COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

Tokyo Stock Exchange First Section

12-Jul.-2019

FISCO Ltd. Analyst

Hiroyuki Asakawa

FISCO

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

Formulated new medium-term plan NEXT 1800, aims for longer-term growth through expansion of core business and with global initiatives and advances in new business fields

SUN-WA TECHNOS CORPORATION <8137> (hereinafter, "the Company") is an independent trading company that specializes in technology products. The Company has steadily expanded its businesses by leveraging coverage of three major areas (electrical machinery, electronics, and general machinery) and two-way trade in which it sells equipment and materials for manufacturers' production lines and then procures the products made by these manufacturers. In recent years, it has been focusing on the engineering business and global SCM solutions.

1. Weaker sales and profits in FY3/19 with sharp slowdown in industrial machinery industry sales in Asia

The Company reported lower sales and profits in FY3/19 at ¥145,410mn in net sales (-0.9% YoY) and ¥3,410mn in operating income (-17.5%). It reduced FY3/19 guidance at the 3Q announcement, and full-year results were on track with the adjusted view and no particular surprises. Sales to mainstay factory automation and industrial machinery industries sharply declined in Asia (particularly China) with US-China trade friction and weakness in Chinese auto sales as catalysts. While sales to the automobile-related industry increased on growing demand for safety equipment such as automated brakes in Japan, this was not enough to fully offset the setback impact.

2. Announced new medium-term management plan NEXT 1800 with FY3/22 goals of ¥180bn in net sales and ¥5bn in ordinary profit

The Company formulated NEXT 1800, a new three-year medium-term management plan covering FY3/20 to FY3/2022, aimed at achieved longer-term growth through measures such as strengthening and expanding core business, growing global business, and pursuing new business areas. As management goals, the plan targets ¥180,000mn in net sales, ¥4,800mn in operating profit (2.7% operating margin), and ¥5,000mn in ordinary profit (2.8% ordinary margin) in FY3/22, the final fiscal year.

3. Planned increases in sales and profits for FY3/20

In FY3/20, the Company expects lower profits on increased sales with targets of ¥150,000mn in net sales (+3.2% YoY) and ¥3,100mn in operating profit (-9.1%). It projects higher sales in the three main regional segments – Japan, Asia, and Europe and the US.

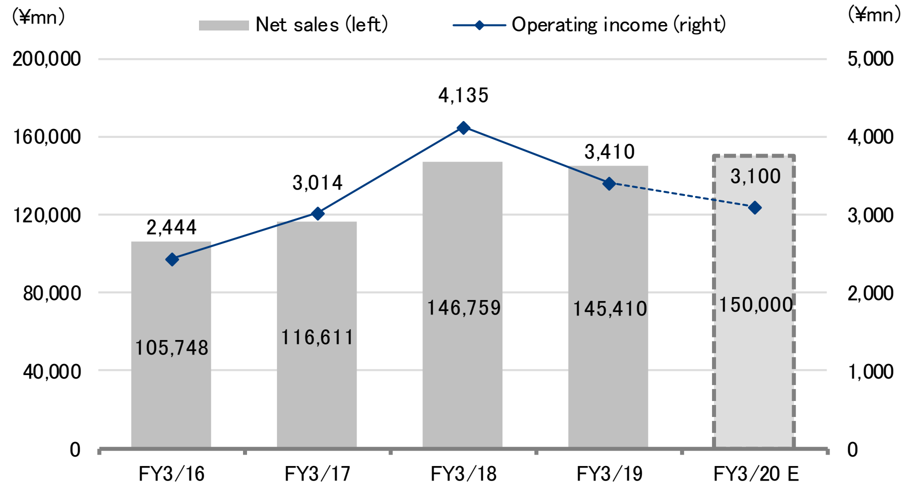
However, it forecasts a decline in operating profit (YoY) because of pressure from higher personnel costs accompanying additions of people in Japan and an increase in logistics costs.

We believe it is reasonably possible to absorb these cost increases if engineering business, where the Company is focusing efforts, steadily expands. However, we intend to monitor trends based on the Company's outlook for the time being because some impact from US tariffs on China are not reflected in the targets.

