Dialogue: OSG President + Analyst

Amid ever-accelerating changes in the structure of industry around the world, OSG is tackling the enhancement of profitability and expansion of growth areas. This dialogue welcomes a securities analyst to delve into issues of interest to investors, such as OSG's view of its competitive environment, its approach to capital policy, and the emerging results of its structural reforms.

Expanding Growth Areas to Compensate for the Slowdown in the Automotive Industry

Tai: A year has passed since "Beyond the Limit," the management plan that the Company has been undertaking since FY2022, entered Stage 2. Could you tell me your views on the achievements to date and on any points that need to be sped up?

Osawa: In "Beyond the Limit," the OSG Group (hereinafter "OSG") first placed its priority on reforming the structure of its businesses. This was grounded in our thinking that revising our sales structure, which was skewed toward the automotive industry, and transitioning to a structure by which we could allocate resources to future growth areas would raise our corporate value and our valuation in the stock market. Looking at the past year or two, it's my sense that even with a global slowdown in the automotive industry, we've been able to raise and supplement our numbers in micro and precision machining and other growth fields. We are also now able to agilely carry out price revisions in specific regions to combat rising labor, raw material, energy, and other costs, which is a major step forward. However, top-line growth has not been enough. Going forward, we will focus on expanding the sales volume of catalog products that have earning power.

We also launched a new policy concerning shareholder returns. By raising the payout ratio to 45% and going with the higher of that or a 3.5% dividend on equity ratio (DOE), I think we've implemented a design that enables stable shareholder returns not only during strong periods but also during phases of weaker performance, which we see as a response to shareholders who are looking for sustainable shareholder returns.

Leveraging Competitive Advantages to Grow OSG's Share of the Global Tap Market

Tai: OSG has set the improvement of profitability as a goal in its Medium-Term Management Plan. There are investors who express agreement with this, but there are also those who want you to talk more about the expansion of sales. On that topic, there are also those who want to hear specific measures for expanding the Company's share of the global tap market, especially with respect to dispelling concerns over changes in demand amid the shift to electric vehicles.

Osawa: There's a reason why we're focusing on improving profitability now. Since the start of the 2000s, OSG has focused on expanding its scale. However, after peaking in 2015, we fell into a state in which sales were increasing but profit struggled to grow. What I realized when I took office as president was that each of our regions was placing undue focus on sales, and thinking of company-wide optimality and profit was fading. In response, we set out profitability as a shared yardstick and, in the current Medium-Term

Dialogue: OSG President + Analyst

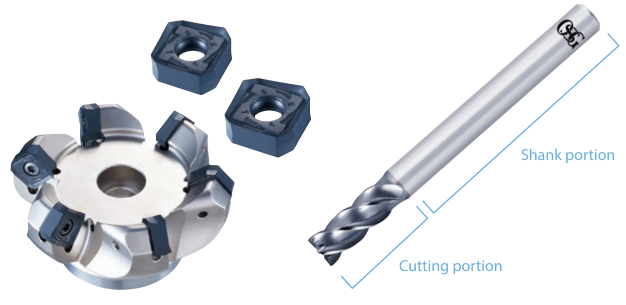
We will achieve both growth and profitability while solidly connecting structural transformation to results.

Management Plan, set operating income margin and ROE as management indices, and are focusing on regaining our capability to earn.
Tai: Investors, including myself, thought that OSG would be able to recover profit margin, which had declined during the COVID-19 pandemic years, by expanding sales. Because of that, we wanted to hear how you were going to expand sales. However, that wasn't what you saw as the problem. Your starting point was a revision of the Company's structure, with overall optimization as a global company and, after M&A, profitability.
Osawa: That's correct. Even during the period when profit wasn't growing, we were generating more than a certain degree of results. Accordingly, I thought that if the whole company could work as one to raise profitability, that would lead to major growth. That's because in that situation, when sales increase, even higher profit follows.
Tai: Regarding the top line, I think growth of tap sales will play a significant role. How do you intend to achieve your target of a 40% global market share?
Osawa: Currently, our global market share in taps is over 30%, but we're somewhat lacking in the speed needed to achieve our target. We first have to raise our share to the upper-30% range. As we're in a position that lets us readily demonstrate our competitive advantages, we intend to engage in M&A, introduce new products, and develop business in a number of industries. Regarding the top line, we see growth industries, such as electronic components, semiconductors, data centers, robotics, and medical care, as also playing driving roles, particularly in Asia. These markets are well suited to expanding the sales of our catalog products. We're also considering further deploying our A-Brand series, which is a higher added value version of our catalog products.

Emerging from Competition in a Dominant Position with Our Strong Technical Capabilities

Tai: Competition with Chinese companies is a concern in Asian markets. How do you view the competitive environment?
Osawa: OSG's competitors fall into two types: Chinese manufacturers, and global manufacturers similar to us. Our image of the latter type is companies that are centered on insert products and compete with us only in some solid products (see image). In this regard, we believe that we will have an advantage here as we intend to step into more micro-related areas. At the same time, while low-price strategies had been a strength of Chinese manufacturers, their price advantage is being whittled away as prices of raw materials continue to rise. Because of this, the battle will be weighted toward performance, which we see as giving us an advantage.

