Q&A Summary of the Conference Call for Institutional Investors and Analysts of Furukawa Electric Co., Ltd.

Date: August 5, 2021 (Thursday) 17:30 – 18:30

Contents: FY2021 Q1 Financial Results

Speaker: **Akihiro Fukunaga**, Director, Corporate Senior Vice President, and General Manager of the Finance and Global Management Division

Q: The Q1 results (operating income of JPY 3.8 billion) appear to be a slow start to achieving the full-year operating income forecast of JPY 26.0 billion, but what is the current situation in each segment?

A: Although it was a somewhat conservative forecast, the Q1 results overachieved the forecast of slightly less than JPY 3.0 billion.
Communications Solutions: Higher raw material prices and soaring transportation expenses were negative factors, but through the strong orders in North and South America, as well as the recovery from Q2 in core optical fiber for customers in North America and digital coherent products, we expect to achieve the full-year forecast.
Energy Infrastructure: Steady progress is being made.
Automotive Products and Batteries: Continued attention needs to be paid to the impact of the lockdowns at our locations in Southeast Asia and the impact of the higher transportation expenses, and currently, a risk of about JPY▲1.5 billion has been incorporated into the forecast.
Electronics Component Materials: Steady progress is being made, and orders are expected to remain firm in Q2. The risks have been incorporated, and it will be fully possible to achieve the full-year forecast.
Functional Products: Demand for 5G and data center products is strong.

Q: Concerning the optical fiber and cable business in North America, I understand that there were multiple negative factors in Q1, but can you provide a more detailed explanation? Also, were factors such as the soaring raw material prices not originally incorporated into the forecast?

A: As shown on Page 9, the negative factors in Q1 results (higher raw material prices, soaring transportation expenses and a temporary decline in sales and demand) had an impact of about JPY▲2.0 billion. This was covered by the increased earnings in North and South America, and operating income was generally as same level as last year. Demand for core optical fiber and digital coherent products has returned in Q2. The impact of the soaring raw material prices was incorporated to a certain extent.

Q: What measures are you taking and how are you hedging the risk in relation to soaring raw material prices?

A: They are basic measures, but we will purchase from multiple suppliers and use alternative materials. The impact is expected to be almost fully eliminated from July. We will thoroughly manage the situation. Also, strengthening sales of small diameter cable such as rollable ribbon will likely contribute to reducing the amount of raw materials used.

Q: In the Automotive Products business, do you expect the operating income from Q2 to be pressured by the lockdowns in Southeast Asia?

A: The lockdowns in Malaysia and India are already affecting operations (due to differences in the timing of the fiscal year adopted at overseas subsidiaries, the impact on the results will become more visible from Q2). On the other hand, the impact of higher transportation expenses caused by port congestion was concentrated in Q1, and the situation will improve in Q2. As a result, the positive and negative factors are expected to basically cancel each other out overall. We expect there is no sudden drop in Q2 compared to Q1 due in part to the start of manufacturing for new vehicle models, even though negative factors may exceed to positive ones.

Q: In the Communications Solutions segment, although net sales were generally unchanged compared to FY2018 Q1, operating income this year was JPY 3.0 billion lower. Will the improvement from Q2 make it possible to achieve the full-year forecast of JPY 4.5 billion?

A: Q1 was affected by the impact of soaring raw material prices, including South America, as well as lower optical fiber prices and higher depreciation expenses (compared to FY2018). On the other hand, as shown in Page 9, there will be multiple improvements from Q2, and I believe we can overcome the slow start and achieve the full-year forecast.

Q: The Q1 negative factors of increased depreciation expenses and soaring transportation expenses will remain ongoing in Q2, but is it correct to assume the other factors will improve from Q2?

A: That is correct. However, optical fiber and cable prices remain at challenging levels (compared to several years ago), and particular effort will be made to increase sales in the businesses with added value, such as the solutions business in South America.

Q: Looking at the North America optical cable shipment forecast on Page 10, shipment volumes fall in Q3 due to seasonal factors, but is this something that is difficult to control and minimize based on the nature of the business?

A: Typically, construction projects decline in Q3 due to the impact of cold waves, so this seasonal factor has been incorporated as a risk. However, orders are currently extremely strong, and they may not fall very much. Also, any drop will be covered through productivity improvements.

