Transcript of Financial Results Conference for Q1 Fiscal 2020, held on August 4, 2020

Asahi Kasei Corporation

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Presentation

Hamamoto: Good afternoon, ladies and gentlemen. Thank you for joining us in the earnings briefing conference call of Asahi Kasei Corporation. I am Futoshi Hamamoto from Investor Relations, serving as the MC. Today, we will first have a presentation on the financial results for Q1 of the fiscal year ending March 2021 by CFO Yutaka Shibata, and then we will take your questions.

Attending this conference call aside from CFO Shibata are: Yozo Sato, from Corporate Accounting & Control; Takuya Takahashi, from Basic Materials Strategic Business Unit, or SBU; Yukifumi Kuwaba, from Performance Products SBU; Hiroaki Sugiyama, from Specialty Solutions SBU; Akira Fukuda, also from Specialty Solutions SBU, Separator Administration; Izumi Kawata, from Asahi Kasei Microdevices Corp.; Kensuke Sakai, from Asahi Kasei Homes Corp.; and Masato Kashiwagi, from Asahi Kasei Pharma Corp.

Without further ado, earnings presentation by CFO Shibata.

Shibata: Good afternoon, I am Shibata from Asahi Kasei to brief you on the financial results. Before going over the presentation material, let me first give a general overview.

Operational results for Q1 were greatly affected by COVID-19 to record a decrease in profit year-on-year. Asahi Kasei has been aiming for sustainable growth by developing new businesses in line with the changing needs of society. At the time of Lehman crisis ten years ago, our operations were greatly affected, but since then, we have increased the proportion of businesses that directly deliver the results of innovation to people's lives.

In starting FY 2020, I explained that we would like to leverage the diversity of Asahi Kasei so as offset the impact of COVID-19 among various businesses and achieve positive outcome as a result. However, it turned out demand for automobile and apparel businesses declined more than expected, affecting related businesses. In addition, there was a significant impact from changes in market prices of raw materials and products.

In Health Care–related businesses, in addition to the fact that they are indispensable for supporting people's daily life, demand for ventilators and virus removal filters for pharmaceutical applications increased under COVID-19, which helped us to counter the negative effect of COVID-19 to some extent.

At the time of earnings briefing in May, the full-year earnings forecast was left undecided. Our current outlook is that, barring extraordinary events, the global economy is expected to have bottomed out in Q1 and gradually recover from Q2 onwards. Based on that assumption, we are showing the operating income forecasts for the full year.

While Homes and Health Care are relatively simple in terms of the geographical regions of operation and supply chain, each business in Material is characterized by far more complex regions and supply chain. Given these differences, we've put together the operating income forecasts not by business but more to indicate the general direction, considering the overall state of relevant markets.

There still are many uncertainties regarding the impact of COVID-19, and we cannot predict how the US-China trade friction would unfold, so those forecasts may be revisited, should there be any major changes. For your information, full-year sales forecasts are included in the financial summary report as qualitative information.

With that, I would now like to go over the presentation slides.

P. 3 Focus of Q1 2020 results

Please turn to slide 3, focus of Q1 2020 results. Operating income in Material decreased as an effect of global economic slowdown under COVID-19, while operating income in Homes and Health Care increased.

As for each business category of Material, Basic Materials posted a decrease in operating income with reduced shipment volumes, effects on inventories of lower market prices for petrochemical feedstocks, and deterioration in terms of trade for acrylonitrile, or AN. Performance Products recorded a decrease in operating income as an effect of significant declines in demand among automobile-related and apparel-related markets. Specialty Solutions recorded an increase in operating income with favorable demand related to communications infrastructure and tablet PCs, together with a firm increase in shipments of lithium-ion battery (LIB) separator.

In the Homes segment, operating income increased with firm performance of condominiums in real estate, and a part of deliveries of order-built homes being postponed from the previous period due to delayed supply of components as an effect of COVID-19. Orders for order-built homes decreased year-on-year due to restrictions on admission to model homes to prevent the spread of COVID-19 infection, but gradual recovery was seen from the latter half of the period.

