COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange First Section

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Summary

A comprehensive engineering company conducting facilities construction work and plant work with strengths of advanced technology and credibility cultivated over a long history

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, manufacture, supervision, installation, sale and consultation of systems and equipment for construction and plant facilities, in office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive engineering capabilities across a diverse range of business operations, combined with advanced technology and credibility accumulated over a history of more than 90 years.

1. In 1H FY3/20, net sales increased 13.8% YoY and operating income exceeding ¥3.0bn

In the 1H FY3/20 results, orders received were ¥100,901mn (down 2.8% year-on-year (YoY)), net sales were ¥91,845mn (up 13.8%), gross profit was ¥13,168mn (up 22.3%), operating income was ¥3,191mn (up 183.3%), ordinary income was ¥3,503mn (up 127.5%), and profit attributable to owners of parent was ¥2,485mn (up 212.0%). The balance carried forward was ¥158,885mn (down 5.3% from the end of the previous fiscal year), a slight YoY decline but it remained at a high level. The gross profit margin increased by 1.0 percentage point (pp) YoY to 14.3%, including because of the ongoing favorable business environment and as the Company continued to work to thoroughly manage costs prices and strengthen the site support system.

2. Promoting the targets in "Century 2025" Phase 2, the medium-term management plan

In March 2016, the Company announced "Century 2025" as its long-term version as a10-year goal toward the 100th anniversary of its foundation. It has positioned the first three years of this plan as "Century 2025" Phase 1, and for FY3/19, which is the final fiscal year of Phase 1, the Company have achieved the numerical targets it had set, which was net sales of ¥195bn and operating income of ¥7.5bn, but it has already achieved these targets. Following on from this, it has announced Phase 2, and while the three key initiatives are a continuation of Phase 1, it has added "Disclose financial & capital policies and ESG policies" and "Reinforce Information Transmission." It has also set management targets in addition to financial performance targets in its quantitative targets for FY3/22, including an ordinary profit margin of 5.0% or above, an annual dividend of ¥60 or above, the acquisition of 5mn or more treasury shares (three years from FY3/20), a ratio of the total return of profits of 70% or above, and ROE of 8.0% or above.

3. FY3/20 forecast

Based on the strong 1H results, the Company upwardly revised forecasts for FY3/20. It is forecasting orders received of ¥200,000mn (down 7.9% YoY), net sales of ¥210,000mn (down 1.1%), operating income of ¥9,800mn (down 7.9%), ordinary income of ¥10,000mn (down 10.7%), and profit attributable to owners of parent of ¥7,000mn (down 22.6%). The FY3/19 results were at an outstanding level, so profits are forecast to decrease YoY. But the forecasts are in line with the targets in the medium-term management plan "Century 2025" and this is not a cause for concern. Given that there is plentiful construction work at hand and the building construction industry surrounding the Company remains active, it is fully possible it will achieve its targets. The Company may even revise the forecast for profit items upward if the construction works in the current fiscal year progress favorably.

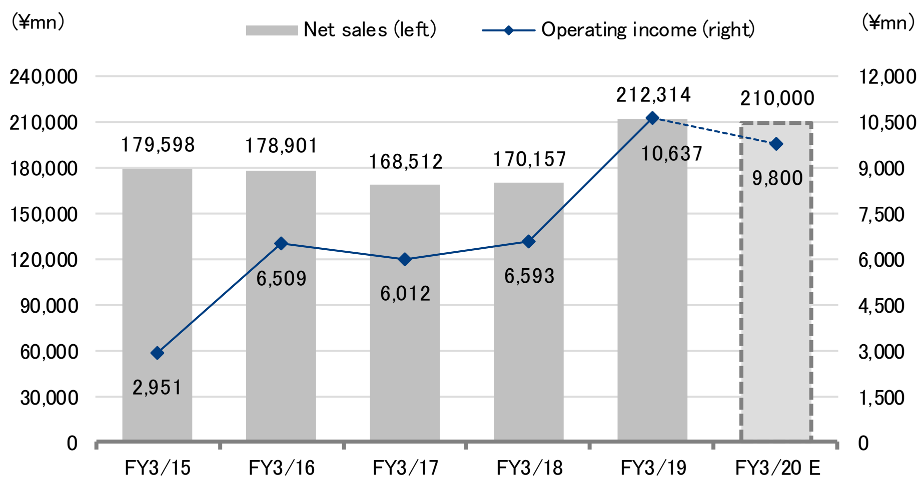
4. Annual dividend increased to ¥70, and Company announces a buyback of 2mn treasury shares during FY3/20.

Up to the present time, the Company has actively returned profits to shareholders through not only stably paying dividends and increasing the dividend in recent years, but also by buying back treasury shares. In FY3/19, it paid an annual dividend of ¥60 (¥20 of which was a special dividend, for a dividend payout ratio of 40.0%), and initially forecast an annual dividend of greater than ¥60 for FY3/20 as well; due to its strong financial performance in the 1H, however, it subsequently announced an annual dividend of ¥70 (¥35 interim, ¥35 year-end). The Company has already retired 2mn treasury shares in the 1H, and has announced it will acquire an additional 2mn shares during FY3/20 (of which 1mn shares have already been acquired). As a result, the Company expects its forecasted total return ratio to exceed 100%, and can be lauded for its proactive approach to shareholder returns.

Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Profits are forecast to decline in FY3/20, but the forecasts are in line with the targets in the medium-term management plan and this is not a cause for concern.
- Actively returns profits to shareholders. Annual dividend increased to ¥70, and Company announces a buyback of 2mn treasury shares during FY3/20.

Results trends



Source: Prepared by FISCO from the Company's financial results

Company outline

One of the largest facilities construction company in Japan. As a Mitsui-affiliate, it has a history of nearly 100 years.

1. Company outline

Sanki Engineering is a facilities construction company that was established in 1925 as a spin-off of the machinery division of the former Mitsui & Co., Ltd. The first large projects for the Company were the Shiga manufacturing plant of Toyo Rayon (currently Toray Industries, Inc. <3402>), and a refrigerated warehouse for Aomori Seihyo. Initially, the Company engaged in heating, plumbing, steel frame construction and the supply of construction materials. It has subsequently branched out into electrical work, developing integrated plant construction planning, design and installation as its main operations.