Key Points

- New medium-term management plan adds engineering and global SCM solutions to core business and aims to accelerate reinforcement and expansion of these areas
- Pursuing 15-20% gross margin in engineering business
- Possible tailwind for global SCM solutions business from US-China trade friction

Results trends



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

Results trends

Sales and profit declines on sudden slowdown in sales to mainstay factory automation and industrial machinery industries

1. Review of FY3/19 results

The Company reported lower sales and profits in FY3/19 at ¥145,410mn in net sales (-0.9% YoY), ¥3,410mn in operating income (-17.5%), ¥3,627mn in ordinary income (-16.6%), and ¥2,628mn in net income attributable to owners of the parent (-14.8%).

The Company lowered full-year guidance on January 30, 2019, and net sales and profits slightly exceeded the revised targets.

FY3/19 results

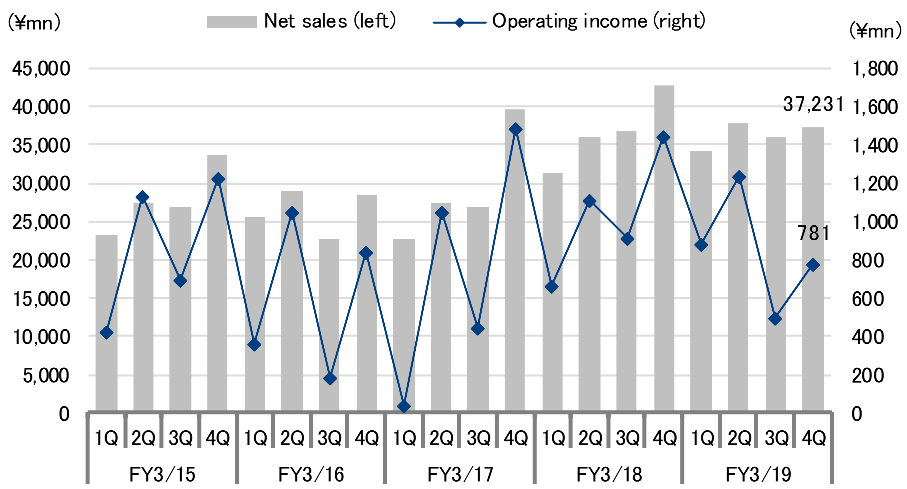
(¥mn)

	FY3/18			FY3/19					
						Full year			
	1H	2H	Full year	1H	2H	Final target	Results	Growth rate (YoY)	Growth rates verses forecast
Net sales	67,348	79,411	146,759	72,164	73,246	142,000	145,410	-0.9%	2.4%
Operating income	1,773	2,362	4,135	2,129	1,281	2,700	3,410	-17.5%	26.3%
Operating margin	2.6%	3.0%	2.8%	3.0%	1.7%	1.9%	2.3%	-	-
Ordinary income	1,951	2,398	4,349	2,312	1,315	3,000	3,627	-16.6%	20.9%
Net income attributable to owners of the parent	1,359	1,726	3,085	1,651	977	2,100	2,628	-14.8%	25.1%

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

The Company slightly adjusted the sales target from the period-start level of ¥157,500mn to ¥150,000mn at the 2Q announcement. Orders were coming in smoothly at that point, and the outlook expected healthy sales in 2H too. However, sharply lower orders in 3Q (Oct-Dec 2018) fueled concerns about results in 4Q when they show up in sales. In light of this situation, the Company updated its full-year outlook again at the 3Q announcement on January 30, 2019, including a downward revision of the sales target to ¥142,000mn. Sales ultimately beat the final target by 2.4% (¥3,410mn) with support from catch-up efforts in 4Q.