Health Care felt some impact of COVID-19, such as reduced outpatient visits and curtailed business activity both in Japan and overseas. In addition, following the acquisition of Veloxis Pharmaceuticals Inc., there was an effect of amortization of goodwill. But thanks to such positive factors as shipment growth for ventilators and virus removal filters as an effect of elevated demand under COVID-19, operating income for the Health Care segment increased.

P. 8 Summary of financial results

On slide 8, you can see the summary of financial results for Q1. Net sales were ¥455.2 billion, down approximately 9% year-on-year. Operating income was ¥30.1 billion, down about 27%. Net income attributable to owners of the parent was ¥13.6 billion, down approximately 44%.

Starting from the next slide, I will explain the statements of income and the balance sheets in some detail.

P. 9 Statements of income

First, slide 9, consolidated statements of income. As mentioned earlier, net sales were ¥455.2 billion. Gross profit margin was 32.9%, about the same but slightly higher than in the previous year due to a year-on-year increase in the proportion of Health Care.

SG&A expenses were ¥119.8 billion, somewhat lower than in the previous year. While travel and transportation expenses decreased under COVID-19, goodwill amortization and labor costs increased in relation to the acquisition of Veloxis. Thus, the size of reduction was rather limited.

Operating income was ¥30.1 billion. Net of non-operating income and loss deteriorated by ¥2.5 billion year-on-year. The main reason was net equity in earnings and losses of affiliates being negative, coming from the deterioration of operating results of PTT Asahi Chemical in Thailand, which was due to the worsening of market conditions of AN and others.

Extraordinary loss was ¥4.8 billion, which was ¥4.5 billion worse than in the previous year. This was mainly due to the recording of business structure improvement expenses at an overseas subsidiary.

The bottom line, net income attributable to owners of the parent, was ¥13.6 billion, a decrease of ¥10.8 billion from the previous year.

P. 10 Balance sheets

Slide 10, balance sheets. As a whole, total assets decreased by about ¥34.2 billion. The main reasons were a decrease in notes and accounts receivable–trade and a decrease in intangible assets, reflecting progress in goodwill amortization.

In liabilities, interest-bearing debt increased by ¥7.0 billion with a decrease in accrued amount payable. Liabilities decreased. Net assets decreased by about ¥4.4 billion due to payment of dividends and others.

The balance of goodwill, interest-bearing debt, and D/E ratio are shown at the bottom left of the slide. As of the end of June, interest-bearing debt increased by ¥7.0 billion at ¥710.8 billion. D/E ratio was 0.52.

P. 11 Cash flows

Slide 11 shows the consolidated cash flows. Cash flow from operating activities was a net inflow of ¥50.1 billion. Major factors include ¥25.5 billion from pre-tax income and ¥26.0 billion from depreciation and amortization. As we mentioned when discussing the balance sheet, trade receivables came down and had a positive impact on working capital.

Cash flow from investing activities was a net outflow of ¥32.8 billion. Cash and cash equivalents at the end of the quarter was ¥206.8 billion.

P. 12 Sales and operating income increase by segment

Slide 12 shows a year-on-year comparison of sales and operating income by segment. The Material segment suffered a decrease in both sales and operating income. Operating income fell year-on-year by ¥17.0 billion. An almost equal amount, ¥16.1 billion, comes from sales volume difference, mostly in Basic Materials and Performance Products.

On the other hand, both sales and operating income were up for Homes and Health Care. Total consolidated sales came down year-on-year by ¥46.9 billion. Operating income declined by ¥11.2 billion.

So that was for Q1 results. Slides 13 through 15 are about the H1 forecast. But I would rather like to discuss that in conjunction with the full-year forecast, so can we go back to slide 4 now?

P. 4 Focus of Q2 2020 forecast

Slide 4 summarizes the Q2 forecast. On a quarter-on-quarter basis, operating income is expected to be even with Q1 for Material, while Homes and Health Care are expected to increase from Q1. On a year-on-year basis, Material and Homes will be down, while Health Care will be up, and total consolidated operating income will be down.