The Company's capital exceeded ¥1,000mn in 1958. In subsequent years, the Company participated in projects undertaken in preparation to host the Tokyo Olympic Games in 1964, and grew in tandem with the expansion of the Japanese economy. The Company diversified from the facilities construction business, such as heating, ventilation, air-conditioning (HVAC), plumbing, and electrical systems into other types of facilities, such as transport equipment, conveyance systems, water treatment facilities and waste treatment facilities. Today, it is a leading domestic facilities construction company. The Company's shares were listed on the Tokyo Stock Exchange in 1950.

2. History

In FY3/16, prior to the 90th anniversary of its establishment in FY3/16, the Company appointed Mr. Tsutomu Hasegawa as President and Representative Director. Subsequently, it announced "Century 2025" in March 2016 as its long-term vision toward the 100th anniversary of its establishment in 2025, which adds President Hasegawa's new strategy to the policy it has taken.

History

1925	Sanki Engineering Co., Ltd. established as a spin-off of the machinery division of the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branches, 6 sub-branch offices, 3 affiliated companies, and around 300 employees
1958	Capital exceeded ¥1,000mn
1963	Completed the Sagami Plant (currently, the Yamato Plant)
1964	Participated in projects relating to the Tokyo Olympic Games, including the Yoyogi National Gymnasium, and the NHK Broadcast Center
1982	Newly established Technical R&D Institute in Yamato City, Kanagawa Prefecture, equipped with facilities for basic research and for large-scale experiments
2000	Opened the Shonan Training Center (Yokosuka City, Kanagawa Prefecture) and strengthened human resource development
2011	Relocated its head office to the current location in the Tsukiji area of Tokyo
2015	90th anniversary of its establishment. Announced its long-term vision "Century 2025"
2018	Opened Sanki Techno Center, a comprehensive training and research facility (Yamato City, Kanagawa Prefecture)
2019	Opened the Yamato Product Center, and completed the STeP (Sanki Techno Park) project

Source: Prepared by FISCO from the Company's website, etc.

Business description

4 main segments, with a focus on the Facilities Construction Business

1. Outline of business by segment

The Company's main operations are divided into four business segments: three facility business segments of Facilities Construction, Machinery Systems, Environmental Systems, and Real Estate. An overview of each segment is set out below.

(1) Facilities Construction Business

The Facilities Construction Business engages in activities including planning, design, installation, maintenance, and repair of facilities including office buildings, schools, hospitals, shopping centers, factories, R&D centers, and other facilities. The scope of activities handled by this business is extensive and can be further divided into the following sub-segments.

a) HVAC and plumbing for buildings

The HVAC and plumbing for buildings business provide HVAC, water supply and wastewater systems, plumbing, area heating and cooling systems, kitchen systems, and disaster readiness systems for general buildings and facilities, such as office buildings, schools, hospitals, department stores, hotels, and warehouses.

b) Industrial HVAC

The industrial HVAC business provides HVAC for factories and research facilities of all industries, especially clean room systems for semiconductor plants and food processing plants, which are areas of strength for the Company, as well as special air-conditioning systems and appurtenances for manufacturers of medical systems, and the like; in addition to environmental control systems and so forth for automobile manufacturers.

c) Electrical systems

The electrical systems business provides electrical systems, communications-related systems, electrical civil works, and so forth.

d) Facility systems

The facility systems business offers project management and other services for the construction or relocation of the offices and dealing rooms of financial institutions and other industries. It also provides central monitoring and automatic control systems, Internet protocol (IP) solutions, network solutions, business continuity plan (BCP) solutions and other services for large-scale buildings.

(2) Machinery Systems Business

The Machinery Systems Business supplies materials handling systems, including various transportation equipment (conveyors, sorting systems, etc.), and conveyance systems for factories and automated warehouses.

(3) Environmental Systems Business

The Environmental Systems Business provides facilities such as water treatment facilities (including facilities to treat drinking water and dispose of sewage, facilities for the disposal of industrial wastewater, and facilities for the treatment or incineration of sludge), facilities for the treatment of waste (including waste incineration facilities, landfill wastewater treatment facilities), and others.

(4) Real Estate Business

The Real Estate Business utilizes vacant land, such as former factory sites, and manages real estate lease business and building management business.

Sanki Engineering's main business is the provision of the facilities and solutions as described above. The Company obtains about half of its orders directly from facility owner clients and half indirectly through general contractors.

Just as the size of the orders varies widely from a few million yen to a few billion yen, the order completion time varies from a few weeks to a few years for longer orders. The profitability of an order varies and may differ from the originally planned profitability depending on factors such as labor and material costs and the management construction schedule. Some orders end up more profitable than originally planned, and some are less profitable.

2. Strengths, distinguishing traits, and competitors

(1) Broad business domain and one-stop shop solutions

It's no exaggeration to say that there are countless companies in Japan providing the same kind of construction and facilities as Sanki Engineering. The Company's strength lies in the wide range of its businesses, which includes HVAC for building, plumbing, industrial HVAC, electrical systems, facility systems, automated control systems for buildings, transportation systems, and water treatment facilities. The Company can provide services for many types of facilities and solutions covering all phases from planning and design, to installation, maintenance, repair, and replacement, depending on the life cycle of the building. This capability allows its customers to place one-stop shop orders to resolve their problems. By making use of "total engineering" and "life-cycle engineering," which combines a wide variety of businesses horizontally, the Company can provide optimal systems with high added value, and this comprises the Company's strength.