Quarterly results trends



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

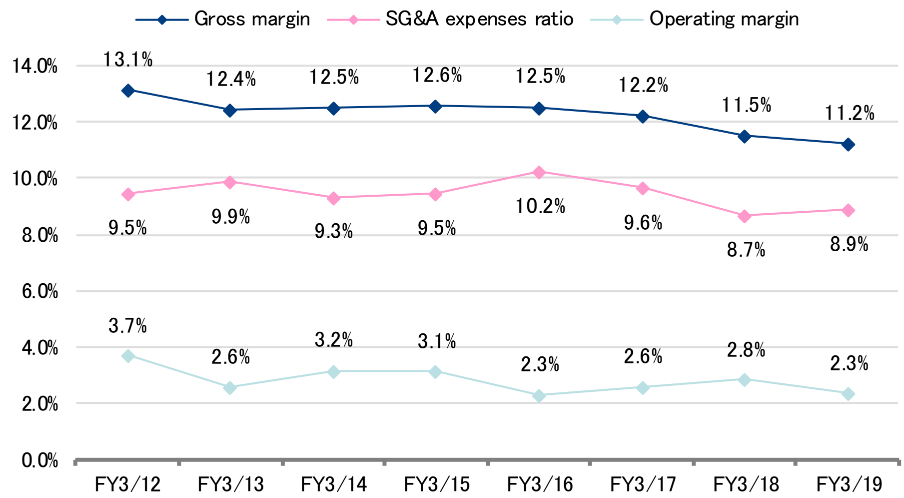
Reduction of the sales outlook from the period-start plan mainly factors in weaker sales in Asia (particularly China) at the regional level and in factory automation and industrial equipment industries, the Company's core areas, as customer industries. As background, US-China trade friction and decline in automobile sales in China triggered rapid cooling off by capital investments and production activities in China. Japanese sales, meanwhile, rose YoY on healthy electronics division sales to vehicle products for the automotive industry. Trends clearly differed by regions and demand areas.

In profits, just as with sales, the Company lowered its operating profit target from ¥4,400mn to ¥2,700mn in the January 2019 revisions. Full-year operating profit ultimately exceeded the revised outlook, similar to sales, at ¥3,410mn and 2.3% operating margin.

Operating margin slipped significantly from 3.0% in 1H to 1.7% in 2H, primarily due to less favorable product mix. Specifically, product mix weakened because of decline in sales to the factory automation and industrial equipment industries in China versus healthy sales of electronic parts to vehicle products for the automotive industry in Japan, as explained above. Recognition of sales on large projects with low profitability in the general machinery business also pushed the margin lower.

Engineering business, which the Company is promoting as a way to improve profit margin, posted ¥11,985mn in sales (-5% YoY) in FY3/19. While sales fluctuate considerably each year depending on whether the business has major projects or not and other factors, they stayed above the ¥10bn level, despite an unstable business environment, in FY3/19. Gross margin, the Company's most important indicator in the engineering business, dropped from 13.4% in the previous fiscal year to 12.6% in FY3/19, because of less favorable product mix that was also seen at the company level.

Trends in various margins



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

Clear differences between trends in Japan and Asia and automotive and industrial machinery industries, respectively

2. Detailed trends by regional segments and business divisions

The Company manages the products it handles and discloses sales by business segment using three divisions – electrical machinery, electronics, and general machinery – and also provides disclosure by regional segments. Below we review trends by divisions and regional segments.

List of trends by business divisions and regional segments

	Japan			Asia			Europe/US		
	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery
Automotive industry	○	○							
Semiconductor industry									
Industrial machinery industry	×	×	○	×	×	○		○	
FPD industry	×		×				×		
Smartphone industry									
Amusement industry								○	

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

(1) Trends by regional segments

a) Japan

Profit fell on higher sales with ¥115,993mn in sales (+0.9% YoY) and ¥1,939mn in operating profit (-16.9%). The Company booked stronger sales of electronic parts for automotive products. This reflects the rising usage ratio of collision prevention automated brakes and other safety devices. In industrial machinery industry, while sales of chip mounters and other equipment increased, sales of electronic parts used in industrial machines declined. In flat panel display (FDP) industry, sales of OLED-related electric products and other equipment slipped. Overall sales still increased YoY thanks to the rise in sales to the automotive industry.

In earnings, operating profit fell mainly on decline in gross margin because of weaker product mix. The Company's core traditional products for the industrial machinery industry, such as control equipment, servo motors, and robots, generate relatively high profitability. Automotive industry business, meanwhile, is generally known to have lower (tighter) profitability. The Company is no exception. Gross margin weakened on the combined effect of decline in sales to the industrial machinery industry and increase in sales to the automotive industry, and this led to the drop in operating profit. Higher logistics costs weighed on profits too.

b) Asia

Both sales and profits declined with ¥37,188mn in sales (-5.8% YoY) and ¥1,208mn in operating profit (-18.8%). In Asia, the Company operates local entities in Shanghai, Shenzhen, and Hong Kong, and China has a high share of business. Sales of electric products and electronic parts to the industrial machinery industry fell in FY3/19, in contrast to the rise in sales of production equipment to the same industry, partly due to the impact of US-China trade friction. Operating profit shrunk as a result of lower profits from the decline in sales and a drop in profit margin. Operating margin was down by 0.6ppt from 3.8% FY3/18 to 3.2% in FY3/19.

c) Europe/US

Both sales and profits declined to ¥8,084mn in sales (-8.8% YoY) and ¥254mn in operating profit (-18.3%). Sales fell YoY, even with increases in sales of electronic products to the industrial machinery industry and electronic parts for amusement machines (casino-related equipment), because of a heavy impact from decline in sales of OLED-related electrical products to the FPD industry. Operating profit fell on weaker sales.

