

FY 2018 Results & Financial Position—Questions and Answers

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Executives

Teruhisa Ueda—President and CEO

Koji Furusawa—Director, in Charge of Investor Relations

Yasuo Miura—Director and Financial Officer

Masahiro Nakanomyo—Jefferies (Japan)

Q: For the Analytical & Measuring Instruments segment, what factors contributed to the 3-point increase in the aftermarket business sales ratio from 27 % last year to 30 % this year? Also, how much do you expect it to increase by two or three years from now?

Ueda: The biggest driver was the increase in number of service contracts. Previously, the number of service contracts was low in regions outside Japan except the United States, but the number has significantly increased as they are deployed in various other regions. The second factor was an increase in consumables products. For the time being, the target ratio is 35 %. Expanding service sales also involved increasing the number of personnel, so we intend to keep that number in balance.

Q: It appears that sales growth of key Analytical & Measuring Instruments models is slowing compared to 3 or 4 years ago, especially for chromatographs. What is the predicted overall market growth rate for key models and for Shimadzu in particular?

Ueda: In the case of chromatographs, the growth rate for liquid chromatographs previously has been high, but as the market size expanded, it has become more difficult to achieve high growth rates in the double-digits. Furthermore, successive new liquid chromatograph markets have not been created either. Nevertheless, we are confident that if we incorporate various technological innovations like AI and IoT technologies, customers will increasingly be inclined to replace their current systems, so we do not think the growth in Shimadzu sales will stop.

Q: How much was invested in the future of the North America market for Medical Systems during FY 2018? Also, given that increased sales and income are planned for Medical Systems in FY 2019, what is the certainty of those increases?

Ueda: We invested quite a bit during FY 2018, but we plan to keep it more balanced this year.

We have a high market share for general radiography systems in Japan, but our market share outside Japan is still an issue. In particular, the current medium-term management plan focuses on expanding a market share for angiography systems. We are starting to achieve significant results in Southeast Asia, but we will continue to implement measures in North America, where results are still weak.

Motoya Kohtani—NOMURA SECURITIES

Q: What are projected investment expenses for FY 2019?

Ueda: A breakdown of the 3.1 billion yen year-on-year increase for FY 2018 firstly included

a 1.1 billion yen increase in R&D expenses, which we do not intend to decrease. Next, depreciation and amortization associated with capital equipment investments increased by 0.9 billion yen, due to construction of the Healthcare R&D Center in the Head Office grounds and other factors. Furthermore, we are also planning to build a new building at Technology Research Laboratory in the Keihanna district of Kyoto and an application development facility in the Kawasaki region of Greater Tokyo, which is scheduled for completion in December 2020. Given the extremely high importance of preparing environments for research and development, we will continue to invest in establishing facilities for joint development that are closer to customers. In addition, investments increased by about 0.7 billion yen for establishing systems and RPA for working practice reforms. We think investment expenses will continue to occur in these three areas.

Q: What are the new liquid chromatograph products released in March? What aspects have received positive feedback?

Ueda: The feedback was very good for the new products exhibited at the Pittsburgh Conference for analytical instruments in the United States. In fact, we already received a purchase order in the United States. The main points of the positive feedback were the low cross contamination when connected to a mass spectrometer and the ability to significantly shorten analysis times. These two aspects were especially judged highly in the United States and Europe. We have received extremely good feedback in Japan as well, where we have already been demonstrating the system.

Q: How much importance are you placing on amyloid MS technology? Approximately when will the technology appear for in-vitro diagnostics (IVD) or laboratory-developed tests (LDT) in the United States or Japan?

Ueda: First, we started the business from contract analysis applications in Japan. However, due to strong requests from the United States, we are considering establishing similar facilities in Europe and the United States for contract analysis as well. Given that the mechanism of dementia still has not clearly been determined and there is debate over whether or not beta-amyloid accumulations alone actually result in dementia, we need to proceed very cautiously. This is the stage for securing various joint research partners and further clarifying the value of analyzing beta-amyloid.

Tomoki Komiya—Mitsubishi UFJ Morgan Stanley Securities

Q: What was the growth rate of key Analytical & Measuring Instruments models in China? What is the current situation and the basis for future plans, broken down by private and public sector demand?

Furusawa: Overall, the growth rate (excluding exchange rate effects) for key models during the fourth quarter (January to March) was 2 %. Of that, the growth rate (excluding exchange rate effects) in China was 6 %, which has continued to increase from the third quarter.