For Material, with recovery of automotive production, we expect recovery in related demand. Despite that, we expect operating income to be even with Q1, as a portion of shipments may be pushed back into Q3 due to production adjustment in part of the supply chain.

On a year-on-year basis, Q2 operating income will be down, due to effects of lower petrochemical feedstock prices and declines in demand among automotive-related and apparel-related markets, as was the case in Q1.

For Homes, we expect operating income to decline year-on-year. While firm performance is expected in real estate such as condominiums, measures to prevent the spread of COVID-19 are slowing down construction work and therefore reducing deliveries of order-built homes. Remodeling will also be affected as the effect of slower orders due to COVID-19 will start kicking in.

Orders for order-built homes are expected to recover, with gradual recovery of customer visits to model homes, and use of digital marketing leveraging information technology.

Moving on to Health Care. For the Health Care business category, we expect operating income to decrease year-on-year. There will be continued impact of the amortization of goodwill related to Veloxis, the effect of COVID-19, and reduced reimbursement prices in Japan, just like Q1.

For the Critical Care business category, however, we expect operating income to increase centered on increased demand for ventilators.

With that, we expect operating income growth for the Health Care segment as a whole.

P. 5 Focus of FY 2020 full-year forecast (1)

Slides 5 and 6 describe the full-year forecast. First on Slide 5.

Regarding the impact of COVID-19, it is still difficult to anticipate the state of infections, economic policies, and recovery of markets in different countries. Nevertheless, we believe the general trend for recovery of economic activity coupled with measures to prevent infection will continue.

Due to uncertainty in market environment, the second-half and full-year forecasts for the Material segment, given its broad scope of business activity, are provided in a range, as are the overall consolidated operating income forecasts.

Between H1 and H2, operating income for Material is expected to increase. We expect recovery mostly around automotive-related demand with the recovery of vehicle production. We also expect demand recovery and improved terms of trade for petrochemical products such as AN.

Operating income for Homes is also expected to slightly increase in H2, with gradual easing of COVID-19 related restrictions anticipated. As is the case for Q2, with gradual recovery of customer visits to model homes and use of digital marketing leveraging IT, we expect orders for order-built homes to recover.

Operating income for the Health Care segment is expected to decrease. In H1, ventilators led the strength, but in H2, we expect the state of COVID-19 infections to improve so that the sudden demand for ventilators would now moderate. There is also the tendency for fixed costs in the Health Care business category to occur in H2.

P. 6 Focus of FY 2020 full-year forecast (2)

Slide 6 describes our full-year outlook for net sales and operating income by segment, both qualitatively and quantitatively, in an attempt to provide some sense of overall direction.

For Material, as I have already mentioned, the segment is hard hit by the spread of COVID-19 and the resulting slow demand among automotive-related and apparel-related markets. We expect net sales to decrease by around 15% year-on-year, and operating income to decrease by around 50%.

For Homes, again, for the same reasons I mentioned earlier, we expect net sales to decrease by around 5% and operating income to decrease by around 30%.

Operations under the Health Care segment have been firm, and there are contributions from acquisitions made in the previous fiscal year, including Cardiac Science Corporation and Veloxis. We expect net sales for the segment to increase by over 15% and operating income to increase by around 25% year-on-year.

All this, together with curtailment of corporate expenses, we expect total consolidated operating income of ¥120–130 billion, down around 30% year-on-year. While the challenging operating environment and uncertainties persist, we will continue efforts to improve performance by curtailing fixed costs, reducing inventories, and making swift and appropriate management decisions according to changes in the environment.

Last but not least, with regard to shareholder returns, the basic policy for stable and continuously increased dividends remains unchanged. Given all the uncertainties, we will only decide on interim dividends after H1, based on results up to Q2 and the full-year outlook then. As in past years, year-end dividends are to be determined when we have full-year results, and upon ascertaining the effect of COVID-19 on the subsequent fiscal year.

This concludes my presentation. Thank you very much for your kind attention.

Question and Answer Session

Hamamoto: We will now take questions.

