2015/3 Q2 Results Briefing Q&A Session
Time and Date: 10:00-11:30 a.m. November 6 (Thursday), 2014
Place: The 18th floor, Daiwa Conference Hall

[Q&A Session]

(Company-wide basis)

Q: Please tell us about the differences in the Mid-term Management Plan, between the initial plan and current forecast. Are there any perspective changes of the Mid-term Management Plan comparing to the initial circumstances?

A: We have been promoting the enhancement of MRO (Maintenance, Repair and Overhaul) business in fields other than precision reduction gears and hydraulic equipment businesses, and have seen steady growths of MRO especially in the railroad vehicle equipment business owing to our marketing efforts, etc.

As the individual component is likely to be vulnerable to price pressure from customers, we plan to modularize and launch value-added products in around two years. For example, with respect to the precision reduction gears business containing no MRO business, we intend to establish networks in Europe, the United States and China to increase sales of actuators which modularize motors and precision reduction gears.

(Precision equipment segment)

Q: Sales projection for the second half shows ¥23 billion in contrast to ¥25 billion for the first half. Although you expect a decrease in sales for the second half, A negative impression from the trend of consolidated orders received as well as the business plan of the products for industrial robot manufacturers in the second half is not received. Please explain the factors attributable to such a decrease in sales for the second half compared with that for the first half.

A: As far as the industrial robot market is concerned, we expect a year-on-year growth of 12% on a full-year basis, taking into account the demand forecasts by the IFR (International Federation of Robotics). Based on this full-year sales assumption, sales for the second half will end up decreasing. It is true that the current orders received have been robust, and it is likely that the sales will exceed our plan if this upward trend continues steadily. However, we remain with the assumption taken from the demand forecast by the IFR as it is difficult to make projections of demands for the three-month period or over, reflecting the short-delivery system.

Q: Please tell us the present factory-operating ratio of precision reduction gears, and your views on the production capacity.

A: Tsu Plant, which manufactures precision reduction gears, has a production capacity of 50,000 units per month operating by three shifts 20 days a month. During the second quarter, the plant operated at almost 90% capacity. However, actually, as we find it difficult to secure workers for the third shift, we have satisfied the demand by operating on Saturdays, instead. It is necessary to increase the number of workers to further boost production, and considering the possible rise in fixed costs, we are already prepared for addressing this issue. We anticipate that we will be able to smoothly shift our production toward future growth once our China plant starts operation.

Q: Please explain the reason for less-than-expected operating income of the precision equipment segment despite the high operating ratio of 90% at Tsu Plant, which manufactures precision reduction gears.

A: The precision equipment segment as a whole shows that the burdens of the allocated SG&A expenses of the Head Office and the new energy equipment business under development placed a downward pressure on operating income, but even the precision reduction gears business alone showed lower profitability than the expected value. We increased procurement from overseas when the yen appreciated, which has in turn become a negative factor due to the weaker yen. Therefore, we remain far short of enjoying the advantage of high operating ratio. In this sense, we are not satisfied with the present profitability.

Q: Which factor among the market, foreign exchange or customer inventories do you consider contributed to the excellent performance of the precision equipment business in the first half? Further, do you expect that the robust performance will continue into the second half?

A: Basically, we believe that our business was led by the strong U.S. market (meaning the demand for industrial robots in the automobile industry). We had to struggle with the strong short-delivery demands from customers in the aspect of supply.

As the forecast period from customers has also shortened for almost three months(from six months ahead to three months ahead), it has been increasingly difficult for us to make projections of the future business environment. We have no information on the inventories of customers.

Q: You told us earlier that the short-delivery demand has been strong in the precision reduction gears business. Is it correct to understand that the present order backlog will be reduced properly in a short period of time during the next quarter?

A: Yes, it is.

Q: Has the new energy equipment business been profitable? What is your plan for the future?

A: The new energy equipment business is a new business under development, and is yet to achieve profitability. In this business, we have three categories. The first is drive units for the existing onshore wind turbines. The second is equipment for offshore wind farming, targeting wind turbines with a generating capacity of 5 MW or more. We intend to commercialize these products starting in two or three years. The principal target customers are European manufacturers, so we need to establish an information gathering base in Europe. The third one is solar tracking equipment for solar thermal power generation plants . This business is lagging behind the schedule. The wind farm in Tonopah (Nevada, U.S.A.), our first project, will start full-fledged operations in January 2015, and if the generating capacity can reach the expected level, we will be able to proceed with the next project. Although the solar thermal power plant business is mainly conducted in the United States, we see potential projects in other countries, and it is expected that a certain amount of sales will be realized from the second half of 2016. Until then, we must endure unprofitability of this business.