(2) Top-class technology and high-quality customer base

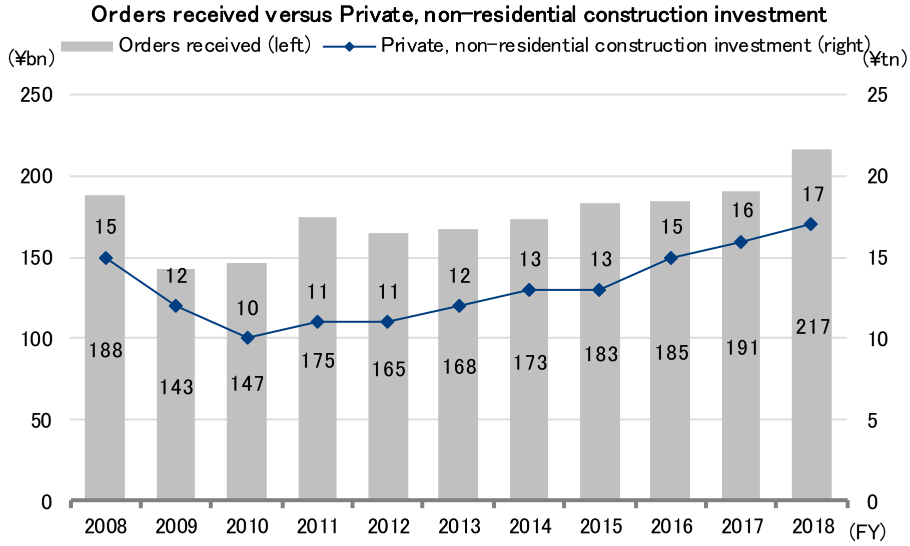
One of the Company's main strengths is the advanced technology it has accumulated since before World War II. Moreover, this top-class technology spans a wide range of fields. Furthermore, Sanki Engineering has earned a reputation for reliability over decades of business, which underpins its extensive, high-quality customer base. This can also be considered a strength of the Company. In addition to its prewar achievements, the Company's involvement in numerous post-war projects, including the construction of facilities for the Tokyo Olympic Games of 1964, have enabled it to obtain orders for recent large projects, such as the ABENO HARUKAS in Osaka and Tokyo Midtown Hibiya.

3. Main competitors

Sanki Engineering's competitors vary by project, but its main competitors among the comprehensive facility construction companies are other large companies such as Takasago Thermal Engineering Co., Ltd. <1969>, Shinryo Corporation (unlisted), Dai-Dan Co., Ltd. <1980>, and Taikisha Ltd. <1979>. Compared to these competitors, Sanki Engineering's strengths lie in its broad business domain and its superiority in industrial HVAC systems, such as clean rooms.

4. Trend in orders received and the economic environment

Given the nature of Sanki Engineering's businesses, orders received are the most important factor affecting the Company's performance. Annual orders received are greatly affected by the overall Japanese market, or the Japanese macro-economy. As the Company's main business is facilities construction, it is influenced by the macro indicator of private sector, non-residential construction investment. The correlation between orders received and private sector, non-residential construction investment is arguably very high.



Source: Prepared by FISCO based on materials from the Ministry of Land, Infrastructure, Transport and Tourism, etc.

Business trends

Operating income increased 183.3% YoY in 1H FY3/20. Balance carried forward will maintain high level of ¥158bn

1. 1H FY3/20 results overview

(1) Earnings

In the 1H FY3/20 results, orders received were ¥100,901mn (up 2.8% year-on-year (YoY)), net sales were ¥91,845mn (up 13.8%), gross profit was ¥13,168mn (up 22.3%), operating income was ¥3,191mn (up 183.3%), ordinary income was ¥3,503mn (up 127.5%), and profit attributable to owners of parent was ¥2,485mn (up 212.0%),

In addition to continued strong business conditions, ongoing rigorous cost controls, a strengthened system for front-line support and other moves saw gross profit margin rise by 1.0pp YoY to 14.3%. At the same time, SG&A expenses stayed at ¥9,976mn (up 3.4%, or ¥331mn, YoY), declining to 10.9% as a percentage of net sales from 11.9% in the same period of the previous year. As a result, operating income increased significantly YoY.

Orders received for facilities construction fell slightly YoY, but remained at a high level in absolute terms. In orders received for the Plant & Machinery Systems Business, the Machinery Systems Business declined YoY, but the Environmental Systems Business saw orders received increase significantly by 70.1% YoY thanks to orders for large-scale projects. As a result, total orders received fell by 2.8% YoY, but remained at a high level. With this, balance carried forward declined by 5.3% YoY to ¥158,885mn, and the Company continues to have plentiful work on hand.

1H FY3/20 results

(¥mn, %)

	1H FY3/19		1H FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	103,819	-	100,901	-	-2,918	-2.8
Balance carried forward	167,809	-	158,885	-	-8,924	-5.3
Net sales	80,723	100.0	91,845	100.0	11,122	13.8
Gross profit	10,771	13.3	13,168	14.3	2,396	22.3
SG&A expenses	9,644	11.9	9,976	10.9	331	3.4
Operating income	1,126	1.4	3,191	3.5	2,065	183.3
Ordinary income	1,540	1.9	3,503	3.8	1,963	127.5
Profit attributable to owners of parent	796	1.0	2,485	2.7	1,688	212.0

Source: Prepared by FISCO from the Company's Summary of Financial Results

(2) Earnings by segment

Net sales and gross profit by segment

(¥mn, %)

	1H FY3/19		1H FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	80,723	100.0	91,845	100.0	11,122	13.8
HVAC and plumbing for buildings	27,111	33.6	32,580	35.5	5,468	20.2
Industrial HVAC	29,774	36.8	30,849	33.6	1,075	3.6
Electrical systems	8,647	10.7	9,845	10.7	1,197	13.9
Facility systems	4,460	5.5	4,962	5.4	502	11.3
Facilities Construction Business	69,993	86.7	78,237	85.2	8,244	11.8
Machinery Systems Business	4,377	5.4	5,294	5.8	916	20.9
Environmental Systems Business	6,132	7.6	7,413	8.1	1,281	20.9
Real Estate Business	923	1.1	1,050	1.1	126	13.7
Others	295	0.4	443	0.5	147	50.1
Adjustments	-998	-	-593	-	404	-
Gross profit	10,771	13.3	13,168	14.3	2,396	22.3
Building HVAC, industrial HVAC, electrical systems	8,529	-	10,565	-	2,035	23.9
Facility systems	641	-	824	-	182	28.5
Facilities Construction Business	9,171	-	11,390	-	2,218	24.2
Machinery Systems Business	798	-	998	-	200	25.0
Environmental Systems Business	713	-	386	-	-327	-45.9
Real Estate Business	287	-	318	-	31	10.9
Others	96	-	124	-	27	28.3
Adjustments	-296	-	-49	-	247	-

Note: From FY3/20, segment profits are disclosed as gross profit
Source: Prepared by FISCO from the Company's Summary of Financial Results

In the Facilities Construction Business, net sales were ¥78,237mn (up 11.8% YoY). By sub-segment, in HVAC and plumbing for buildings, net sales increased 20.2% YoY to ¥32,580mn. The balance of orders received in industrial HVAC, an area of specialty for the Company, saw high levels primarily in semiconductors and others in the electrical industry, driving net sales of ¥30,849mn (up 3.6% YoY). Electrical systems also maintained its strength, rising 13.9% YoY to ¥9,845mn. Facilities systems were up 11.3% YoY to ¥4,962mn.