Detailed trends by regional segments

(¥mn)

		FY3/18			FY3/19		
		1H	2H	Full year	1H	2H	Full year
Japan	Net sales	52,385	62,617	115,002	57,653	58,340	115,993
	YoY	27.6%	22.4%	24.7%	10.1%	-6.8%	0.9%
	Operating income	935	1,398	2,333	1,065	874	1,939
	YoY	24.5%	-1.1%	7.8%	13.9%	-37.5%	-16.9%
	Operating margin	1.8%	2.2%	2.0%	1.8%	1.5%	1.7%
Asia	Net sales	17,734	21,757	39,491	18,646	18,542	37,188
	YoY	49.7%	20.5%	32.1%	5.1%	-14.8%	-5.8%
	Operating income	674	815	1,489	778	430	1,208
	YoY	118.3%	60.4%	82.4%	15.4%	-47.2%	-18.8%
	Operating margin	3.8%	3.7%	3.8%	4.2%	2.3%	3.2%
Europe/US	Net sales	3,758	5,107	8,865	4,204	3,880	8,084
	YoY	98.6%	15.3%	40.2%	11.9%	-24.0%	-8.8%
	Operating income	162	148	310	275	-21	254
	YoY	868.1%	-	-	69.7%	-	-18.3%
	Operating margin	4.3%	2.9%	3.5%	6.5%	-0.5%	3.1%

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

(2) Trends by business

Electrical machinery sales dropped 9.6% YoY to ¥24,569mn. This segment mainly handles servo motors, inverters, and other equipment. In FY3/19, decline in sales of OLED-related products to the FPD industry stood out and spinning machine sales also dropped from the previous year. Increased sales of electrical products for equipment used in the automotive industry, meanwhile, were not enough to offset setbacks in other areas and segment sales were down by roughly 10%.

Electronics sales eased 1.0% YoY to ¥109,370mn. This segment handles a broad range of products that do not fit into electrical machinery and general machinery segments. While the products are described as electronic parts, they do not include low-voltage parts and mainly consist of power sources, connectors, semiconductors, various types of sensors, and LCD panels. In FY3/19, while sales of electronic parts and electronic parts to the industrial machinery industry dropped considerably in Japan and Asia, sales of electronic parts for vehicle equipment to the automotive industry climbed in the Japanese market. Sales of electronic parts for amusement equipment rose as well. Thanks to these upbeat areas, decline in segment sales was just 1.0% YoY.

General machinery sales rose 25.3% YoY to ¥11,470mn. This segment mainly handles manufacturer production facilities and equipment, including SPE products, industrial robots, clean robots for FPD transport, and inspection equipment. In FY3/19, even though sales of LCD panel-related equipment to the FPD industry declined, segment sales rose significantly YoY due to booking sales for a major equipment deal for the industrial machinery industry (chip mounters) and higher sales of equipment to the metal products industry. Nevertheless, sales missed the period-start target as recognition of some major deal sales slipped to FY3/20.

Detailed trends by business segments

(¥mn)

	FY3/18			FY3/19		
	1H	2H	Full year	1H	2H	Full year
Electrical machinery	12,390	14,776	27,166	13,332	11,237	24,569
YoY	35.9%	27.1%	31.0%	7.6%	-24.0%	-9.6%
Electronics	50,339	60,097	110,436	53,553	55,817	109,370
YoY	37.1%	22.4%	28.7%	6.4%	-7.1%	-1.0%
General machinery	4,619	4,537	9,156	5,278	6,192	11,470
YoY	10.4%	-22.7%	-8.9%	14.3%	36.5%	25.3%
Total net sales	67,348	79,411	146,759	72,164	73,246	145,410
YoY	34.7%	19.2%	25.9%	7.2%	-7.8%	-0.9%

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

New medium-term management plan NEXT 1800

Announced the new three-year medium-term management plan NEXT 1800
Aims to realize growth with four core policies (strengthening core businesses, etc.)

