

Questions and Answers

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Executives

Koji Furusawa—Director, in Charge of Investor Relations

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Q: About how much unrealized gains from inventories are included in the first quarter of last year? It seems to be one reason that profit decreased. Please explain.

A: Last year, exchange rate effects due to unrealized gains from inventory increased operating income by 0.71 billion yen. This term, exchange rate effects decreased operating income by about 0.1 billion yen. On a year-on-year basis, that means exchange rate effects decreased operating income by about 0.8 billion yen.

A (Miura): The actual elimination amount due to unrealized gains was a negative 1.5 billion yen, year-on-year. When only increases/decreases due to exchange rate effects were isolated, they accounted for 0.8 billion of the 1.5 billion yen year-on-year decrease.

Q: How does it relate to the negative 0.5 billion yen in exchange rate effects on consolidated operating income you mentioned in your opening remarks?

A (Miura): Separate from the negative 0.8 billion yen due to unrealized gains from inventory, sales transactions, i.e. increased selling prices and increased selling and administrative expenses due to exchange rates resulted in a positive 0.28 billion yen. Combined, these two amounts resulted in a 0.5 billion yen decrease in operating income due to exchange rate effects.

Q: How big is the delay you mentioned for Analytical & Measuring Instruments sales in North America?

A (Oyagi): The delay is presumably due to the uncertainty about the current administration's policies in the United States, but the size of the delay has not been disclosed.

Q: My impression is that government regulatory demand has accounted for a major portion of Analytical & Measuring Instruments sales in China for several years. However, would you explain the reasons and background for the proportional shift in demand between public versus private sector demand and for the currently strong private-sector demand? Also, please comment regarding whether this phenomenon is temporary or ongoing.

A: The proportion of private-sector demand has always been high in China, with about 45 % public and 55 % private sector demand. In the last few years, though, the proportion of public-sector demand has increased to about 50 % due to the strong government demand resulting from China's 12th Five-Year Plan. However, the proportion of public-sector demand decreased for this term, because the projects from the 12th Five-Year Plan are winding down and the projects from the 13th Five-Year Plan have not fully started yet. Due to financial investments by the government and other factors, the economic recovery in private-sector demand has been extremely large. Previously, only pharmaceuticals and contract analysis fields were strong, but now chemicals and electrical/electronic fields are also expanding. As a result, the proportion of private-sector demand has increased to 66 % in the first quarter.

We think this trend will continue for a while, but the proportion of public-sector demand is expected to increase a little once new projects from the 13th Five-Year Plan start up.

Masahiro Nakanomyo—Jefferies (Japan)

Q: When you explained that exchange rate effects for unrealized inventory gains accounted for a negative 0.8 billion yen of the total year-on-year negative 1.5 billion yen and an increase/decrease in inventory quantities accounted for a negative 0.7 billion yen, are those amounts on a consolidated basis? If so, how much of that is for the Analytical & Measuring Instruments segment?

A: Yes, the values are on a consolidated basis, but it is valid to understand that the Analytical & Measuring Instruments segment accounts for most of that.

Q: Did inventory quantities increase that much in the Analytical & Measuring Instruments segment due to strong demand?

A: We think the inventory increase is within a normal range considering that sales are increasing. Unrealized gains from inventory also increased due to improved gross margins on inventory applicable for determining unrealized gains.

Q: When simply comparing first quarter results for the Analytical & Measuring Instruments segment from last year and this year, it appears profitability has decreased, but is it reasonable to assume there has been no fundamental changes in the competitive environment and actual conditions have not worsened?

A: Yes, that's correct.

Q: Since you did not change the full-year outlook, does that mean you did not change the breakdown by region? If not, it means growth in China, for example, was stronger in the first quarter than it will be for the full year. Does that imply you anticipate any particular factors that will slow growth in the second half?

A: No fundamental changes were made to the breakdown by region.

A (Miura): For example, I mentioned earlier that Analytical & Measuring Instruments segment results had stagnated in other Asian countries, but one factor that affected results was that shipments were stopped in anticipation of the unified GST system introduced in India, but that issue should be resolved starting from the second quarter. In other words, if all such factors are taken into consideration, no overall major changes are expected in the regional balance.

Corrected comment: There are no changes in the full-year earnings outlook, but in terms of regions, the proportion of sales in China increased and decreased in Japan.

Q: You explained that strategic investments were a factor resulting in the decreased income, but how large were the investments? Also, what was the breakdown by segment and how often are other strategic investments expected from the second quarter onward?

A: About 0.6 billion yen of strategic investments were made in the first quarter. We also estimate 0.3 billion yen for labor costs and 0.3 billion yen for depreciation and amortization. Relevant factors include the subsidiary SLA in South America acquiring a distributor, starting up marketing innovation center and innovation center in Singapore, introducing a new enterprise resource planning (ERP) system at the head office, increasing and improving production equipment at the Malaysia Plant, increasing and improving production equipment for hydraulic equipment, and costs of outsourcing administrative processes associated with the recent acquisition of Alsachim. Collectively, such factors resulted in 0.6 billion yen of investment expenses during the first quarter, which is projected to total about 2 billion yen for the full year.

Q: I think the plan was to increase R&D expenses and depreciation and amortization expenses this year, compared to last year. Are these investments part of that plan?

A: Yes, we plan to increase R&D expenses by 1.4 billion yen from last year, but that increase does not include the 0.6 billion yen figure mentioned earlier. We also plan to increase depreciation and amortization expenses by 1.5 billion yen for the year, with 0.3 billion yen of that included in the 0.6 billion yen figure. These figures are all consistent with the plan.

Motoya Kohtani—NOMURA SECURITIES

Q: The gross margin is 3.6 % lower than for the first quarter last year. What caused that decrease?

