group will dynamically and swiftly pursue to bolster its profitability, robustness and stability, the basis of "Confident-based Management", our corporate philosophy.

Thank you.

[Q&A Summary]

Q. The trend of your financial result and forecast in FY2020 is different from other companies in the same industry. Does it result from the difference in the composition of the main product and the customer?

A. We consider that difference in financial results and forecasts may have risen from the differences in the product and customer mix. Our main product is bearing steel, and many of them are used for critical components such as suspension parts. Not only automobile but also industrial machinery and construction machinery make up a large proportion of our customer.

Q. With regard to the goodwill of Ovako, you mentioned "indicators of impairment" based on accounting standards. Does it mean that there will be an actual impairment of Ovako's goodwill in the future?

A. Indicators of impairment do not lead directly to an actual impairment. We just mentioned an estimate of the financial impact, in case the impairment would occur. We consider that one of the reasons Sanyo's PBR is currently below industrial average is that we may not have disclosed sufficient information related to Ovako to the market.

Q. MSSS in India carried out a write-off of goodwil in fiscal 2019. How do you view the future of MSSS?

A. Last fiscal year, we carried out a write-off of MSSS's goodwill and at the beginning of this year, we were quite confident to reinforce the profitability of MSSS. Unfortunately, the current situation India is quite problematic and MSSS has also been affected by the circumstances. However, MSSS has secured orders for railways, and the demand for automobiles has been picking up. We will effectively capture the recovering demand in India and regain profitability.