In the Plant & Machinery Systems Business, total net sales increased 20.9% YoY to ¥12,707mn. Machinery Systems Business net sales were ¥5,294mn (up 20.9%) and Environmental Systems Business net sales were ¥7,413mn (up 20.9%). Other than these facilities work segments, net sales in the Real Estate Business increased 13.7% YoY to ¥1,050mn due to factors including the start of leasing of part of the former Yamato Plant site to Nippon Life Insurance Company. As a result of the above, sales increased in every segment and sub-segment.

Beginning in FY3/20, profits by segment are being disclosed as gross profit. This amounted to ¥11,390mn for the Facilities Construction Business (up 24.2% YoY), breaking down into ¥10,565mn (up 23.9% YoY) for building HVAC and plumbing, industrial HVAC and electrical systems, and ¥824mn (up 28.5% YoY) for facilities systems. In the Plant & Machinery Systems, the Machinery Systems Business reached ¥998mn (up 25.0% YoY), with the Environmental Systems Business at ¥386mn (down 45.9% YoY). In the Real Estate Business and Others, gross profits were ¥318mn (up 10.9% YoY) and ¥124mn (up 28.3% YoY), respectively.

(3) Orders received by segment

Orders received by segment

(¥mn, %)

	1H FY3/19		1H FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	103,819	100.0	100,901	100.0	-2,918	-2.8
HVAC and plumbing for buildings	32,385	31.2	32,810	32.5	425	1.3
Industrial HVAC	38,495	37.1	28,741	28.5	-9,753	-25.3
Electrical systems	12,013	11.6	12,198	12.1	185	1.5
Facility systems	5,350	5.2	5,905	5.9	555	10.4
Facilities Construction Business	88,244	85.0	79,656	78.9	-8,587	-9.7
Machinery Systems Business	6,536	6.3	5,479	5.4	-1,057	-16.2
Environmental Systems Business	8,776	8.5	14,933	14.8	6,156	70.1
Real Estate Business	923	0.9	1,050	1.0	126	13.7
Others	320	0.3	324	0.3	4	1.3
Adjustments	-982	-	-543	-	438	-

Source: Prepared by FISCO from the Company's Summary of Financial Results

Orders received for the Facilities Construction Business overall reached ¥79,656mn (down 9.7% YoY), a year-on-year decline, but this was because of an outstanding level of orders in the previous year, and levels remain high in absolute terms. By sub-segment, HVAC and plumbing for buildings was up 1.3% YoY to ¥32,810mn, exceeding the previous year. Industrial HVAC fell by 25.3% YoY to ¥28,741mn. While this represented a negative YoY result due to a large-scale semiconductor project obtained in FY3/19, the level is high and exceeds that of 1H FY3/18 (¥27,060mn). Electrical systems maintained its level on a YoY basis at ¥12,198mn (up 1.5%), while facility systems were also strong at ¥5,905 (up 10.4% YoY).

In the Plant & Machinery Systems Business, orders received for the Machinery Systems Business reached ¥5,479mn (down 16.2% YoY), but these are relatively strong results considering that the high levels in FY3/19 and FY3/18 reflected orders for large-scale projects. Meanwhile, the Environmental Systems Business captured orders for two large-scale projects, resulting in a significant increase to ¥14,933mn (up 70.1% YoY). As a result, orders received in the Plant & Machinery Systems Business totaled ¥20,413mn (up 33.3% YoY), and together with the Facilities Construction Business, orders received for the facilities work segments overall reached ¥100,070mn (down 3.4% YoY).

In areas other than facilities work segments, orders received in the Real Estate Business totaled ¥1,050mn (up 13.7%), and in Others totaled ¥324mn (up 1.3%). Total orders received in 1H FY3/20 (including adjusted amounts) was ¥100,901mn (down 2.8%), a slight YoY decline but still a high level. As a result, the balance carried forward at the end of 1 H FY3/20 was ¥158,885mn (down 5.3%), staying at a high level.

There was a total of seven orders for large-scale projects (those exceeding ¥1,000mn), worth ¥18,952mn. On a YoY basis, the number of such orders fell, but the total value rose (1H FY3/19: 9 orders, ¥15,873mn; 1H FY3/18: 8 orders, ¥19,052mn). Future results for the Environmental Systems Business in particular will likely be driven by large-scale projects that differ in type from waste and water and sewage treatment plants.

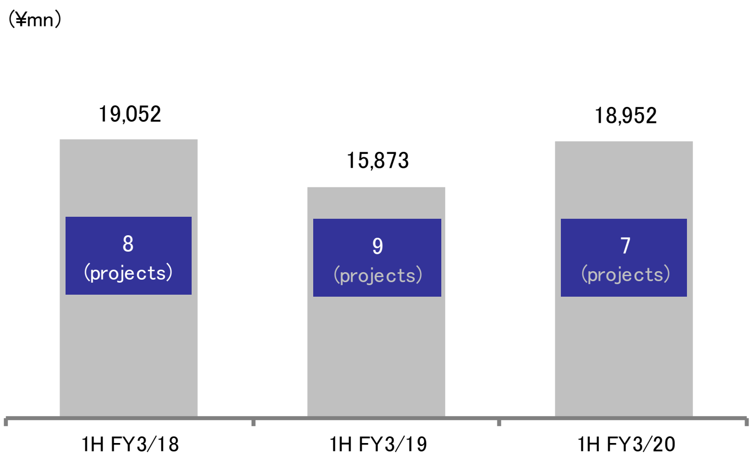
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(projects)

