

Kaga Electronics Co., Ltd.
Financial Results Briefing
for the First Half of the Fiscal Year ending March 2022
Main Questions and Answers

Date and time : Thursday, November 25, 2021 16:00-17:00
(Online briefing)

<Points to note>

“Main Questions and Answers” has been posted as a reference for the convenience of those who were unable to attend the financial results briefing. Please be aware that it is not a transcription of all matters discussed at the financial results briefing, but rather a brief summary of what Kaga Electronics judges to be the key points. Please also note that the statements contained in this document that relate to the future, such as results forecasts, are based on information currently in the possession of Kaga Electronics and certain assumptions that have been judged to be reasonable. Actual performance, etc. may differ substantially due to a range of factors.

Results for the first half, full-year earnings forecast

Q: In the first half, the profit margin in the EMS business was over 6%. Will you be able to maintain this profit margin going forward? Alternatively, will you aim for a higher profit margin?

A: We think our profit margin is slightly higher than our industry peers, which we believe is the result of having prioritized profitability in our business operations to date. We have no intention to change this policy going forward.

Over the next three years of our medium-term plan, we intend to operate our businesses in a way that ensures that we can secure profits, instead of just pursuing net sales, based on this approach of prioritizing profits.

Q: In the electronic components business, which fields specifically are growing in the automotive market?

A: First, one field that is growing is components related to head-up displays. We also sell components for other parts, lights, battery pack units for emergency notification equipment, etc.

In addition, there are also AC/DC converters, which the latest cars are equipped with. Following the typhoon in Chiba last year, when a Japanese automaker loaned cars to regional governments, these AC/DC converters received significant praise. Subsequently, the move to equip hybrid vehicles with these converters as standard has accelerated. These components also contribute significantly to net sales.

Q: Why have inventories increased?

A: The main reason for the increase in inventories is the build-up of inventories at EMS plants overseas. When assembling EMS circuits, we begin production after all components are ready. Production lines will stop if there is a shortage of even one component, so we ensure that we hold larger inventories than normal when there are component shortages. Even so, when there are component shortages, we delay the production of those models, which affected temporary building up and increase in component inventories.

Furthermore, under cash flows from operating activities, we recorded an outflow of 2.0 billion yen, because strong profits were canceled out by accounts receivable, a decline in accounts payable, and an increase in inventories. Regarding interest-bearing debt, our net D/E ratio turned from negative to positive, albeit close to zero, because interest-bearing debt amounted to just over 44.0 billion yen, despite cash and deposits of just over 40.0 billion yen. However, looking at Kaga Electronics as a whole, we believe that we still have ample ability to borrow funds, and are not concerned about the level of interest-bearing debt.

In addition, accounts receivable and accounts payable had increased significantly as of March 31, 2021, but they tend to decline after both net sales and procurement peak, which resulted in a significant decline

as of September 30, 2021. In this way, we expect cash flows from operating activities to improve as soon as tight supply and demand for components eases, even if only a little.

Each EMS plant currently does have some safety stocks, due in part to requests from customers. However, production will move forward as components come in, causing the decrease in inventories to accelerate. Furthermore, compared to our competitors, we have an extremely rigorous approach to inventories and control them very tightly, with almost no dead stock. Since all of our plants are currently in operation, we believe that inventories will decrease as soon as the component shortages ease to some degree.

Q: Specifically, what sort of risks do you expect in relation to the full-year earnings forecasts for the current fiscal year, such as opportunity losses from tight supply and demand of electronic components or the impact of rising distribution costs?

A: In electronic components, the balance of supply and demand is tight across all components, not just for semiconductors, but also materials, and we expect these conditions to continue in the future. As such, we believe it is possible that products may not be ready, even if we do our utmost to gather components. Transportation costs have also increased three- or fourfold, as components that previously took around one month to get from Hong Kong to the U.S. now take around 2.5 months. We think this factor will put pressure on expenses.

Q: In the first half of the current fiscal year, operating income exceeded internal forecasts by 3.0 billion yen. I believe this is partly due to good performance in the EMS business, as well as higher profit from tight component supply and demand. I expect tight component supply and demand to continue in the second half, but why have you only factored downside risk into your forecasts for the second half, and not this upside? Were there any one-time factors in the first half? Isn't the forecast of 15.0 billion yen conservative?

