

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

Date: Thursday, November 21, 2019
Speaker: Representative Director and President;
Shinya Higuchi

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

Q. I consider that there will be little impact on profit if the price of scrap remains unchanged for the next year, because the positive and negative impact of Sanyo and Ovako will be offset, am I right? In addition, I think that demand for the special steels would stagnate for a while even if the final demand would recover, because the inventory adjustment for special steels takes some time due to the length of the supply chain. How do you forecast the trend of the special steels market in the near future?

A. As you know, the impact of fluctuations in the scrap price will be nearly offset because of the difference in and symmetrical impact of the iron scrap surcharge system of Ovako and Sanyo.

We expect that the demand will almost return to its original level at the end of this fiscal year, but it is difficult to precisely forecast when the economic activities in China and India will regain the former robustness. We are carefully following the status of inventory adjustments related to bearings and automobiles, but even if the inventory adjustment period would be over, the quantity of orders might not return to its original level unless the actual demand returns. In addition, we regard that the demand for special steel will only recover somewhat after the final demand has returned, due the inventory adjustment effect. We do not think that inventory adjustments have been completed, so we consider that the real recovery in demand for special steel would happen in the next fiscal year.

Q. Production capacity will increase about 120,000 tons per year after the completion of the capital investment in No.2 Bar &Wire Rod Mill. I consider that it will be not easy to run the Mill at full capacity, unless you transfer some orders of bearing steel from Muroran works of Nippon Steel to Sanyo, just as an example. When will the full operation be realized?

A. The capital investment in No.2 Bar &Wire Rod Mill is not only aiming a capacity increase but also eliminating the bottleneck of the integrated manufacturing process. In addition, we think that it will be quite effective in terms of delivery and quality improvements as well.

The discussion between Sanyo and Nippon Steel are proceeding, and we will try to expand each area we both are more capable at. We consider that Sanyo will take over the manufacture of bearing steel of Nippon Steel and Nippon Steel will take over the manufacture of engineering steel of Sanyo. We believe that it will take two to three years to realize this on a large scale because we need customer approval to transfer orders among each other.

Q. Could you please tell us the current status of synergies between Ovako and Nippon Steel?

A. Ovako possesses a global sales network, and we are proceeding with marketing some of Sanyo's products by using this network. Sanyo and Nippon Steel are now able to exchange procurement information, and some concrete actions of joint procurement are proceeding. Some positive effects of joint procurement are expected to be realized soon.

Q. In the consolidated statements of cash flows, you are specifying 4.7 billion yen as "the revenues from the refund of the conditional acquisition consideration for the share of subsidiary". Could you explain the precise meaning? What was the agreement with Nippon Steel regarding the acquisition? Will this affect the amount of goodwill or not?

A. 4.7 billion yen deposits are due to the price-adjustment of the share of Ovako which we acquired from Nippon Steel. In accordance with the agreements with Nippon Steel, Ovako stock prices are adjusted based on the Ovako's cash flow at the time of becoming Sanyo's subsidiary. The original acquisition price was projected to be 67.2 billion yen, but we finally agreed to acquire the share of Ovako to be about 63 billion yen after some adjustments.

There is no significant impact on the amount of goodwill, since it was calculated based on the value after being adjusted.

Q. I think that Sanyo's high cleanliness steel would be more advantageous when the electrification of automobiles would proceed. How much market share do you have in the hybrid and electric vehicle market?

A. It is still not clear how far and when electrification will proceed. Nevertheless, if electrification would proceed, there are parts that would completely disappear, decrease or increase.

For example, crankshafts are used only for internal combustion engines, and they are likely to decrease, but Sanyo is not that active in this customer segment. In the case of reduction gear, our market share of the case-hardened steel for gears is somewhat high. In the case of suspension (hub), large bearings are contained in the wheels, and we have a quite significant market share. Therefore, we think that we are relatively in a favorable position if electrification would proceed. On the contrary, we think that the competitive environment will be more challenging, since competitors would endeavor to capture the growing demand of parts related to electric vehicles.

Q. What do you think about the change of market size of special steel and bearing steel over the next five to six years if the electrification of automobiles proceeds? The demand of ordinary steel, such as hot rolled steel has been decreasing after the Lehman shock, but I think that a market size of special steel has maintained its stability. What do you think about the future of the special steel market?

A. As a matter of fact, during the 30 years of Heisei period(1989-2019), the domestic demand of ordinary steel has decreased and the demand of special steel has increased. The reason of the increase of special steel during that period is mainly attributable to the growth of parts export from Japan, mainly in the areas such as automobiles, machine tools, semiconductor manufacturing equipment, and robots. It may be difficult to expect a continuous growth in the future, since the demand of special steel per unit may decrease, due to electrification of automobiles, and competition with Korean and Chinese manufacturers would intensify, but we consider that demand of special steels will not decrease so much.

Q. I think that the diameter of bearings will become smaller, since the demand for more compact bearings will increase in the future. The smaller the diameter, the lower the rolling efficiency. How do you cope with this shift to smaller diameter by introduction of RSB rolling mill?

A. This RSB is quite capable to adapt to the shift to smaller diameters and lot sizes. If we would have not invested in the RSB, the production volume could have further dropped in the future. In the conventional process, quite many numbers of rolling mills were installed, and it took us time to exchange the rolls to cope with the change of diameters of products. However, the RSB enables us to shorten the roll changing time and simultaneously will improve productivity because the capability of reduction is far larger than the conventional one. Productivity would have gradually decreased, due to the shift to smaller diameters and lot sizes, if we would not have invested in the RSB. The introduction of RSB enables us to increase productivity despite the changes in the market demand.

Q. More than half a year have passed since you acquired Ovako. What is your current impression of OVAKO after half a year of ownership?

A. We consider that Ovako is quite performing in a difficult market environment, and making strenuous efforts such as to maintain its market share in German parts manufacturers, even though Ovako is located in the Nordics. We regard that the performance of OVAKO compared to other companies in the special steel industry in Europe is quite favorable,.

On the other hand, Ovako still has room for significant improvement, if we compare the practices between Sanyo and Ovako. Currently, Ovako is striving to improve its performance, especially in the area of production. We are already starting to receive some positive results, and are looking forward to deepening our collaboration and enhancing our mutual performance.

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