Mr. Watabe: Watabe from Morgan Stanley MUFG Securities. I have two questions. First on the Material segment. The profit level for Q1 was not bad in light of COVID-19. Can you give us the breakdown by business category, compared to the previous quarter? I imagine there was an impact of inventory valuation loss by the gross average method, especially on Basic Materials and Performance Products. Also, what about the projection for Q2?

Takahashi: Takahashi from Basic Materials. Operating income fell by about ¥2 billion, from ¥400 million in Q4 to minus ¥1.7 billion in Q1. As we reported, during Q4, there was a stoppage of naphtha cracker, which pushed down profit by about ¥1.5 billion. So that was a positive factor quarter-on-quarter. But that was more than offset by the impact of inventory valuation loss by the gross average method due to lower raw material prices, and shrinking of market price spread and slightly lower sales volume of AN, thus worsening by ¥2.2 billion.

From Q1 to Q2, we expect smaller effect of inventory valuation factor due to lower raw material prices and a slight recovery in demand for AN derivatives, mainly ABS. Given these factors, we expect operating income to improve by approximately ¥2.9 billion, from minus ¥1.7 billion in Q1 to ¥1.2 billion in Q2.

Kuwaba: Kuwaba from Performance Products. Profit of fibers decreased from Q4 to Q1, affected by the apparel business. In former performance polymers, synthetic rubber was slightly positive due to a large drop in raw materials in Q1. Engineering plastics posted lower profit due to a decline in the volume. Consumables posted an increase in profit quarter-on-quarter as a general trend, benefiting from the demand created in relation to people staying at home.

From Q1 to Q2, we expect a recovery in shipments of fibers, synthetic rubber, and engineering plastics, contributing to an increase in profit. Synthetic rubber expects a decrease in profit as prices will drop due to the effect of shipment time lag. Engineering plastics expect an increase with a recovery in sales volume. Consumables expect a decline in profit despite decent sales volume due to an increase in fixed costs and increased activity.

Sugiyama: Sugiyama from Specialty Solutions. Please look at slide 32. From Q4 of FY 2019 to Q1 of this fiscal year, specialty solutions posted lower sales and higher profit. The automobile-related business was hit hard. The lead-acid battery separator and electronic devices deteriorated rather considerably. On the other hand, the volume of LIB separators grew steadily, and electronic materials grew from applications related to 5G communications infrastructure, and tablet applications owing to so-called stay-at-home–related demand. In addition to these, we contained fixed costs by considerable amount, and as a result, sales decreased but profit increased.

From Q1 to Q2, we expect sales to be roughly flat and operating profit to decline significantly. We expect electronic materials for automotive applications to be slightly positive in Q2, but we do not anticipate any significant increase. On the other hand, for electronic materials, the stay-at-home demand which was enjoyed in Q1 is projected to moderate. With regard to electronic devices, we expect automotive applications to bottom out in Q2. This timing is slightly different from other products.

Mr. Watabe: I see, thank you. My second question is on Critical Care. Can you tell us about the movement of ventilators from Q1 to Q2, to Q3? If that's difficult, can you talk about sales increase of conventional products other than ventilators for Q1 and H1?

Shibata: This is Shibata speaking. First, regarding ventilators, we are projecting that the shipment of orders received from the US government will mostly be completed in H1. As for Q3 and beyond, we are still uncertain about the status of infection, so we have not factored in significant demand for H2. As for products other than ventilators, shipments of AEDs didn't grow due to the effect of COVID-19, while defibrillators for hospitals and LifeVest wearable defibrillator posted firm performance. Toward H2, the impact of COVID-19 is still not certain, but in our current forecast we are assuming a moderate growth on a conventional product basis.

Mr. Watabe: I see. Thank you. As for the volume of ventilator shipments in Q2, would it be the same as in Q1?

Shibata: Actually, more in Q2. In fact, the Critical Care forecast expects a rather sizeable contribution from shipment of ventilators in Q2.

Mr. Watabe: So, in Q1, it was mostly conventional products, correct?

Shibata: No, actually ventilators were included to some extent.

Mr. Watabe: I see. Thank you, that's all.