1. Overview of the new medium-term management plan NEXT 1800

The Company aims to realize longer-term growth by formulating medium-term management plans once every three years and thoroughly implementing them. It announced NEXT 1800, the new three-year medium-term management plan, in May 2019.

In its long-term management vision “Sun-Wa Vision 2025,” the Company calls for “strengthening core businesses to build operations that contribute to advances in industrial activity in local societies as a total coordinator of production sites and distribution and help in attaining the goal of ¥250bn in consolidated sales in FY3/26.” It positions NEXT 1800, the new medium-term management plan, as an action plan for the next three years toward realization of the corporate mission and Sun-Wa Vision 2025, similar to previous medium-term management plans.

NEXT 1800 presents four items as fundamental policies, including “contribute to customer production activities by strengthening core businesses.” It also highlights priority measures for each of the policies. We review the details of plan measures later in this report. In the core portion of income growth, the Company hopes to make improvements and achieve further advances versus Challenge 1500, the previous medium-term management plan, and realize a growth strategy with even higher certainty, while also carrying out initiatives for new business creation that lay the groundwork for growth over a longer term as a new initiative. Additionally, it places more emphasis on themes with strong social content, such as work style reforms that enhance productivity by utilizing ICT in a way that addresses changes in society, achievement of a corporate culture that stimulates interest in work, and contributions to SDGs (sustainable development goals), than previously.

Fundamental policies in NEXT 1800

Contribute to customer production activities by strengthening core businesses
- ★ Strengthen core businesses
- ★ Promote collaboration with business partners to bolster solution proposals

Expand global business capabilities to support market demand
- ★ Strengthen hiring of overseas local employees and organizational capabilities
- ★ Consider establishment of new locations

Pursue new business fields to accelerate sustainable growth
- ★ Strengthen investments in new business creation
- ★ Cultivate managerial personnel by adopting an intrapreneurship program
- ★ Create new value through SCM improvements

Initiatives to realize a sustainable society
- ★ Foster a corporate culture that stimulates interest in work by boosting employee engagement
- ★ Implement work style reforms that “enhance productivity” utilizing ICT
- ★ Conduct initiatives that contribute to SDGs
- ★ Fulfill corporate social responsibility (promote CSR and compliance)

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

Management goals for final-year FY3/22 at ¥180bn in net sales and ¥5bn in ordinary profit

2. Management goals in the NEXT 180 plan

Management goals in NEXT 1800, as suggested by the plan name, are ¥180,000mn in net sales, ¥4,800mn in operating profit, and ¥5,000mn in ordinary profit in FY3/22, the final fiscal year.

The previous medium-term management plan targeted ¥137,000mn in FY3/19 net sales, and the Company achieved this goal. In profits, however, sudden changes in the business environment, as mentioned earlier, kept it from reaching ¥4,500mn in ordinary profit.

Since the new medium-term management plan starts at the low FY3/19 earnings level, the profit goal (particularly profit margin), compared to sales, appears weaker than in the previous plan. Nevertheless, we attribute this aspect to the plan being based on recent conditions and see a reasonable possibility of the Company attaining profit margin that exceeds the plan in light of its reinforcement of efforts to expand engineering business and improve profitability compared to the previous medium-term management plan.

Management goals of NEXT 1800

(¥mn)

	FY3/19 results	Medium-term management plan NEXT 1800		
		FY3/20 management targets	FY3/21 management targets	FY3/22 management targets
Net sales	145,410	150,000	165,000	180,000
Operating income	3,410	3,100	3,800	4,800
Operating margin	2.3%	2.1%	2.3%	2.7%
Ordinary income	3,627	3,300	4,000	5,000
Ordinary margin	2.5%	2.2%	2.4%	2.8%

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

Below we describe the detailed content of initiatives aimed at realizing management goals in the new medium-term plan.

Aims to accelerate improvement of profit margin and expansion of business opportunities by adding engineering and global SCM solutions to core businesses

3. Priority measures for "contribute to customer production activities by strengthening core businesses"

We think this theme is most important out of the four fundamental policies because it addresses income growth more directly.

The Company's revision of "core business" content in the new medium-term management plan (versus the previous plan) deserves notice. Specifically, it adds engineering and global SMC solutions to core businesses. The Company is a technology-oriented trading company and has operated as a leading distributor for major industrial equipment manufacturers, such as Yaskawa Electric <6506>. While this distributor business remains the core business, the Company has also worked to create added its unique value. These efforts contribute to higher margin and expand business opportunities.