A: When we supply the components our customers are requesting under the current component shortages, we are using different formats than usual for our transactions, and we do not know how long these circumstances will continue. Also, for electronic components, it is not like if we keep searching for products, we will keep finding them. We think that at some point we will run out of alternative products to supply, and we are thus cautious in our forecasts for the second half.

Q: You made an acquisition related to communications modules from TAIYO YUDEN. What was the aim of this M&A?

A: TAIYO YUDEN offered this business for M&A as part of its strategy of concentrating and selecting its businesses. On the other hand, we expect the communications market to grow in the future, so we decided to acquire this business after some consideration.
We intend to conduct further M&A in the future related to electronics if there are merits for Kaga Electronics.

Next medium-term plan

Q: In the final fiscal year of your next Medium-Term Management Plan, you are aiming for net sales of 150.0 billion yen in the EMS business. What industries will drive performance over the next three years?

A: In terms of industries that will grow, there is overwhelming potential in the automotive industry, and indeed, this industry has grown over the past three years. Our customers are also performing very well, and are expanding production lines at various sites in line with this growth.
In addition, medical equipment is also growing at a relatively stable pace. Customers in the medical industry in the U.S. are continuing to perform extremely well, and transactions with Kaga Electronics are increasing.

Transactions related to office equipment and air-conditioning equipment are also increasing, and we are expanding our plants accordingly. We are also focusing on industrial equipment, etc., and have succeeded in acquiring customers at a good pace.

Q: In the Medium-Term Management Plan, you plan to further strengthen earnings from mobility, communications, environment, industrial equipment, medical and healthcare, but what specific measures are you planning?

A: Mobility and communications have been growing fairly rapidly together with sales of electronic components. For medical equipment, we have already completed applications for some products and are close to creating some products, so we also expect a contribution to profits from this field.

For example, in communications, there is significant demand for partially assembled products and unit sales. In sales talks for electronic components, communications methods, etc., we also receive many requests for products that are supplied as units. Recently, we acquired the wireless modules business of TAIYO YUDEN, which is also a unit product business. In this way, there is potential for various kinds of unit businesses, which we intend to add to our portfolio one by one.

Q: In the next Medium-Term Management Plan, you are targeting net sales of 54.0 billion yen in fiscal 2024 in the CSI business. Specifically, how will you grow this business? Are there any initiatives already in place?

A: Performance in the CSI business has been weak, owing to a fallback from stay-at-home demand and the GIGA School Program, as well as a shortage of semiconductors for PCs. However, there is ample potential for growth once components are available, so we expect steady growth in this business. There has also been very strong growth in sales of software for schools and educational institutions. In addition, sales of communications and security software products are also growing, so we think the outlook appears promising.

Q: I believe that in your next Medium-Term Management Plan, you intend to conduct M&A totaling 150.0 billion yen, but what sort of companies will you be targeting in the future? Will you take the path of acquiring electronic device trading companies, such as Kaga FEI and Excel, or will you focus on different targets? Also, do you currently have any deals that you expect to be completed?

A: When considering M&A opportunities, we intend not to limit ourselves to electronic device trading companies, but also EMS-related and electronics-related companies if we have the opportunity. At present, I cannot provide an answer either way about whether or not we are in talks concerning any deals. Thank you for your understanding.

Component shortages, industry trends

Q: What is the current industry environment, in terms of the current shortages in the electronic components industry?

A: Shortages are currently ongoing, and we expect these conditions to continue for some time. Kaga Electronics is not associated with any particular manufacturer, so we are taking this as a chance to gather various types of components, which we are supplying to customers.

In the past, customers sometimes made orders for one year in the future, but the longest orders we are receiving at the moment are until the end of March 2023. Given these circumstances, we think there may be some excess orders. As such, we think we may see surpluses in the future.

Q: You mentioned that component shortages will continue, but when do you think they will be resolved?

A: This is my personal opinion, but I think they may be resolved by around the end of 2022, or perhaps sooner.