Mr. Okazaki: Okazaki from Nomura Securities. I understand that the index of LIB separator shipment trends is not available for Q1, so can you describe the movement of automotive applications and consumer electronics applications? Also, what about the outlook for Q2 onward? In addition, some of your competitors say price competition is becoming more severe due to some competition with Chinese separator manufacturers. Do you not share that view?

Fukuda: Fukuda for separators. First, sales volume of LIB separators increased from Q4 to Q1. The wet-process separators saw a strong demand for information communication devices such as laptop computers and tablet PCs. The dry-process separators saw a recovery in the energy storage system, or ESS, market. Both dry-process and wet-process separators for automotive applications were affected by COVID-19. Still, sales volume increased as sales exceeded the impact of the customer plant shutdowns and the temporary disruption in product qualification.

From Q1 to Q2, we expect sales to increase based on the assumption that the impact of COVID-19 will ease. Both the results for Q1 and the outlook for H1 assume a year-on-year sales volume increase by close to 30%,

And with regard to prices, no significant change from the past, and we are continuing tough price negotiations with our customers.

Mr. Okazaki: I see. So, I take it that from Q4 to Q1 shipment for laptop and tablet PCs and ESS grew, while automotive applications struggled a bit due to the impact of COVID-19 and others. And for Q2, you expect each of these three application areas to be strong, especially the automotive to recover, correct?

Fukuda: Yes, that is correct.

Mr. Okazaki: My second question is on ventilators. Am I correct to understand that the orders from the US government amounting $350 million are basically recorded in Q1 and Q2, but not in H2?

Shibata: This is Shibata speaking. We expect most of the shipments to be made through Q2, but I think there will be some in Q3 as well.

Mr. Okazaki: Do you mean in addition to the original orders?

Shibata: No, we expect the delivery on the orders of $350 million to be made over Q1, Q2, and Q3.

Mr. Okazaki: I see. Next, in the Health Care segment, I think the sales will fall roughly ¥20 billion from H1 to H2. Do I understand that this is basically in relation to ventilators?

Shibata: As for the forecast for H2, we are focusing on operating profit, and the sales forecast does not have solid numerical figures associated with it. That's why the financial summary only shows qualitative information on sales forecast, without numerical indication. Specifics may vary depending on the makeup, so I'm afraid I can't say more. Please regard the forecast as broad qualitative information.

Mr. Okazaki: Would it be correct to understand that the profit margin of the ventilators is contributing to raising the profit margin of Critical Care overall?

Shibata: I'm afraid I can't give you the details, but basically the conventional part of our business is more profitable. The ventilators in question are for special applications, not meant to be a mass-produced product. And rather costly measures have been applied, including quick capacity expansion. So, in terms of profit margin, you can safely assume that conventional part of our business is better.

Mr. Okazaki: I think the profit margin was 12% in Q1 FY 2019, 13% for the full year, and 17% in Q1 of this fiscal year, and projected to be 22% in Q2. Quite an improvement. Am I correct to assume that this is because products other than ventilators are improving?

Shibata: One factor is the decline in SG&A expenses due to COVID-19. And as is the case with Health Care overall, one cannot generalize because the profit margin varies considerably depending on the product mix. Among pharmaceuticals, there is a big difference between in-licensed products and in-house development, and also in medical devices, product mix makes a big difference.

Mr. Okazaki: I see. Thank you.

Mr. Yamada: Yamada from Mizuho Securities. The first question is on the Homes segment. Looking at Q1 results, the deliveries of order-built homes were better than I expected, and the remodeling didn't drop much, nor did the construction materials. Regarding Q2 onward, as various restrictions get removed, the situation should improve over Q1. So, can we assume that Q1 was the bottom?

And, did COVID-19 entail any additional costs in Q1? Also, orders for order-built homes fell sharply in Q1, and I think this will have some negative impact on sales in Q4. When will the actual impact be felt? Furthermore, in light of the current situation under COVID-19, what are your thoughts on new orders in and beyond Q2?