	1H FY3/18	1H FY3/19	1H FY3/20
Offices	1	1	-
Hotels	-	1	-
Factories	2	5	2
Research and institutes	1	-	-
Logistics Center	-	1	-
Hospitals	-	1	1
Others	1	-	2
Railway and airport facilitie	1	-	-
Waste processing facilities	2	-	1
Water treatment plants and sewage plants	-	-	1
Total	8	9	7
Total (¥mn)	19,052	15,873	18,952

Source: Prepared by FISCO from the Company's results overview

Large-scale projects with orders exceeding ¥1,000mn



Source: Prepared by FISCO from the Company's results overview

2. Financial condition

The financial condition at the end of 1H FY3/20 was that current assets were ¥115,368mn (down ¥25,973mn YoY), which was due to factors including a ¥28,929mn decrease in notes and accounts receivable on completed construction contracts and others. Noncurrent assets were ¥53,235mn (down ¥744mn), which was primarily because of a decrease in investments and other assets of ¥748mn, while an increase in tangible noncurrent assets have settled down following the completion of the Yamato sites and other factors. As a result, total assets at the end of 1H FY3/20 were ¥168,603mn (up ¥26,717mn).

Current liabilities were ¥64,503mn (down ¥26,814mn), mainly due to a ¥23,551mn decrease in notes and accounts payable on construction contracts and others. Noncurrent liabilities were ¥13,951mn (down ¥280mn), with the main factors including a decrease of ¥695mn in long-term loans and an increase of ¥149mn in liability for retirement benefits. As a result, total liabilities at the end of 1H FY3/20 were ¥78,454mn (up ¥27,094mn). Total net assets were ¥90,149 (up ¥377mn). This was mainly due to factors including a ¥2,100mn decrease in retained earnings from the payment of dividends and a ¥2,413mn decrease from the retirement of treasury shares.

Condensed balance sheet

(¥mn)

	FY3/19	1H FY3/20	Change
Cash and deposits	42,612	41,865	-746
Notes and accounts receivable on completed construction contracts and others	85,243	56,314	-28,928
Current assets	141,342	115,368	-25,973
Tangible noncurrent assets	14,329	14,328	-1
Intangible noncurrent assets	688	693	5
Investments and other assets	38,961	38,213	-748
Noncurrent assets	53,979	53,235	-744
Total assets	195,321	168,603	-26,717
Notes and accounts payable on construction contracts and others	68,286	44,735	-23,550
Short-term loans	6,874	6,875	0
Payments received for work in progress	3,395	6,221	2,825
Current liabilities	91,317	64,503	-26,814
Long-term loans	5,220	4,525	-695
Liability for retirement benefits	3,120	3,269	149
Noncurrent liabilities	14,232	13,951	-280
Total liabilities	105,549	78,454	-27,094
Total net assets	89,772	90,149	377

Source: Prepared by FISCO from the Company's financial results

3. Cash flow conditions

In 1H FY3/20, cash flow provided by operating activities was ¥5,369mn, with the main cash inflow items being profit before income taxes, etc., of ¥3,613mn, and an ¥29,496 decrease in trade receivables, and the main cash outflow item being a ¥23,810mn decrease in trade payables. Cash flow used in investing activities was ¥584mn, due mainly to ¥1,375mn in purchase of property, plant and equipment. Cash flow used in financing activities was ¥3,184mn, with the main cash outflow items including ¥695mn in net decrease in short- and long-term borrowings and ¥2,383mn in dividends paid.

As a result, the balance of cash and cash equivalents at the end of 1H FY3/20 had increased ¥1,554mn from the end of the previous fiscal year to ¥44,865mn.

Condensed statement of cash flows

(¥mn)

	1H FY3/19	1H FY3/20
Cash flows from operating activities	1,434	5,369
Profit before income taxes	1,389	3,613
Change in trade notes and accounts receivable (- indicates increase)	10,409	29,496
Change in trade notes and accounts payable (- indicates decrease)	-6,014	-23,810
Cash flows from investment activities	-2,051	-584
Purchase of property, plant and equipment	-2,002	-1,375
Cash flows from financing activities	-2,007	-3,184
Change in short- and long-term borrowings (- indicates decrease)	-713	-695
Dividends paid	-1,211	-2,383
Change in cash and cash equivalents (- indicates decrease)	-2,671	1,554
Cash and cash equivalents at end of period	42,195	44,865

Source: Prepared by FISCO from the Company's financial results

4. Completion of STeP Project

Since FY3/17, the Company has been implementing the redevelopment of its land and buildings into STeP (Sanki Techno Park), primarily the property it owns at the Sanki Yamato Site (including the Sanki Yamato Site building and the former Yamato Engineering Center). This project was completed in 1H FY3/20.

In May 2018, the Company began leasing part of the land at the former Yamato Engineering Center to the Nippon Life Insurance Company; by October 2019, it had begun leasing the entire property (40,000 m2). In October 2018, the Sanki Techno Center was completed and is currently operating. In September 2019, the Yamato Product Center began full-scale operations, marking the completion of the STeP project. Use of these facilities going forward is expected to improve gross profit margins through improved productivity while increasing net sales in the Real Estate Business.

