Main questions and answers at the FY2024 results briefing

Q1.
According to this fiscal year's plan, orders received are expected to decrease compared to the previous year. Could you explain the background behind this projection?

A1.

The forecast of orders received is based on projections currently being compiled by each department. However, there is some upside potential, particularly if the yen continues to weaken. In addition, if the service business performs better than expected, there could be additional upside in the figures. Conversely, if the global economy experiences a temporary slowdown, there is a downside risk due to a possible deceleration in new project opportunities.

However, considering the current electricity demand situation, we believe the risk of a significant decline is low. In particular, demand for AI and data centers has surged, leading to a substantial increase in power consumption. In fact, we heard that Mitsubishi Heavy Industries is receiving a very high volume of inquiries for gas turbines and has already been forced to turn down new orders. Many of these gas turbine projects also include our pumps, so we expect steady demand to continue.

In Japan as well, the 'Long-term Decarbonized Power Source Auction' has commenced, and the 7th Basic Energy Plan anticipates an increase in electricity demand, reversing the previous downward trend. This is also a response to the rising demand from AI and data centers. The government is strongly committed to this sector, and many power companies—from Hokkaido Electric Power to Kyushu Electric Power—are actively advancing their initiatives.

Furthermore, investments are expanding into next-generation energy fields such as energy storage batteries, and our company is also paying close attention to these areas. While this was once unthinkable, there are now movements overseas, including in the United States, to reassess coal-fired power and to resume oil development. Companies like Exxon have already initiated such projects, leading to an overall revitalization of the energy sector.

In this context, the figure of 90 billion yen is merely a projection based on the current circumstances. The orders backlog amounts to approximately 100 billion yen, and while our company currently has no plans to restrict order intake, this could change depending on future circumstances. Therefore, at this stage, this figure should be viewed as an approximate estimate.

Q2.

I understand that the policy for this fiscal year is to strengthen manufacturing capabilities. In that context, you mentioned plans to increase the in-house production ratio. What is the current in-house production ratio, and what is the final target?

A2.

The order backlog has already exceeded 100 billion yen. However, the current forecast for operating profit is 6.7 billion yen, meaning that approximately an additional 3 billion yen is needed to achieve an operating profit margin of 10%. As I mentioned earlier, the plan to bridge this gap focuses on two main points: expanding the service business to improve overall profit margins, and promoting in-house production to enhance cost efficiency.

Specifically, in FY2024, subcontracting costs exceeded initial expectations, causing a temporary increase in expenses. However, from this fiscal year onward, there is a plan to gradually bring about half of this work back in-house. We expect this shift to in-house production to improve profits by approximately one billion yen.

Therefore, during Phase 2, we aim to raise the operating profit margin to around 10% by strengthening our ‘make it ourselves’ approach while enhancing our service business to improve the overall profitability.

Q3.

In your earlier explanation, you mentioned that although there were various troubles in FY2024 resulting in decreased profit, the company's structure has been established.

Specifically, could you clarify whether the current system is already capable of handling sales on the scale of 100 billion yen, or if the organization and scale have been set up recently to aim for 100 billion yen in sales and still require a final push?

From a medium- to long-term perspective, could you also explain when this system was considered fully in place with the target of achieving 100 billion yen in sales?

A3.

Let me explain the expression "the structure has been established" that you asked about. This refers to the stage when various measures were decided and actions began to be implemented. Specifically, we are advancing front-loading of operations, reducing workload through AI utilization, and developing a more flexible manufacturing system. However, the full effects of these initiatives are expected to appear not in this fiscal year but from next fiscal year onward.

The machining facility in India is currently under construction and is scheduled to start operations around March next year, so its impact this fiscal year will be limited. Production transfer to the Kyushu Torishima plant began in September, increasing our production capacity. By absorbing the previously disrupted production, we expect to see some improvement in the second half of the year.