Public sector demand accounted for 34 % of sales in the fourth quarter (January to

March), which is somewhat lower than the approximately 40 % in the third quarter (October to December). However, public sector demand tends to decrease in the fourth quarter due to Chinese New Year holidays and the National People's Congress held during that quarter, so we think that the growth potential of key models in China has remained the same.

Q: You explained measures for rebuilding businesses of the Aircraft Equipment Division, but how are the current measures different than previous measures to improve profitability?

Ueda: The Aircraft Equipment Division has an extremely large number of long-term agreements, so we are renegotiating those agreements as it becomes possible. We are also implementing new measures, such as launching the testing and inspection business and other new businesses.

Q: Several years ago, a comment about shareholder returns was included that indicated Shimadzu has the option to buy back shares, but in reality that has never occurred. Has Shimadzu's policy changed about buying back shares?

Ueda: Basically, we still would like to actively buy back shares if appropriate conditions are satisfied and our guideline of providing a total return of 30 % remains unchanged. However, we intend to keep it in balance with investments for future growth.

Yukihiro Koike—UBS Securities

Q: In the overview of the ratio of net sales for the Analytical & Measuring Instruments segment by market (slide 11), there was a comment indicating that in pharmaceuticals field, the degree of interest varied depending on the region. If so, what is your view of conditions in the pharmaceuticals industry for each region?

Ueda: For many years, the pharmaceuticals industry has been mainly split between new drugs and generics, but more recently new segments have emerged, including biopharmaceuticals, peptide drugs, and other drugs based on mid-sized molecules. Given those circumstances, one observation is that pharmaceutical manufacturers seem to be divided between whether to focus resources on generic drugs or on new drugs.

Another observation is that, not surprisingly, the level of progress differs depending on the country. For example, newly emerging economies, such as in Southeast Asia, are in the stage of creating more and more domestic pharmaceutical manufacturers, where growth is presumably mostly for generic drugs. In developed economies, such as Europe and the United States, the major pharmaceutical manufacturers are optimizing operations by separating their in-house R&D functions from their outsourcing functions. Consequently, CROs and CMOs are on the rise.

Therefore, our healthcare business affects not only drugs, but also CROs, CMOs, and even the chemical industry, which seems to be complicating the situation in some ways.

Q: A competitor of Shimadzu's Analytical & Measuring Instruments segment commented that capital investment by generic drug manufacturers decreased due to the lower value of drug shipments following the centralized drug procurement policy of the Chinese government that began in November 2018. How does Shimadzu currently view that situation?

Furusawa: So far we have not felt any direct effects from the government regulation for adjusting drug prices, to which the competitor is referring. We feel we need to monitor the situation a little longer.

If anything, the impact was even greater to us when the temporary demand from generic drug companies for compliance with GMP-based pharmaceutical safety standards ended two years ago.

Q: The medium-term management plan has targeted 20.0 billion yen in sales from advanced healthcare, but current circumstances suggest that level of sales is not actually being achieved. What is different than expected, in terms of external factors versus internal Shimadzu-specific factors. Furthermore, what countermeasures do you intend to implement?

Ueda: There is no change in our view that advanced healthcare will be an important area in the medium and long-term, but the reality is that some aspects are more difficult than expected, due to various regulations.

The first issue is compliance with the Japanese Pharmaceutical and Medical Device Act. For example, it requires a variety of data in various formats, even for clinical trials, making the hurdle of compliance with the act seem especially high. The first reason progress is not being made with the sense of speed we anticipated is that if an established test method with an extensive track record already exists, breaking through that wall of precedent is not easy.

The second reason is the various ethical issues that can emerge during technology development. For example, bringing blood to our facility for analysis can involve ethical difficulties. Instead, we need to install instruments at a hospital so that blood can be analyzed at the hospital in various ways. That is another aspect that is quite different than the business model we had initially imagined.

Q: In the analysis of year-on-year increase/decrease in operating income, improvement of real profitability was reported as 1.5 billion yen. If profitability improved by 1.2 billion yen from April to December, then the improvement for January to March should be 0.3 billion yen, but what caused that difference?

Miura: Firstly, the reported value represents the cumulative results from day-to-day cost reduction measures. Furthermore, the difference is also caused by the Aircraft Equipment segment accounting for a smaller ratio of sales and the Analytical & Measuring Instruments segment accounting for a larger ratio of mass spectrometer sales for January to March.