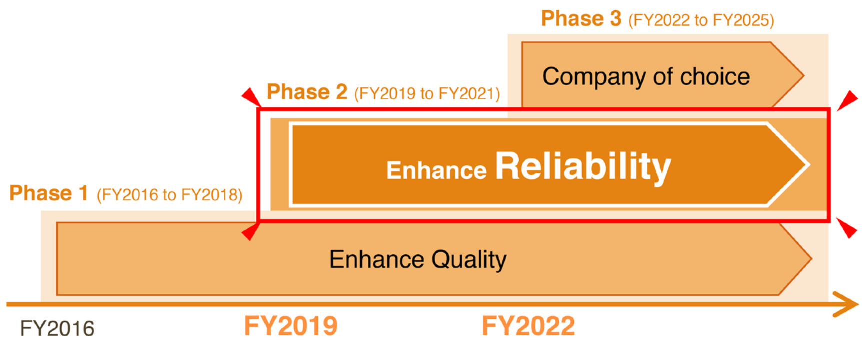
Medium-term management plan

Century 2025 Plan, Phase 2 from FY3/20

1. "Century 2025" Plan: from Phase 1 to Phase 2

The Company has announced a 10-year long-term vision "Century 2025" that covers from FY3/17 to FY3/26, the 100th anniversary of its establishment. The ultimate goal of this long-term vision is to be "The Company of Choice." The Company has divided the 10 years into three phases described below in order to achieve this goal and the Company's policy is to implement business strategies promoted in each phase of medium-term management plan.

Long-term vision “Century 2025”
We will strive over the next 10 years to become the company of choice for customers by further enhancing the quality and reliability we provide.



■Phase 1 ⇒ We will enhance quality by refining our skills and wisdom and developing our human resources as a foundation for responding to change.

■Phase 2 ⇒ Superior quality generates stakeholder satisfaction, and stakeholder satisfaction and confidence leads to reliability.

■Phase 3 ⇒ Increased reliability will encourage more stakeholders to choose our company.

Source: From the Company’s materials

The Company has already achieved the quantitative targets for Phase 1 of the medium-term management plan, which were net sales of ¥195bn and operating income of ¥7.5bn in FY3/19.

2. Phase 2: The basic policies are a continuation of Phase 1

“Century 2025” has entered Phase 2 from FY3/20, but since the initiatives in Phase 1 are already steadily showing their effects, the Company has set the basic policies for Phase 2 as

(1) continue to pursue further quality for technologies and people from the initiatives in Phase 1, and continue to implement the key initiatives from Phase 1, of “Strengthen Core Businesses,” “Promote Growth Strategies,” and “Enhance the Sanki Brand.”

(2) and in addition, promote understanding of the Company by "Disclosing financial and capital policies and the ESG policy" and "Strengthening the ability to communicate information."
By working on these initiatives, it is aiming to increase “reliability” to become “The Company of Choice” from the next phase, Phase 3.

3. Phase 2: Strengthen core businesses

It will implement initiatives to “Improve component technologies and achieve stable growth.” From FY3/20, the Facility Systems Business will be separated from the Facilities Construction Business segment and become one of core businesses.

Improve component technologies and achieve stable growth

Segment	Initiative
Facilities Construction Business	Improving productivity and maintaining high profitability by establishing company-wide organizational construction system, including subcontractors, and utilizing the “Sanki Techno Center”
	Improving construction quality through the use of digital tools such as ICT and BIM
	Improving quality of sales and design by revitalizing internal communication
Facility Systems Business	Providing new consulting services
Machinery Systems Business	Expanding hybrid system products and services to meet the labor reduction and automation needs
	Establishing production management systems and improving productivity at the new “Yamato Product Center” plant
Environmental Systems Business	Proactively receive orders for infrastructure facilities corresponded to changes in society and environment, such as the declining population
	Developing energy saving and energy creating fields such as biomass gasification power generation facilities

Source: Prepared by FISCO from the Company's materials

4. Phase 2: Initiatives to promote growth strategy

Implement initiatives to pursue future growth in the areas of technology and business.

Pursue future growth in the areas of technology and business

Item	Initiatives
Developing next-generation technologies through the R&D Center	Developing technology in digital fields such as ICT, AI, and cloud computing using open innovation
Further catering to labor reduction and automation needs	Creating next-generation technology at the new “Yamato Product Center” plant
Steadily development of overseas business	Rebuilding foundations for local systems with an eye to business tie-ups and M&A
Rebuilding the food service equipment business	Utilizing the food service equipment plans and management knowhow accumulated by the Company
Promoting stock-based businesses for the future	Proactively receiving orders for new large-scale construction projects and DBO projects to expand LCE projects

Source: Prepared by FISCO from the Company's materials

5. Phase 2: Initiatives to enhance the Sanki Brand

Implement initiatives to Develop human resources that possess the Sanki spirit and contribute to society.

Develop human resources that possess the Sanki spirit and contribute to society

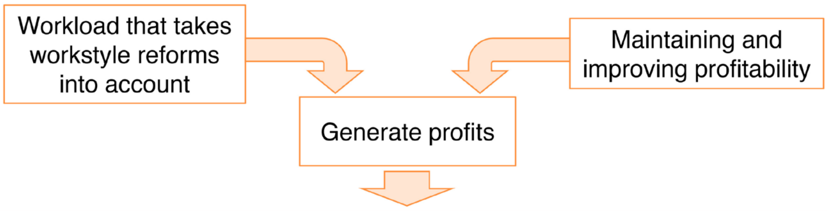
Item	Initiatives
Enhancing quality of human resources and technology	Utilizing the “Sanki Techno Center” to provide through education and training on topics such as technology, safety, ethics, management, and manners for everyone from new employees to veteran employees, including subcontractors
	Establishing better frameworks relating to HR, salaries, and welfare, etc. through communication
	Developing a healthy workforce and enabling the coexistence of a diverse workforce through the “Smile Work Guidelines”*
Social contribution activities	Contributing to the resolution of global environmental problems through business activities
	Proactively support culture and sports activities, starting with environmental activities

*: The Company's own guidelines which provide tips on how to promote diverse work styles
Source: Prepared by FISCO from the Company's materials

6. Phase 2: Financial and capital policies

Establish financial and capital policies to rise medium- to long-term corporate value.

Raising medium- and long-term corporate value



Item	Initiatives
Investments in the future	Strengthen investments for future growth, such as R&D, capital investments and education
Return of profits to steakholders	• Set total return ratio as targets and return profits to shareholders in a stable and continuous manner • Return funds to business partners by improving payment terms and other means
Improved capital efficiency	• Continuously reduce strategic shareholdings • Review the composition of epuity capital and ensure the flexibility and maneuverability of capital policies

ROE of 8.0% or more

Source: Prepared by FISCO from the Company's materials

7. Phase 2: ESG policies

Implement initiatives to create sustainable social value.