A: Exchange rate effects occurred on unrealized gains from inventory that had a negative 0.1 billion yen impact on the gross margin. In addition, 0.6 billion yen of service expenses were transferred from selling and administrative expenses to product costs this term, which resulted in a combined 0.7 billion yen decrease in the gross margin. On the other hand, gross income increased by 0.5 billion yen for sales transactions, which is the portion relevant to business operations. Including all such factors, the gross margin for this term is equivalent to 38.4 %, rather than 37.7 %. Even though a gross margin of 41.3 % was reported last year, if the 0.7 billion yen worth of unrealized gains from inventory are ignored, the gross margin would have been 40.2 %. Consequently, the gross margin effectively decreased only 1.8 % from 40.2 % last year, excluding exchange rate effects, to 38.4 % this term, excluding exchange rate effects. This 1.8 % decrease is a better indication of true profitability.

The reasons for the 1.8 % decrease include problems with our segment mix and problems with our product mix within respective segments, which account for a 1.0-point decrease. Gross margin decreases in certain turbomolecular pump markets accounted for a 0.3-point decrease. Those are the main reasons for the lower gross margin.

Q: Was the 1 % product-mix decrease caused by an increase in Analytical & Measuring Instruments products with lower gross margins? Did such products increase in Japan?

A (Oyagi): As you point out, even though LC, GC, and MS products are doing well, the reality is that sales of other less-profitable products increased. That is probably one cause. Also, as you point out, there was an increase in less-profitable sales in Japan as a region.

Q: Does that mean we do not have to worry about core operations, because gross margins did not decrease for LC, GC, and MS products?

A (Oyagi): That's correct. Ignoring exchange rate effects, the proportion of LC, GC, and MS sales has expanded, year-on-year, which has benefited us. However, it is also true that the decreasing profitability of other product areas has been pulling profitability downward.

A (Miura): For example, in the aftermarket business, products such as the multi-vendor services we started in Japan have been performing quite well. Activities such as these are also performed for strategic reasons, in consideration of future market share and other factors. Consequently, they have very different profitability levels than LC and MS products. Therefore, I hope you will view the results positively in terms of realizing strategic objectives.

Q: The Analytical & Measuring Instruments segment is extremely strong in China, but all of your competitors reportedly are also doing extremely well. That makes me feel worried about potential pitfalls. What sorts of risks do you anticipate?

A: One risk is that sustaining economic progress has been highly dependent on financial investments. As background for expanded financial investments, one reason investments are being expanded is that the government needs to maintain economic growth in preparation for the National Congress of the Communist Party this fall. Another reason is the trend of expanding debt, especially at state-owned companies. These factors remain a source of uncertainty.

Q: I assume the recently acquired company Alsachim is involved in making products that are used in mass spectrometry for clinical applications, but does that mean you intend to take an active role in that process or, alternatively, are you mainly interested in Alsachim in terms of developing a line of reagent products?

A: The French company Alsachim is involved in developing and selling stable isotopes and reagents.

Their reagents and examination methods provide a big advantage for selling our mass spectrometers, because we can offer one-stop services. Our basic view is that the reagents themselves will help expand Shimadzu sales within sales channels outside Japan, including via sales subsidiaries outside Japan, and will provide a base for expanding Shimadzu's reagent business in the future.

Akihiro Ban—SMBC NIKKO SECURITIES

Q: The report indicates that orders increased by over 20 % in North America, but is that increase due to a recovery from last year's low orders for pain management or because sales increased in pharmaceuticals or other markets? Also, were the increased orders mainly for LCMS-8050/8060 models?

A: First, note that pain management orders decreased in both the first and second quarters of last year. On that basis, things are improving. Orders have been increasing not only for pain management, but also for pharmaceuticals, chemicals, and energy fields. Therefore, the 20 % increase is representative of overall orders. In terms of products, LCMS orders have clearly been growing, but I cannot offer an accurate breakdown by model.

Q: You reported that you intend to increase the market share of LCMS-8060 systems in the pharmaceuticals market. What is the progress in that regard?

A: 8060 unit sales have been increasing steadily, but we still have not broken into the mega pharmaceutical market. Nevertheless, sales are steadily increasing to CROs, testing laboratories, and others in peripheral fields, so we are feeling satisfied with our current accomplishments thus far.

Q: What is the proportion of LCMS-8050 and 8060 unit sales, high-end models, and so on?

A: This term, the global proportion of high-end models is about 60 %, which is down from 70 % in the first quarter last year. Unit sales are increasing for the 8060 model, but decreasing for the 8050. We are not certain of the reasons, but it may be due to the slight shipping delays caused by North American customers in the Analytical & Measuring Instruments segment, as mentioned earlier. From a long-term perspective, we are not very worried.

Toru Sugiura—Daiwa Securities

Q: Which first-quarter results were higher than initially projected at the beginning of the year and which were lower, in terms of either regions or products?

A: Net sales have exceeded initial projections. In terms of regions, India and Southeast Asia results are slightly lower than estimates, but orders are currently strong in those regions, so we expect results to improve from the second quarter.

In terms income, the biggest factor causing increased sales, but decreased income, is unrealized gains from inventory. However, operating income for respective divisions is currently exceeding the initial plan.

Q: You reported that gross margins for turbomolecular pumps decreased due to increasing quantities, but could you explain the background for that? Please also explain your outlook for semiconductor and flat panel display applications, where I understand sales are increasing for both applications.

A: Some turbomolecular pumps are sold to semiconductor companies and those sales drove first-quarter results, but due to the considerable purchasing power of such companies, profitability was slightly worse than in other markets. Furthermore, semiconductor and flat panel display markets remain extremely strong, so good results are expected to continue for the first half and full year.