Sakai: Sakai from Homes. In Q1, as Shibata described at the beginning, there were some deliveries that had been pushed back from the previous period, so we were able to deliver a relatively good number in Q1. Still, there are cases of rather significant delays in construction periods, including having to implement measures to prevent COVID-19 infection and so on, and we expect effects to be felt in Q2 and beyond. In addition, order level was quite low in Q1, and I think this will affect the deliveries to be made in H2.

With regard to remodeling, the turnaround time between order and sales recognition is shorter than order-built homes. Therefore, the slower orders in Q1 will have an impact on Q2 results. While orders for order-built homes were hard hit in Q1 due to COVID-19–related restrictions, in Q2, model home visitors are recovering. We do not expect a return to normal levels even in H2, though. At the same time, we are leveraging IT for remote meetings, virtual model houses, and online viewings, among various efforts to boost orders.

Mr. Yamada: Is it correct to understand this way? When the state of emergency was declared, you chose to totally close your model homes. Now you have reopened them, resumed traditional marketing activities, and you are getting orders through new, online channels in addition. Is that so?

Sakai: Well, compared with April and May, the situation is much improved, in that we are receiving visitors at model houses. But the visitor count is still lower than before. And there are still infection control measures in place. So, although the situation is much improved from Q1, our activities at model homes are still restricted. We are using remote meetings, etc. in order to compensate for that as much as possible, as part of recovery efforts.

Mr. Yamada: What about additional costs? Has there been any significant cost increase due to COVID-19?

Sakai: No, not in particular.

Mr. Yamada: Thank you. My next question is on Health Care. With regard to the newly consolidated Veloxis, I think you were expecting an annual growth of around 30%. Q1 growth appears to be almost at that level, but what is the situation on the ground with COVID-19, etc.? And how is PPA, purchase price allocation, going?

Shibata: This is Shibata speaking. With regard to Veloxis, yes, there is an impact of COVID-19. In the US, we see some decline in the number of renal transplant surgery. But despite some impact there, things are generally in line so far, and business growth has been steady at around 30%.

On PPA, the amortization comes to around ¥12 billion over the full year. In Q1 we booked roughly ¥3 billion of that. The information is on slide 10. This amount has been fixed.

Mr. Yamada: Thank you very much.

Mr. Umebayashi: Umebayashi from Daiwa Securities. My first question is on Health Care. Considering that ¥3 billion in amortization of goodwill etc. related to Veloxis, the Q1 income figure looks pretty good.

Given that year-on-year top-line increase was only ¥2 billion, my guess would be that there was a positive impact of sales mix difference. Did it come from increased shipments of virus removal filters? Or, on the pharmaceuticals side, since I do not see much change in sales except for the Veloxis effect, were costs controlled down? Can you please explain the income figure in the face of that amortization of goodwill?

Kashiwagi: Kashiwagi from Asahi Kasei Pharma. Last year, we launched a new autoinjector formulation of Teribone osteoporosis drug. Our plan was to drive growth centered around that new product. Due to COVID-19, however, marketing activity by medical reps was severely limited during Q1, making it very difficult to achieve the originally-expected sales growth. But at the same time, it also meant less marketing expenses. That is why Q1 operating income was almost unchanged from the same period previous year.

With regard to H1 and for the full year, now that medical reps are resuming activities, we do expect this product to drive growth. At the same time, R&D activity around the domestic drug pipeline is to pick up from Q2. With all that, operating income would be almost level or perhaps slightly down year-on-year.

Mr. Umebayashi: Thank you for that. What about medical devices?

Hamamoto: Hamamoto from Investor Relations speaking. For medical devices, net sales came in level with the previous year while operating income was up. There were negative impacts from the weaker euro, and decreased shipments of some products. As was discussed earlier, however, shipments of Planova virus removal filters increased, and that led to higher capacity utilization. In addition, operating expenses came in lower than budgeted, due to COVID-19 restrictions.

Mr. Umebayashi: Thank you very much. My next question is about Basic Materials, on AN. The AN spread may be recovering, but still appears weaker than other basic chemicals, despite overall economic activity bottoming out. I suspect this may be due to propylene prices staying at a relatively high level, but what is your view on the tighter AN spread relative to other commodities? Can you also tell us about capacity utilization in Q1 and Q2, please?