ESG Policies

Item	Initiatives
E (Environment)	Contributed to global environmental problems through business activities by decarbonization, saving energy and creating energy
	Continue with “SANKI YOU Eco Contribution Points”
	Continue to participate in cultivating “Sanki Forest” and the afforestation projects
S (Society)	Pursue workstyle reforms by continuing with the “Smile Project” and “Smile Site Plan”
	Carry out measures to improve communication
	Proactively carry out cultural and sports support, starting with environmental activities
G (Governance)	Continue with initiatives aimed at achieving better governance, based on “Sanki Engineering’s Corporate Governance Guidelines”

Source: Prepared by FISCO from the Company's materials

8. Phase 2: Strengthen the ability to communicate information

The Company is actively communicating information by implementing initiatives to further spread awareness of the Sanki brand both internally and externally.

Proactive transmission of information

Item	Initiatives
Augment IR activities	Disclose basic policies for financial & capital policies
	Continue to create opportunities for dialogue with shareholders and investors (such as implementation of corporate tours)
	Continue to participate in exhibitions for individual investors
	Augment the integrated corporate report, “SANKI REPORT”
Expand PR activities	Continue to participate in exhibitions that have a high marketing effect
	Promoting understanding of the Company through corporate messaging and advertising
	Appeal to a wide range of customers using a wide variety of media

Source: Prepared by FISCO from the Company's materials

9. Financial performance targets: Management targets now being disclosed along with financial performance targets

Financial performance targets

(¥bn , %)

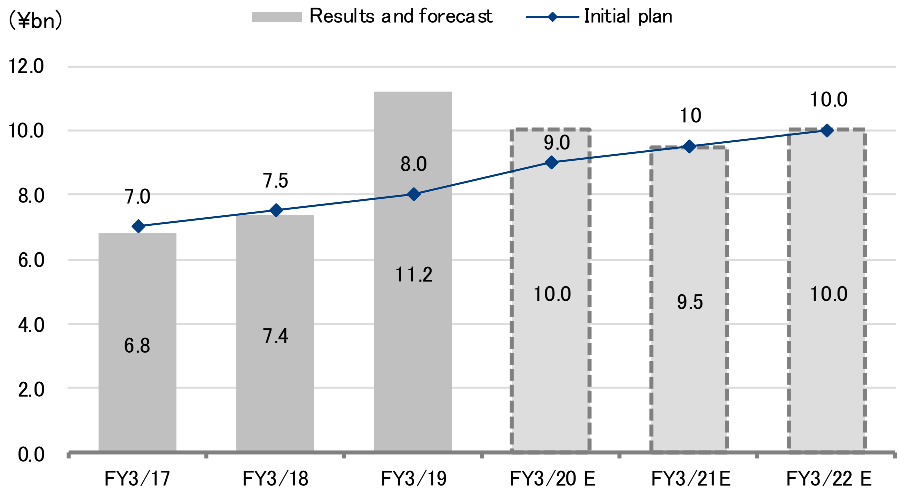
	Phase 1			Phase 2		
	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22
Net sales	1,685	1,701	2,123	2,000	2,000	2,000
Gross profit	225	250	316	300	310	320
Gross profit margin	13.4	14.7	14.9	15.0	15.5	16.0
Ordinary income	68	74	112	90	95	100
Ordinary income margin	4.1	4.4	5.3	4.5	4.8	5.0

Source: Prepared by FISCO from the Company's materials

In consideration of the external environment and the promotion of employees’ work-style reforms, it is targeting total net sales for the three years of ¥200bn, while targeting gross profit margin, which the Company holds in the highest importance, of 16.0% and an ordinary profit margin of 5.0% for FY3/22.

However, forecast net sales and ordinary income for FY3/20 have already been revised to ¥210bn and ¥10bn, respectively, exceeding the planned numbers for “Century 2025” Phase 2.

Ordinary Income Results and Forecasts



Source: Prepared by FISCO from the Company's materials

Management Targets

Phase 2 Management targets	
Ordinary profit margin	5.0% and higher (final fiscal year)
Dividends	Annual dividends per share of ¥60 and higher
Acquisition of treasury stock	About 5 million shares
Total return ratio	70% or higher
ROE	8.0% or higher

Source: Prepared by FISCO from the Company's materials

Outlook

Decline in profit forecasted, though an upward revision from initial forecast

● **FY3/20 outlook**

For the FY3/20 full year results, the Company is forecasting net sales of ¥210,000mn (down 1.1%), operating income of ¥9,800mn (down 7.9%), ordinary income of ¥10,000mn (down 10.7%), and profit attributable to owners of parent of ¥7,000mn (down 22.6%). Earnings are projected to decrease compared to FY3/19, however, the forecast has been revised upward from the initial forecast which was ¥8,800 (down 17.3% YoY) in operating income. These forecasts assume orders received of ¥200,000mn (down 7.9%) and balance carried forward of ¥139,829mn (down 12.0% from the end of the previous fiscal year).

Breaking down net sales, in the Facilities Construction Business, they are forecast to be ¥171,000mn (down 4.6% YoY). By sub-segment, sales are expected to be ¥71,000mn (down 0.8%), basically unchanged YoY, for HVAC and plumbing for buildings. Sales are expected to be ¥65,000mn (down 11.6%) for industrial HVAC due to the outstanding results achieved in FY3/19. Sales of electrical systems are forecast to be slightly increased YoY at ¥24,000mn (up 3.4%), and those of facility systems to increase to ¥11,000mn (down 0.3%). In the Plant & Machinery Systems Business, net sales for Machinery Systems are forecast to increase slightly to ¥12,000mn (up 1.8%), while Environmental Systems is projected to increase significantly to ¥25,000mn (up 22.1%) from construction work at hand.

In the mainstay Facilities Construction business, orders received are forecast to be ¥163,000mn due to the favorable performance in FY3/19. By sub-segment, in HVAC and plumbing for buildings, orders are expected to be ¥67,000mn, in industrial HVAC, ¥61,000mn due to the rebound from having received a large-scale project obtained in FY3/19, in electrical systems, ¥23,000mn, and in facility systems, ¥12,000mn (up 10.9%). In the Plant & Machinery Systems Business, orders are expected to be ¥12,000mn for Machinery Systems and ¥23,000mn for Environmental Systems, both mostly unchanged YoY. As a result, overall orders received including Real Estate Business and Others are forecast to be ¥200,000mn.