Q: I understand that the decline in core optical fiber and digital coherent products in Q1 was temporary, but what was behind this decline?

A: Concerning core optical fiber, our customers in North America faced similar raw material shortages and were unable to fully operate their facilities, but (similar to us,) the impact is diminishing from July. The raw materials are mainly resin related, and the shortages are due to the impact on the supply chain of the huge cold wave in the United States. Recently, orders from customers are strong, and there have been no problems since July. Concerning digital coherent products, demand declined due to a delay in the communications system installation plan, but demand will return from Q2.

Q: The Q1 result of JPY 0.8 billion in the Automotive Products business is much lower than FY2019 Q1 (JPY 2.7 billion). Did COVID-19 have a major impact?

A: The reversal of an allowance in FY2019 Q1 (approx. JPY 1.4 billion) and the higher depreciation expenses (approx. JPY 0.4 billion) and transportation expenses (approx. JPY 0.7 billion) in FY2021 Q1 compared to FY2019 Q1 had a large impact. From Q2, the increased sales of aluminum wire harness will cover the higher depreciation expenses, and I believe it will be possible to gradually get the results back on track. Also, profits in the battery business (in the Automotive Products and Batteries segment) tend to be concentrated in the second half.

Q: Fixed costs such as depreciation expenses are higher. What are your thoughts regarding the improvement in profit of JPY 8.0 billion in Q1 shown in Page 6? As the breakeven point rises due to higher fixed costs, I believe the higher raw materials prices and soaring transportation expenses will likely have an impact, but what efforts will you make to keep the full-year profit forecast unchanged?

A：We expect to realize benefits from changes in the product mix and reducing the cost of manufacturing. The Transformation Division activities explained last year remain ongoing. The scope of the activities has been expanded, and they are expected to have a larger positive impact. On the other hand, depreciation expenses will increase, and particularly for automotive products, it is necessary to make the investment before generating any sales and profit. Therefore, although depreciation expenses are occurring first, I expect sales to cover these expenses, and while working to reduce the cost of manufacturing, we will strive to receive orders for higher value added projects. Last year, we cut indirect manufacturing expenses to a significant extent, and although some of these expenses will have to be returned to a normal level in line with net sales, we will thoroughly differentiate between the necessary and unnecessary expenses.

Q：In the optical fiber and cable business, were there any changes in the main products, such as changes in optical fiber shipment volumes in Q1 and the progress of the earnings growth plan for rollable ribbon cable?

A：Orders for optical fiber and cable were strong. Our order book exceeds production capacity. Concerning rollable ribbon, too, we have received large orders, and shipments for some of the orders began in July. We are in the middle of increasing the ratio of rollable ribbon from 20% to 30%. We expect the ratio to exceed 30% at the end of the fiscal year, and it is progressing as planned. By region, the ratio remains unchanged at 70% in North America. Growth on a fiber volume basis is expected to be 15% globally and over 20% in North America. Definitely capturing the strong demand in North America will be very important for achieving the plan.

Q：Energy Infrastructure had a good start in Q1. Is it correct to assume that the overseas submarine power cable projects will contribute to profits this year, or will there be some technical factors such as the impact of higher copper prices?

A：Shipments for the submarine power cable project in Indonesia have begun. Currently, everything is proceeding generally as planned. Concerning copper prices, the terms are generally determined separately with each customer, and there are cases of sliding adjustments based on the price and cases of determining the price when placing an order and then hedging that price. Given this, the plan has been formulated so there is minimal impact on the profits, and the same is true for Q1, too.

Q：Is the reason for the high inventory to respond to a large order in the future or has non-productive inventory been accumulating?

A : Concerning the inventory assets balance, the higher copper prices had an impact of about JPY 6.0 billion, there were other factors such as foreign exchange rates and new consolidation. Therefore the balance has increased by about JPY 10.0 billion. Most of the factors are external, and I do not believe it is at a particularly problematic level. Another factor is the project orders, which pushed inventory assets higher by about JPY 1.0 billion. We are strategically building up our inventory as a measure in response to COVID-19, as well as in preparation for a rapid recovery in orders from the second half after the semiconductor chip problem has been resolved in the automotive industry. These factors have an increase in inventory assets by JPY 6.0-7.0 billion. Once demand actually returns, the inventory levels will return to normal.

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