In sum, we expect that the improvement of the new energy equipment business will be after 2016, and given the present situation, it is unlikely that this business will achieve the target of the MidtermManagement Plan.

(Transport equipment segment)

Q: Please tell us about your prospect for the demand for the Chinese high-speed railways in FY 2014 and FY 2015.

A: With respect to the Chinese high-speed railways, we understand that the current order receipts have hit a peak. We doubt the prospects of receiving more orders than this year, because we anticipate that the most optimistic volume of order receipts for FY 2015 would be the same level as in FY 2014. We heard that the Chinese high-speed railroad vehicles will be domestically produced in China from FY 2016, and if this will be realized, our sales for the Chinese high-speed railways are expected to decrease gradually. On the other hand, we forecast that the demand for the Chinese subways will increase, and we will endeavor to expand sales aiming at a 20% market share. Concurrently, our efforts will also be focused on building relationships with European railroad vehicle manufacturers.

Q: Please explain the reasons for operating margin in the transport equipment business reaching as high as approximately 20%, from the viewpoint of both constant factors and temporary factors.

A: In both the railroad vehicle equipment and the marine vessel equipment businesses, for which demand has been recovering, the production has been conducted by almost the same number of employees and systems as in the past when the demand was still low. As a result, we could achieve high profitability in the first half, but actually, at the production sites, the working situation has become tough for the employees. If we continue this situation for a long time, this system including employees cannot last for long and will fail one way or another. We understand that the high level of operating margin in the first half was a temporary phenomenon because we plan to implement investments for future growth in these prospective businesses toward second half.

(Aircraft and hydraulic equipment segment)

Q: With respect to the hydraulic equipment business, given the present sluggish conditions of the Chinese market, it may be difficult to expect a recovery in FY 2015. What is your plan to continue with this business toward the future?

A: We need to reorganize the hydraulic equipment business. The market as a whole will grow over a five-year period, but we don’t expect a recovery to the peak level we experienced in the past as far as the Chinese market is concerned. The first thing we should consider is to develop measures for securing profits under an environment of low demand. In addition, we have been considering regrowth strategies as it is likely that a growth opportunity can be expected by increasing the product lineups. We are not satisfied with the present operating margin, and want to bring it back to the previous levels.

Q: Do you have a plan to consolidate the two plants into one in China?
A: The details are still under consideration, but we will take all possible measures.

Q: Is it correct to understand that you will take actions for improvement in a short period of time amid little prospects for the recovery of the Chinese market in FY 2015?
A: In China, the Lunar New Year is a very important holiday season. Therefore, we will wait until the end of this period to start our renovation. If impairment losses will be recorded, we will treat them properly by the end of FY 2015. Full recovery is our goal for 2016.

(Industrial equipment segment)

Q: As to the advantages of the acquisition of Gilgen (automatic doors business), please explain the progress and achievements of the improvement of development and after-business-operations that Nabtesco had sought in the acquisition.

A: In terms of products close to consumers such as automatic doors, there are differences of specifications and the products between Europe and Japan. For Russia, we designed new products according to the European standards. Through the acquisition, we have adopted the European concept of focusing on after-sales business to our business in Japan.

The aggregate net sales of the value chains (VC) in Japan amount to ¥37 billion including the three domestic mega-distributors engaging in sales, maintenance and service. Net sales of our automatic door business alone engaging in manufacturing exceed ¥10 billion, with a share of 60% to 70% as far as maintenance and service are concerned, which is higher than the competitors'. However, with more intensified competitions in the VC, we have strengthened our Group as a whole partly by converting Nabco Door, Ltd. into a wholly owned subsidiary.

Q: Sales of automatic doors have increased in the past few years resulting from the acquisition. Please explain your M&A strategy toward the future.

A: In the advanced countries, the automatic door market has matured, and the efficiency of the market has accelerated through the selection and reorganization of distribution networks and manufacturers, which will rapidly lead to M&A. We intend to expand our market share in Europe through organic growth and M&A. Meanwhile, as the Japanese market does not exactly show a favorable response to M&A, the oligopoly is becoming more apparent. We have increased our market share in Japan by about 20% over the period of approximately 20 years, and will endeavor to expand sales and gradually boost the market share with all Group companies.

Q: Please tell us how far you expect that Gilgen will grow.

A: If we look at Gilgen alone, the Swiss market has been growing at an annual rate of 2% to 3%. In the three-year period after the acquisition, we integrated the management and IT systems, and formulated a Medium-term Management Plan for Gilgen. The business plan spans five years, during which we are pursing an increase in sales by 20% to 30% as the whole VC.