FY3/20 forecast

(¥mn, %)

	FY3/19		FY3/20 E			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	217,096	100.0	200,000	100.0	-17,096	-7.9
HVAC and plumbing for buildings	65,639	30.2	67,000	33.5	1,361	2.1
Industrial HVAC	82,729	38.1	61,000	30.5	-21,729	-26.3
Electrical systems	23,342	10.8	23,000	11.5	-342	-1.5
Facility systems	10,821	5.0	12,000	6.0	1,179	10.9
Facilities Construction Business	182,533	84.1	163,000	81.5	-19,533	-10.7
Machinery Systems Business	12,049	5.6	12,000	6.0	-49	-0.4
Environmental Systems Business	21,705	10.0	23,000	11.5	1,295	6.0
Real Estate Business	1,926	0.9	2,000	1.0	74	3.8
Others	960	0.4	600	0.3	-360	-37.5
Adjustments	-2,078	-	-600	-	1,478	-
Net sales	212,314	100.0	210,000	100.0	-2,314	-1.1
HVAC and plumbing for buildings	71,558	33.7	71,000	33.8	-558	-0.8
Industrial HVAC	73,493	34.6	65,000	31.0	-8,493	-11.6
Electrical systems	23,214	10.9	24,000	11.4	786	3.4
Facility systems	11,033	5.2	11,000	5.2	-33	-0.3
Facilities Construction Business	179,300	84.5	171,000	81.4	-8,300	-4.6
Machinery Systems Business	11,791	5.6	12,000	5.7	209	1.8
Environmental Systems Business	20,471	9.6	25,000	11.9	4,529	22.1
Real Estate Business	1,926	0.9	2,000	1.0	74	3.8
Others	718	0.3	600	0.3	-118	-16.4
Adjustments	-1,893	-	-600	-	1,293	-
Gross profit	31,684	14.9	32,000	15.2	316	1.0
SG&A expenses	21,046	9.9	22,200	10.6	1,154	5.5
Operating income	10,637	5.0	9,800	4.7	-837	-7.9
Ordinary income	11,204	5.3	10,000	4.8	-1,204	-10.7
Profit attributable to owners of parent	9,046	4.3	7,000	3.3	-2,046	-22.6

Source: Prepared by FISCO from the Company's financial results supplementary materials

Given that currently there is ample work in hand, we feel there is every likelihood that the Company will achieve the above targets. Going forward, the point to pay attention to is avoiding unexpectedly unprofitable projects by rigorous progress management. In respect of orders also, the environment surrounding the construction and HVAC industries is good, and given that there is expected to be an ample volume of works, it is felt that it is possible for the Company to secure their target for orders received.

Gross profit margins were high (14.9%) in the previous year, but the Company plans to exceed that figure to secure a margin of 15.2% by enacting a variety of profit improvement measures, including continuing to establish and enhance various front-line support systems; enhancing the ability of the Procurement Division to negotiate in procuring materials; and continuing to support front-line purchasing operations through collective management. Through these measures, the Company projects ¥32,000mn (up 1.0% YoY) in gross profit if the net sales target is achieved as planned. Meanwhile, SG&A expenses are expected to increase 5.5% YoY to ¥22,200mn, and as a result, operating income is forecast to fall 7.9% YoY to ¥9,800mn. That said, given a breather in the rise in extraordinary expenses (human resource investments, pay revisions, etc.), SG&A expenses may not rise as much as expected, and if net sales and gross margins perform to plan, operating income going forward may be revised upward.

Shareholder return policy

The Company has expressed a shareholder return policy calling for a total return ratio of 70% or greater and an annual dividend of at least ¥60. Increased dividend, acquisition and retirement of treasury shares represents an active approach to shareholder returns.

The Company actively returns profits to shareholders. While its basic annual dividend was ¥15 through FY3/14, a change in profit structure prompted a dividend increase beginning in FY3/15. Due to strong results in FY3/19, the Company implemented a special year-end dividend of ¥20 in addition to the normal ¥40 dividend, for a total annual dividend of ¥60 (a dividend payout ratio of 40.0%). Further, while the Company had initially called for an annual dividend of at least ¥60 for FY3/20, strong results in 1H FY3/20 led it to announce an increase to ¥70 (interim ¥35, year-end ¥35).

Also, as part of its measures to return profits to shareholders, the Company has actively acquired its treasury shares on the stock market and retired them. In 1H of FY3/20, it retired 2mn of its treasury shares, and plans to acquire another 2mn shares during the fiscal year (of which 1mn have already been acquired).

Looking at the Company's buy-backs of treasury shares and the dividend amounts from FY3/14 to FY3/19, we see that the total amount was ¥20,678mn, and the ratio of this amount to the total profit attributable to owners of parent during this period, or in other words, the ratio of the total return of profits (weighted average), was 76.0%. In the three years from FY3/20, it intends to acquire around 5mn treasury shares, and combined with the dividend, to achieve a ratio of the total return of profits of 70% or above. In such ways, we can highly evaluate the Company's positive approach to returning profits to shareholders, and moreover the fact that it has clarified its specific policies for returning profits to shareholders in Phase 2 of the medium-term management plan.

Shareholder returns

	Sale of treasury stock		Dividend amount (B)	Amount of shareholder returns (C) = (A) + (B)	Profit attributable to owners of parent
	No. of shares	Amount (¥mn) (A)			
FY3/19	1,000,000	1,191	3,595	4,786	9,046
FY3/18	3,000,000	3,679	2,136	5,815	3,906
FY3/17	0	0	1,906	1,906	4,698
FY3/16	0	0	1,906	1,906	5,327
FY3/15	2,000,000	1,604	1,270	2,874	2,461
FY3/14	4,000,000	2,408	983	3,391	1,763
			Total	20,678	27,201
			Total return ratio (weighted average)		76.0%

Source: Prepared by FISCO from the Company's financial results and results briefing materials

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