The Company promoted engineering and global SCM solutions businesses from this perspective. These are actual sales methods for products handled by the three divisions as distributor business, rather than separate business units. However, since increasing sales in engineering business and expanding the global SCM solutions business are closely tied to expansion of the three divisions, we think the Company added them to core business content as clarification of its intent to further strengthen related activities.

(1) Overview and progress of the engineering business

The Company's traditional distributor business divides handled products into three areas – electrical machinery, electronics, and general machinery. Since usage aims (for example, production materials and facilities) and demand drivers (such as consumption demand for final products and capital investment demand) differ for each area, the Company achieved growth by handling sales activities separately through organizations for the three divisions.

With advances in functionality and shift to software for handled products accompanying technology developments and increased sophistication of customer needs, however, the Company has been having difficulties in addressing requirements and bolster momentum and opportunities just by selling products on a standalone basis. It hence has been putting effort into combining products from the three areas for sale to customers as a system. This is the engineering business. In other words, the engineering business is not a separate new business, but a sales method for the various products handled in the distributor business.

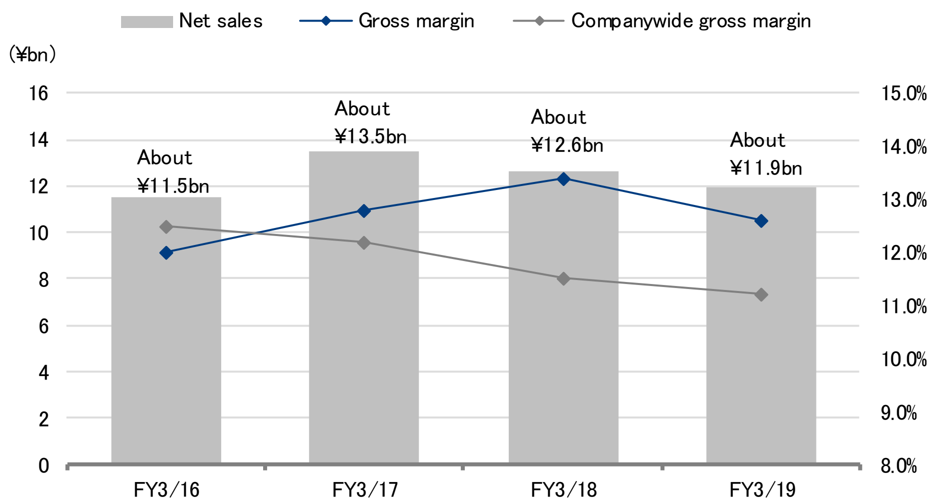
Using a food example, while the Company had been selling meat, vegetables, and rice separately (distributor business), its engineering business seeks to sell a "curry rice" meal that utilizes these ingredients. The Company provides added value in the latter in procurement of curry powder spices, an essential ingredient for a curry roux and creation of flavors for the curry mix.

Engineering business has been steadily expanding and continues to remain stably above the ¥10bn level, which had been the primary goal at the business launch, in the past few years. We think this is a major reason for "upgrading" engineering business to a core business.

A key point to recognize, meanwhile, is that engineering business is just a sales method for the Company's traditional distributor business and its sales overlap with sales from the three business divisions (in other words, its sales are a reference value and not independent of these divisions). We think the engineering business is important because of its anticipated contributions to a higher profit margin for the entire Company. As explained earlier, expansion of engineering business leads to larger added value (procuring spices and creating flavors). This portion earns very high profitability because it utilizes accumulated knowhow and experience as raw materials. Gross margin on engineering business sales still clearly exceeds the Company's overall average. We expect further expansion of engineering margin and significant contribution to higher overall profitability if the Company can broaden its line-up of spices and flavors in the future.

Goals in the new medium-term management plan do not set values separately for engineering business. We think one reason for this approach is that sales do not simply climb upward to the right depending on what happens with major projects each year. However, since profit margin was the original motivation in starting engineering business, we expect the Company to earnestly pursue this area. In our dialogue with the Company, it has repeatedly talked about gross margin in the 15-20% range for engineering business. We hence believe it is likely to aim for this level in the new medium-term management plan too.

Trend in engineering business sales



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

(2) Overview of the global SCM solutions business

The Company has also focused on expansion of global SCM solutions business over the past few years (similar to engineering business). It must be noted that the global SCM solutions business is a sales and marketing method for the three existing business divisions (electrical machinery, electronics, and general machinery) too, and its sales overlap with sales for the three segments, in the same way as engineering business.

