Sanyo Special Steel Co., Ltd.
IR Briefing Regarding the Business Results for the FY2019 2Q
Q&A Summary

Date: Wednesday, October 30, 2019
Speaker: Director, Member of the Board and Managing Executive Officer;
Kozo Takahashi

** 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 non-consolidated sales volume in the second half of FY2019 is assumed to be similar to the first half, although the second quarter declined drastically from the first quarter. Why do you think the second half volume to be equivalent to that of the first half? And, how do you think about the demand of each customer segment?

A. Some users have recovered their volume to the actual demand-based quantities as inventory adjustments have been completed, but there is no sign of a significant recovery in the demand. We believe that customers are still watching the situation because of uncertainty about the outcome of trade friction between the United States and China. On the other hand, we can now accept orders which we had to reject because of capacity limitation. In addition, Sanyo, Ovako and Nippon Steel will cooperate to maximize synergies, and we expect some orders coming to Sanyo. These are reasons why we consider the sales volume in the second half of FY2019 to be the same level as that of the first half.

Q. Though we consider it to be unlikely that scrap prices will fundamentally rise in the near future, there is a historical tendency that scrap prices will rise in winter. As a matter of fact, scrap prices rose from $220/t to $250/t in Turkey. How do you think about the impact on the earnings of second half of FY2019 if scrap prices rise?

A. Iron scrap prices have dropped dramatically, but recently they have stopped falling. However, we don't think that the supply and demand balance will tighten. We consider it to be unlikely that prices will rise significantly.

Q. In the previous briefing session (July 30, 2019), you explained that Ovako's sales price is declining due to intensifying competition of general-purpose product segment. How about the situation since then?

A. As mentioned on P21 in the IR material, the impact of Ovako's sales price and product mix deterioration has been estimated to be -0.7 billion yen from the previous 2H forecast to the revised 2H forecast, which includes the decline in sales prices due to intensified competition in general-purpose products.

Q. Regarding the collaboration among Sanyo, Nippon and Ovako, will the actual collaboration between Sanyo and Nippon Steel start only after the completion of Sanyo Factory Renovation and the change of Sanyo's operational structure?

A. The discussion is ongoing on the premise that both parties will expand each area they are more capable at. We consider that Sanyo will take over the manufacture of bearing steel of Nippon Steel. We are on the path of materializing each concrete action of collaboration.

Q. Please tell us the prospects of demand by industries, such as automobiles, bearings, and Semi-conductors, regarding Sanyo's sales volume forecasts for the second half of the fiscal year.

A. Because inventory adjustment in the areas such as robots, machine tools, and semiconductor manufacturing equipment have already continued for a long time, the inventory adjustment in those fields have started to show signs of completion. In terms of sales expansion, we will try to recover sales in general areas and export, in products such as high-alloy steels like stainless steel, that we have been unable to accept orders because of our limitation in our production capacity.

Q. Some of Nippon Steel's special steel facilities have halted operation due to natural disasters. Does this affect your sales volume in the second half of the fiscal year?

A. One of Nippon Steel's steel making mill at Kimitsu has stopped operation due to damage by the typhoon. This No.1 steel making plant supplies material for special steel bars. We have received a request from Nippon Steel for support, and we included this volume into our revised forecast.

Q. What is the change in sales volume of Ovako in FY2019 compared with the previous fiscal year?(Year on Year Basis)

A. Just for your reference, Ovako was not our consolidated subsidiary in the previous fiscal year. The sales volume of FY2019 decreased by about 12% in the first half and will decrease by about 14% in the second half compared to the same period of the previous fiscal year.

Q. The impact of Ovako's scrap surcharge time lag will be 1.2 billion yen in FY2019. Please tell us the breakdown of the first half and the second half.

A. Among 1.2 billion yen; 0.2 billion yen is of the first half and 1.0 billion yen is of the second half.

Q. Sales volume forecasts for the current fiscal year have declined considerably. Inventory adjustments in the supply chain may have resulted in a decline more than the actual demand decrease. Please tell us where the level of actual demand is in this year's sales volume plan.

A. It's quite difficult to answer, but bearing steel orders fell sharply from June to August 2019, as shown in the statistics of special steel orders. We think this is a movement caused by inventory reduction. We suppose that if this inventory reduction proceeds to a certain extent, the demand will return to the actual base. We are carefully watching what the actual demand level after the end of inventory adjustment will be.

Q. The difference in the cost of consumable goods, outsourcing, and logistics is merely 0.1 billion yen between the first half result of FY2019 and the second half forecast of FY2019 (IR material P25). In such circumstance, is it possible to negotiate the reduction of prices, such as electrodes and refractory bricks, in the second half of FY2019? How do you think about the direction of the prices of these materials from the current term to the next term?

A. Electrode prices have reached its peak because supply and demand balance has become slack, but it takes some time that this effect actually appears in our production cost. Our logistics costs have not significantly increased in the first half of the fiscal year, but they will increase from the second half of the fiscal year. As a result, we expect the direction of the prices of auxiliary materials will not change so much.

Q. Forecasts of capital expenditures and depreciation for FY2019 have increased considerably, including Ovako. What is the prospect for FY2019 and the following years?

A. The remaining capital investment amount of No. 2 Bar & Wire Rod Mill, aimed to eliminating production bottlenecks in FY2020, will be ¥6.0 billion, which is less than that of ¥13.5 billion in FY2019. Therefore, the amount of capital investment in FY2020 will decrease to the extent of this difference. Depreciation expense will increase in FY2020 compared to FY2019 as this investment will begin to be amortized. We think that the capital investment amount of Ovako and MSSS will be almost the same as this year.