

Financial Results for the Second Quarter

of Fiscal Year 2019

April 1, 2019 - March 31, 2020

(Q&A)

【Event Summary】

Date : November 27, 2019 15 : 00~16 : 00

Venue : Shinko Building Nihonbashi 1 9F, 1-17-10 Nihonbashi, Chuo-ku, Tokyo

Speakers : Takuro Sasaki President & CEO

Toru Kurono Executive Vice President & COO

Akitaka Tejima Head of Business Management Division

Executive Officer

Tatsunori Kura General Manager of General Affairs Department

Question & Answer

Q: I would like to ask three questions. First of all, I would like to ask you about how you are looking at the domestic market environment. This can be broken down into several questions, but first about the first half of the year. I think you mentioned that there was a positive impact from school air conditioning, but I assume other factors were quite good as well. Given that FA applications show signs of weakness, which applications were strong?

Including that, in the second half. I believe that you expect significant growth for cabinets in the second half of the fiscal year, so please tell me, what are each of the strong points for the first half and the second half of the fiscal year? This is the first question.

Sasaki: The domestic market environment has been improving significantly since last year. As I explained earlier, domestic capital investment in the non-manufacturing sector is increasing as the end stage of the strong construction demand. I actually don't know if it's the end stage, but that's now coming to the electrical equipment and materials industries as a whole. Setting aside the FA-related distributors, the electrical equipment and materials companies that handle our products are generally performing well.

Regarding the impact of school air-conditioning, there is a certain amount of orders every year. To give you a rough idea, the normal amount for school air-conditioning is around 500 million yen, which is about 2 billion yen this year. Compared to the impact of solar power, the impact is within assumptions.

The school air-conditioning business has mostly been complete for regular classrooms this fiscal year, but hardly any of the special classrooms or gymnasiums have installed them. The question is how the government will set policies, meaning that it's a matter of whether or not you get a budget. There are many views on this, and we do not have any particular knowledge.

On the other hand, given that gymnasiums are used as evacuation centers in the time of natural disasters such as typhoons, the lack of air-conditioning has to be addressed, according to some opinions. What is generally said is that although the scale may not be as large as this year, the demand should continue in the next fiscal year onwards, to some extent.

When asked which are the main strong areas, as you pointed out, FA is not very strong when viewed from our merchandise, including cabinets for FA, or the performance of FA agencies.

For cabinets, sales for FA are probably around 95% of the previous year's level. Then there is general electric construction perhaps from building demand. I don't know whether or not factories are included, but probably there is demand towards the Tokyo Olympics, including hotels and other facilities, including to meet inbound demand. You can see a lot of cranes from high-rise buildings in Tokyo. A number of development projects are underway, it is my opinion that something like super domestic demand seems to remain solid.

Regarding the current status of orders, our orders have a very short lead time, so we can only look about two months ahead. But orders for cubicles for high-voltage power reception and distribution are being received at a considerable time ahead, so we can say the recent situation is strong. I can't say anything about what will happen next year, but we aren't seeing any weakening signs at this point.

In addition, among our cabinets, we have self-supporting cabinets, which are large cabinets for power distribution boards, and the demand is extremely high. This suggests that while custom board makers usually make boards or cabinets in-house, or outsource them, the outsourcing contractors are probably busy, and the delivery time is tight. In that case, they may shift to our large, self-supporting cabinets. This demand is very strong. That's the situation.

Q: If that is the case, it will be quite difficult to predict the situation through the next fiscal year. Could you tell us any factors that will enable your company to grow through your own efforts towards next fiscal year, if any?

Sasaki: I mentioned that the production capacity for the solution business is full, and the question is whether we should expand it. This will depend considerably on manpower.

I mean that production is simply labor-intensive. As I showed in the diagram, it is not only necessary to increase the number of workers in production, but also a variety of other roles, such as design and drawing, and sales personnel, starting with estimates. In other words, we have to increase the number of people, including middle-back roles for sales activities. But we cannot quickly increase the number of people in the current environment. Even if it were to be increased, they would probably not be immediately contributing, and it might take about two years, so we have to do our best with the current force.

Moreover, there are various factors to consider before deciding to increase our workforce. Based on our learned experience, domestic capital expenditure will inevitably fluctuate, as you know. Although the capital investment cycle is said to be 10 years, our business often goes back and forth in about three to four years, and there is a debate about whether to increase the workforce, even a little.

Q: Thank you. The second point is about your business in Southeast Asia.

You have recently announced plans to construct a new plant, but I have had the impression that it has not grown much, honestly. I'd like to know if you have any plans for accelerating growth in the next fiscal year or the year beyond.

Sasaki: I understand that your question concerns our announcement to build a plant through a joint venture with BANGKOK SHEET METAL PUBLIC COMPANY.

What we will do going forward is a question of how we will expand our market and business domains. This is certainly the core of sustainable growth.