Additionally, we are aiming to finalize agreements on several M&A deals within this fiscal year and proceed with subsidiary and group formation. The effects of these efforts will also become fully apparent from next fiscal year onward.

Therefore, we do not consider this fiscal year as the stage where the "structure has been established," but rather as the first year of Phase 2 during which countermeasures have begun. At this point, the main goal is to recover from past challenges, and we do not expect significant profit margin improvements. Since visible results will come from next fiscal year onward, we ask you to monitor our future efforts closely.

Q4.

You have talked about the target of 100 billion yen in sales and 10 billion yen in operating profit for some time. Was this target based on the assumption of in-house production? Or was the decision to accelerate in-house production made suddenly in response to the recent lack of profit in the second quarter?

A4.

It is the former. We prepared the budget and proceeded with orders based on the in-house production rates for fiscal years 2022 and 2023.
At that time, we expected an operating profit margin of 8 to 9%, assuming that it would approach 10% with the expansion of services.
However, in reality, orders exceeded expectations, and our planning capacity could not keep up, causing disarray on the ground.

For example, if we had clearly set a limit not to accept orders beyond our production capacity, the problem would have been less serious. However, we actively accepted orders, which made it difficult to cope. This was a “growing pain”.

While we took orders to meet customer expectations, the operating profit margin would likely have been stable if sales had stayed around the initially planned 80 billion yen. It is true that the amount exceeding that range negatively impacted our profitability.

Currently, due to the weak yen, we are focusing on domestic production. However, we also want to ensure flexibility to respond in case the yen strengthens in the future.

Therefore, we are strengthening our production systems in India and China. Also, the Egyptian government is encouraging more manufacturing of end parts locally in the future. Given this background, various plans, including a global manufacturing system, have existed as a concept from the beginning.

Q5.

Regarding order profitability, I understand that your company has a certain lead time from order to delivery. Therefore, it is difficult to immediately reflect increases in raw material prices in the selling prices. Over the past two years, rising raw material and labor costs have squeezed profits.

Has the selling price now mostly caught up with costs? Or selling prices have not yet risen sufficiently, and profit improvement is expected through price increases from FY2025 onward?

A5.

The situation varies by market. In the public sector, which accounts for about 20 billion yen in sales, there is a government cost estimation standard. Price changes are gradually reflected in the prices.

For example, even if labor costs rise from 20,000 yen to 25,000 yen per day, the estimation standard only allows a gradual increase from about 20,000 yen to 21,000 yen. As a result, profit margins declined in FY2022 and FY2023 but are improving and expected to stabilize this year.

Overseas, Order amounts are determined based on actual costs. For example, for a 1 billion yen project, we estimate material prices up to two years in advance and secure purchase prices beforehand. Therefore, costs are almost fixed. However, if a planned in-house process is outsourced, unexpected costs occur, reducing profit margins. Last year, many expensive urgent outsourcing costs occurred, causing a significant drop in profit margins.

This was a serious issue in the first half of the previous fiscal year, leading to a downward revision of the full-year plan and a recovery effort in the second half.

However, this is still not enough. Therefore, we are strengthening our system through in-house production and capital investment, such as establishing a new facility in India and actively looking at acquiring machining companies. grouping machining companies.

In overseas, prices are fixed based on costs at the time of order, so even if prices rise, profits are not greatly affected. For example, if selling prices increase by 1%, it would mean about 200 million yen in additional profit on 20 billion yen in sales, but competition is fierce.

Moreover, not only cost but also delivery time is very important. For instance, while competitors take a year and a half, we can deliver in one year and two months. This is one of our major competitive advantages.

Q6.

Are the competitors mainly European and American manufacturers? Also, do local Asian manufacturers compete with you as well?

A6.

The competitive situation varies depending on the region. In the Middle East, only European and American manufacturers handle the most critical parts of seawater desalination. However, since they also manufacture in India and China at lower costs, we cannot easily raise prices. We see this as a matter of balance. Our business model is to first deliver a large number of pumps and then complement that with highly profitable services.