Global SCM solutions business has roots in procurement agent, logistics agent, and delivery period management services handled by the Company in past years. These services constitute an important function required of trading companies, and the Company has naturally provided such functionality. Renewed emphasis on these services as global SCM solutions business, meanwhile, reflects both circumstances on the customer side and the Company's own strategy.

On the customer side, even large manufacturers face shortages in personnel to handle global logistics, inventory management, and materials procurement, particularly because these areas have been targeted by cutbacks in business structure reforms and restructuring processes. However, the reality is that larger companies are more inclined to pursue efficient manufacturing operations and frequently implement business transfers and other revisions that extend across countries. Consequently, such activity creates outsourcing needs in these areas. The Company aims to acquire this demand by leveraging its knowhow and overseas network accumulated over many years as a technology-oriented trading company.

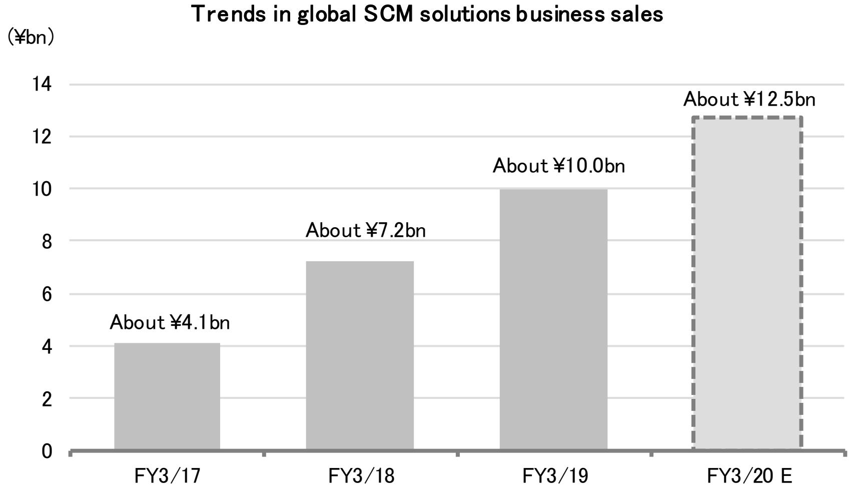
The Company's strategy, meanwhile, aims to expand business opportunities with global SCM solutions business as the catalyst and broad collaboration with engineering business. Global SCM solutions business shoulders some of the customer administrative load. While the Company charges fair fees that provide an income source since it treats this activity as a business, profit margin is fundamentally low. With a focus on improving profitability as a top management goal, expansion of global SCM solutions business seems to move in the opposite direction because of downward pressure on margin through erosion of product mix. Yet this is not what actually happens. Since orders often involve unloading of entire processes because of customer-side circumstances explained above, global SCM solutions business typically leads to growth in other transactions and helps in obtaining opportunities for engineering business.

Using the moving business as an example, conventional procurement agent and logistic agent services just moving a person's items from the former home to the new home. In global SCM solutions business, meanwhile, the service also extends to setting up televisions and PCs for immediate use after the move and procuring and installing antennas and Wi-Fi equipment. Engineering business corresponds to selection and procurement of antennas and Wi-Fi equipment suited to the new area and wiring installation. The move might lead to more business too if an order is received for landscaping work.

Progress by the global SCM solutions business is healthy as well. The Company prepared this business during the medium-term plan that was two plans before the JUMP 1200 medium-term plan, and then focused on reaching ¥10bn level in sales in Challenge 1500, the previous medium-term plan, and attained the goal in FY3/19. Given this progress, it positions the global SCM solutions business as a core business and strengthens it further in NEXT 1800, the new medium-term management plan.

As an actual change, the Company formed the global SCM solutions division in April 2019 and switched from passive sales operations to proactive sales operations.

Trends in global SCM solutions business sales



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

The Company has not disclosed numerical goals for the global SCM solutions business in the new medium-term management plan, just as its stance with the engineering business. Since it moved past ¥10bn level in sales, which had been the goal, in FY3/19 as previously mentioned, we think the next target for the time being is ¥20bn. We see a possibility of accelerated efforts to revise production sites and transfer operations across countries amid changes to the global free trade regime mainly driven by US-China trade friction and Brexit. If this happens, it could create major business opportunities for the Company's global SCM solutions business because of shortages in teams to carry out these revisions on the manufacturer side. We intend to closely monitor growth in global SC solutions business, including awareness of collaboration with engineering business.