Takahashi: Takahashi for Basic Materials. As you rightly said, the AN spread is pretty tight at the moment, although we believe that it will improve going forward.

On the demand side, a large part is for use in ABS. ABS capacity utilization is now coming up, led by those in China, where the economy reopened relatively early after COVID-19–related shutdowns, and in South Korea. With regard to demand for use in acrylic fiber, there is still uncertainty around the textile industry as a whole, but capacity utilization is gradually rising. So, the demand side is improving.

On the supply side, however, there is more pressure. Many suppliers reduced production in May, but maintenance turnarounds have been completed and all that capacity is now coming online. Additionally, we understand that new capacity in China came online at the end of June.

Furthermore, as you rightly mentioned, propylene prices have stayed somewhat high, on the back of strong demand for use in nonwovens and supply disruption.

As such, there are a lot of uncertainties. Demand may be strong, but supply pressure and the high propylene price are still squeezing spreads. Having said so, propylene prices would come down, demand is recovering, and more production adjustments would happen, so that spreads should gradually recover.

Now on capacity utilization. Last year our capacity utilization was at 80%. In April we brought it down to 70%, and that is still the case now for our combined capacity in Japan, South Korea, and Thailand. We may adjust that going forward, depending on demand levels.

Mr. Umebayashi: Thank you very much.

Mr. Nishihira: Nishihira from Okasan Securities. I have two questions. First on fibers. Can you tell me about demand for nonwovens, how it was in Q1 and how it is in Q2, please?

Kuwaba: Kuwaba for Performance Products. Among nonwovens, for Lamous microfiber suede, mostly used for automotive applications, there was a significant decline in shipments between Q4 and Q1, but we expect recovery in Q2.

On the other hand, demand for spunbond and other nonwovens is firm. There is strong demand for hygienic materials such as diapers. There is also COVID-19–related demand for use in surgical masks and medical gowns.

Mr. Nishihira: Thank you. My next question is on Homes, and in particular, costs. Are costs of building materials falling now? What about labor costs, are they starting to come down?

Sakai: Sakai for Homes. With regard to the cost of building materials, the picture is mixed, with some coming down and some going up. Meanwhile, logistical costs have been rising since last year. In total, costs are going up rather than down. With regard to labor expenses, that for our employees are not really affected by COVID-19.

Mr. Nishihira: Thank you very much.

Mr. Omura: Omura from Mitsubishi UFJ Morgan Stanley Securities. I have a question about ventilators. My understanding was that, in that contract with the US government, all deliveries would have had to be made by July 3rd. Is it correct to understand that there was a delay, and therefore part of what was supposed to be in Q1 was pushed back into Q2?

Hamamoto: Hamamoto from Investor Relations speaking. Yes, there was that initial deadline, but later, some adjustments were made in consultation with the US government in view of the situation on the ground, and as a result, a new delivery schedule was agreed. That’s how we understand it.

Mr. Omura: Thank you. And can I take it that a considerable part of that contract was actually pushed back into Q2?

Hamamoto: Yes.

Mr. Omura: Thank you for that. Going back to Specialty Solutions, can you elaborate further on the operating income decline from Q1 to Q2, please? Is it correct to understand that the decline is largely driven by electronic materials?

Sugiyama: Sugiyama for Specialty Solutions. As mentioned earlier, between Q1 and Q2, while electronic materials for automotive applications would be slightly up, on the electronic devices side, things happen with a delay, so that is still coming down, and would bottom in Q2.

Additionally, there was this special stay-at-home–related demand for electronic materials used in tablets, note PCs, etc. This was highest in Q1. Along the supply chain there was a rush to secure and build up inventory levels for such materials. A lot of demand, therefore, was brought upfront into Q1, and now that it has run its course, there would be a reactionary decline in Q2.

To recap, while recovery in automotive applications is a positive factor, there will be a larger decline related to electronic materials, and that is why operating income will be down quarter-on-quarter.

Mr. Omura: Thank you very much.

Hamamoto: With this, ladies and gentlemen, we conclude today's earnings briefing. Thank you very much for joining us.