Q7.

Given the increase in the order backlog, the sales forecast for FY2025 seems somewhat conservative. Is this because not many of those orders will be recorded as sales within this fiscal year?

A7.

As of the end of March 2025, our order backlog stands at ¥104 billion.
Some of these will be recorded as sales in FY2025, while others will be carried over to FY2026 or later. However, there are very few projects that extend into FY2027, as we currently have limited long-term overseas projects.

We have carefully reviewed the portion of the backlog to be recorded in FY2025 and, factoring in short-cycle orders such as services and spare parts that are received and completed within the same fiscal year, we are forecasting sales of ¥89 billion. Although there is potential for upside, we have set this figure due to certain risks—such as delays in public infrastructure projects that may postpone sales recognition, or shipping delays even when our production is ready.

Q8.

Despite a significant increase in the order backlog for services, your forecast of the subsidiaries is lower gross margin for FY2025. What assumptions or factors are behind this projection?

A8.

While a large portion of our subsidiaries' business is in services, not all of it is. The overall increase in service orders is also driven by domestic service growth, so the performance of all subsidiaries does not directly reflect the trend in the service business as a whole.

The subsidiaries' plan is based on the sum of each company's individual projections and reflects their current circumstances. The anticipated decline in sales is mainly due to our subsidiary in China, which represents only a part of the total subsidiary group.

The 1.1-point decline in gross profit margin is considered negligible and within the acceptable range. Additionally, the exchange rate assumption has changed—from 150 yen in the previous estimate to 145 yen this time—which results in a projected decrease of around 3% in both revenue and profit due to currency conversion effects.

Q9.

Is it possible to reduce packing and shipping costs even as standalone sales increase? Was there a specific reason for higher costs in the previous fiscal year, such as increased air shipping?"

A9.

As sales increase, packing and freight costs fluctuate depending on the sales mix. Due to accounting standards, items such as sales commissions and packing/shipping costs—which would normally be included in cost of sales—are recorded under SG&A expenses. These costs vary by project and, while they include some fixed components, they are largely variable in nature.

For the current fiscal year, despite the expected increase in sales, these expenses—particularly sales commissions and packing/shipping costs—are projected to decrease by around 1 billion yen. As a result, total SG&A expenses are expected to decline.

Q10.

Could you provide an overview of the expected changes in orders for this fiscal year, by segment—public sector, private sector, and overseas—or by region?

A10.

As for public-sector projects, the Construction Business Act requires the assignment of supervising engineers. A shortage of such dedicated personnel limits our ability to take on new orders, so the current situation is quite challenging. Accordingly, our order forecast for this year is more conservative than last year.

On the other hand, private-sector demand depends on trends in capital investment. Triggered by the start of ammonia co-firing and the long-term decarbonized power auction, several companies including JERA and Kyushu Electric Power have launched new projects targeting 2030. Additionally, commercial demonstrations related to hydrogen for 2030 are progressing, so private-sector demand is expected to grow significantly in the future. Overseas operations are expected to remain steady.

By region, orders in Africa have settled down, but many projects are underway in the United States. However, due to tariff issues and others, future responses will need to be considered while monitoring the situation. In the U.S., power demand for AI and data centers is growing rapidly. We expect significant growth in power demand in both Asia and the U.S.

Regarding the Middle East, we expect stable demand for seawater desalination as long as crude oil prices remain around $70 per barrel. In the Europe and North America market, the situation in Europe is somewhat challenging, but overall conditions are expected to improve once the U.S. market picks up.

Q11.

What is the breakdown of the 10 billion yen operating profit between the parent company and subsidiaries?

A11.

The expected operating profit for the parent company in FY2025 is 3.6 billion yen. The subsidiaries' operating profit, before consolidated adjustments, is 3.3 billion yen.

We believe the service division within the subsidiaries will grow significantly going forward.

For the parent company, if in-house production progresses at the current production scale and SG&A expenses remain stable, we also expect profits to increase.