As you pointed out, we cannot suddenly bring our domestic solution and standard product businesses overseas. This business model has taken decades to build and is difficult to imitate.

Overseas, distribution channels and other networks are not necessarily in place. Producing distribution boards will naturally lead to price competition. We have been trying out distribution boards at a small scale in Thailand, but the cost competitiveness is insufficient because we cannot produce them in-house. In terms of local networks, we are now considering building new factories in cooperation with partners, taking on a cost-competitive structure, and working with each other on a win-win basis.

Q: Finally, the third point. What is your strategy for Kitagawa Industries, and since I think it has been some time since the acquisition, how can you expect synergies, especially with the non-consolidated business? Please tell us if there are any updates about this area.

Sasaki: A year ago at the start of the acquisition, we had secretly thought there might not be many synergies. But following the acquisition, we found that there are more opportunities than expected for our development team and their development team to work together.

There are some areas that are still confidential, but there are actually emerging cases where Kitagawa Industries is helping our standard business or things related to our new businesses. There are synergies in this sense.

However, their business is fundamentally different from the distribution board or cabinet business. For example, we think that it will take a considerable time for synergies to emerge abroad.

Q: I think you talked about synergies in terms of sales channels, but do you feel that there is not much?

Sasaki: On the sales channel, we have some domestic distributors and FA-affiliated distributors in common, but I think it will take a little more time to get some kind of additional benefit from the sales channel.

Q: I think your figures are excellent in general, but according to the forecast for major group companies on page 21, Aichi Electric Works and Taiyo Electric Mfg. are shown with the rain mark. In particular, I think that Aichi Electric Works had some shipment suspended. Could you tell me how this has converged?

Sasaki: Shipments have basically continued to be suspended. This is because the capability stated in the catalog was not being achieved.

However, we are delivering it to customers who say they want it as long as there is a certain level of output. I think I said that the impact was less than we thought, and that was due to a relatively large number of customers that accepted it as is. However, we believe that the suspension of shipments will probably continue more or less until next year.

Q: Why will it continue until next year?

Sasaki: We are currently conducting a variety of tests, and it will probably take until next fiscal year for them to come out with confidence in line with the catalogue.

Q: I see. What is the situation at Taiyo Electric?

Sasaki: Taiyo Electric has the rain mark. It is a manufacturer of control panel boards with sales around 1.5-2 billion yen, so there is no significant impact on the consolidated results as a whole. But the order situation was extremely poor through the summer compared to the beginning of the period, so it may make losses. The losses are going to be small nonetheless, but we've heard that they are recovering lately, and the situation is now turning from rainy to cloudy.

Q: I think you are looking for a collaboration with Panasonic, but what is the situation and how you intend to proceed?

Sasaki: Looking at Slide 38, we have started collaboration, and there is just one product, which is an industrial breaker called Kantouch breaker. We started to produce it in August at our Thai plant, ELETTO.

There is also a prospect to cooperate in the distribution board business. Panasonic has a distribution board business, and there is perhaps a debate about the conventional approach, so they are offering to partner with us. This has been the starting point.

However, since we cannot reach an agreement without mutual benefits, we are still considering the question of whether or not we can see benefits for both parties, and it is taking a considerable amount of time.

Q: The production of power distribution boards has also been considered?

Sasaki: We are considering it.

Q: Excuse me. You mentioned that performance has been strong not only on a non-consolidated basis, but also at subsidiaries. At the beginning of the fiscal year, the Gathergates had a loss of about 400 million yen, and the impression was that it would take about two years for the company to return to profitability. Is this likely to be achieved ahead of schedule?

You also mentioned that the demand for SunTelephone was also quite strong, so you invested ahead of schedule, and the situation was somewhat pressuring on profits. I heard that the full recovery of this investment is expected to start in about three years. What is your image of whether this recovery is likely to progress ahead of schedule?

Sasaki: First of all, regarding Gathergates, although it was originally planned to post a loss, it is likely that the deficit will be reduced more than expected in the current fiscal year. However, it is still a little difficult to achieve profitability next year. We are not yet confident enough to say that it will actually be ahead of schedule.

As for SunTelephone, sales are certainly growing. Since the original denominator is small, the profit margin is about 20%, but the growth is driven by some large-scale projects which do not necessarily have high profit margins. However, since sales have already increased so much, profits have been increasing as well.

Anyway, I think the general manager Tejima explained last time, but it is basically likely to take two to three years.

Q: Price increases in the previous fiscal year made a full contribution to the non-consolidated results. This is not changed frequently, so do you think you will go with this price for a while, and if you have the opportunity, you will be able to raise prices again?

Sasaki: We don't think it's easy to do so. We will keep it for a while. This has been the first price increase since 2005. We actually think 13 years has been too long. We tried to revise prices before the global financial crisis, and in fact, we revised the catalog, but it was abandoned with the financial crisis. So, this is something that cannot be done frequently. It's difficult to gain acceptance.