Tai: The technical capabilities of Chinese manufacturers have also improved. You don't see that as much of a threat, do you?
Osawa: Naturally, we're wary. However, OSG has been doing business in China for over 20 years, and our production bases and sales networks have put down roots there. We're something like a Japanese-Chinese hybrid company. Our policy is to leverage this strength and actively capture areas beyond the automotive industry in the high-demand Chinese market.



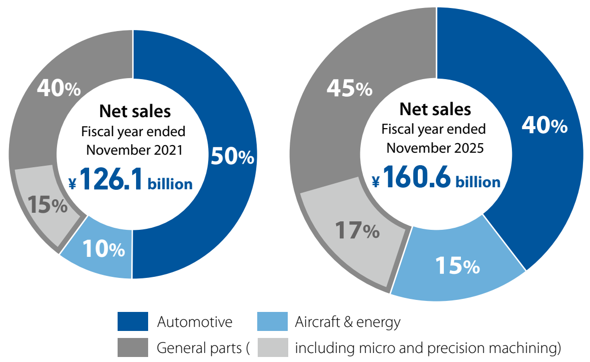
Insert products
Products used in roughing, with replaceable cutting edges

Solid products
Products used in finishing, with the cutting portion and shank portion being one piece

The Scale of Sales by Customer Industry

Tai: I'd like to ask about how values are shown in OSG's plans. It's my impression that percentages are widely used in your plans. In recent years, some companies have even released medium-term management plans that purposely don't state absolute amounts. What are your thoughts concerning such disclosures?
Osawa: In our Medium-Term Management Plan, we set out KPIs related to profitability and efficiency, such as ROE of 10% or higher and an operating income margin of 16% or higher. In terms of the composition of sales, we've indicated goals of reducing the percentage of automotive-related sales from 40% to eventually about 30%, raising the percentage of micro and precision-related products to over 20%, and raising the percentage of A-Brand products among catalog products to 50% to 60%. We see these as measures that will bring about improved profit, and values that make our current situation easy to understand.
Tai: Regarding the composition of sales, though, it can be difficult to get a true picture of results when the denominator changes. In investors' minds, it's difficult to tell whether some results stem from growth through offense or from a decrease in something else.
Osawa: That's a point on which we want there to be no misunderstanding. As an example, we're increasing in terms of absolute scale in multiple areas. It's not a matter of simple replacement, with a decline in automotive business meaning growth in something else (see diagram).
Tai: So, the fields that are growing and volumes are changing. I see.

Breakdown of net sales by customer industry



A Business Foundation Resistant to Economic Fluctuations, and Growth in Earning Power During Strong Periods

Osawa: What I'd like to again communicate to investors is that OSG is a company capable of both growing and being profitable. In our Medium-Term Management Plan, initiatives aimed at growth industries have begun to appear in numeric form while we move forward in reducing our dependence on the automotive business. Growth industries represent markets that have demands for high precision and yield, and require the ability to handle difficult-to-cut materials. These are markets in which we can powerfully leverage our know-how. OSG also possesses a strength in its ability to provide tangible and intangible value through process improvement, coating, after-sales services for tools, and more. We have a 35-country network that captures the latest information on markets and a production system that advances reductions in the workforce, automation, and digitalization. By continuing our strategy of leveraging these assets to solidly secure volume zones in growth industries, we intend to achieve growth accompanied by profit against the backdrop of a high marginal profit rate.
Tai: I look forward to seeing how that develops. I'd like to see the Company further strengthen its way of communicating information, in a way that will increase your PER. In addition to improving ROE, if it were possible to get the full picture of structural transformation by, for example, enhancing disclosure of industry-specific information, that would boost market expectations and eventually lead to a higher PBR.
Osawa: It is true that areas attracting attention, such as the keyword "semiconductors," have recently moved the stock market considerably. However, communication that fuels excessive expectations also leads to significant backlash. So, we want to deepen dialogue with the market through industry-by-industry disclosure at the right time when solid results of structural transformation have become apparent.
Tai: I understand. In the area of capital policy, in FY2025, the Company bought back shares and issued a commemorative dividend in response to PBR falling below 1.0. The message was clear and the market reacted positively.
Osawa: Thank you for saying so. We are strongly aware of our PBR. Recognizing that we had let our stock price languish, we held internal discussions on our vision for capital allocation and took action. We considered that alone to be insufficient, though, and so also launched the new shareholder returns policy mentioned earlier.
Tai: If the Company combines further growth with an easily understood plan for returns that resist being swayed by business conditions, positive evaluation by the market would surely follow.
Osawa: OSG's business has an aspect of serving as a barometer of economic sentiment in the manufacturing industry. Our capability to detect economic swings at an early stage can be viewed as a strength. On top of that, even during economic downturns, fluctuation in our performance is relatively limited due to the nature of our business, as tools are consumables. Because we have already built high profitability into the business, its foundation does not experience major swings. At the same time, profitability rises significantly during boom periods. Our goal is to remain a company that grows steadily while reflecting movements in industry and the economy, always maintaining the interest of stakeholders.