Promoting localization of overseas sites to expand transactions with non-Japanese companies

4. Priority measures for "expand global business capabilities to support market demand"

The Company lists two detailed priority measures to address the theme of global business expansion – 1) strengthen hiring of overseas local employees and organizational capabilities and 2) consider establishment of new locations.

We think the "strengthen hiring of overseas local employees and organizational capabilities" measure refers to reduction of overseas operation costs and improved efficiency. The Company currently dispatches people from Japan to work at overseas locations, and these Japanese employees primarily handle business activities while utilizing local hires. While expansion and reinforcement of overseas operations is an unstoppable trend in terms of the Company's own situation and also global conditions, we believe the aim of this initiative is mainly strengthening related personnel at overseas sites with emphasis on local employees. The next step is clearly expansion of transactions with non-Japanese companies.

For the second item, we think the Company has not made final decisions yet, though India seems to be a leading candidate from the standpoint of recent global economic conditions and the Company's current overseas initiative situation. Nevertheless, the Company clarified a stance of dynamically responding as needed in light of global economic trends.

Intends to steadily broaden to new business areas from the periphery of current core businesses

5. Priority measures for "pursue new business fields to accelerate sustainable growth"

The Company lists the following three priority measures for this fundamental policy – 1) strengthen investments in new business creation, 2) cultivate managerial personnel by adopting an intrapreneurship program, and 3) create new value through SCM improvements.

"New business areas" mentioned by the Company refer to gradual inclusion of peripheral work to existing distributor business (such as logistics, production, SCM, and fabless processing) as its own businesses. It also envisions cooperation with external partner companies and acquisitions through M&A in some cases.

While cultivation of managerial personnel by adopting an intrapreneurship program is primarily intended as a personnel development method, it could also lead to development and cultivation of new business areas as described in the previous measure.

SCM improvement refers to deployment of warehouse management systems to precisely comprehend the cost structure related to logistics. This is an important initiative to promote reinforcement of global SCM solutions business even more than previously. It might also be related to entry into new business areas cited above.

Improving corporate "quality" and becoming a "correct company" with the aim of attracting selection by investors

6. Priority measures for "initiatives to realize a sustainable society"

This fundamental policy lists four priority measures. We think they are initiatives to realize a desirable corporate image, rather than efforts to achieve income growth. In the current world of "ESG" occupying an increasingly larger role in making investment choices, we believe these initiatives are very important in becoming a "selected company" along with direct effects to expand profits.

The priority measures include "implement work style reforms that "enhance productivity" utilizing ICT." We can say this is an initiative that could expand profits by raising productivity.

Outlook

Targeting higher sales in all three regions – Japan, Asia, and Europe/US
Forecasts lower profits in Japan and Europe/US and profit decline on higher sales on an overall basis in the period-start plan

● Overview of FY3/20 forecasts

The Company forecasts for higher sales and lower profits in FY3/20 at ¥150,000mn in net sales (+3.2% YoY), ¥3,100mn in operating income (-9.1%), ¥3,300mn in ordinary income (-9.0%), and ¥2,400mn in net income attributable to owners of the parent (-8.7%). These results are in accordance with the management targets in the new medium-term business plan.

Overview of FY3/20 forecast

(¥mn)

	FY3/19			FY3/20					
	1H	2H	Full year	1H		2H		Full-year forecast	YoY
				Forecast	YoY	Forecast	YoY		
Net sales	72,164	73,246	145,410	74,000	2.5%	76,000	3.8%	150,000	3.2%
Operating income	2,129	1,281	3,410	1,500	-29.5%	1,600	24.9%	3,100	-9.1%
Operating margin	3.0%	1.7%	2.3%	2.0%	-	2.1%	-	2.1%	-
Ordinary income	2,312	1,315	3,627	1,600	-30.8%	1,700	29.3%	3,300	-9.0%
Net income attributable to owners of the parent	1,651	977	2,628	1,150	-30.3%	1,250	27.9%	2,400	-8.7%

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

The Company announced FY3/19 results and FY3/20 guidance on May 10, 2019. On the same day, the US government disclosed its application of additional tariffs on China (raising the tariff on imports worth $200bn from 10% to 25%). The impact of these tariffs hence is not reflected in guidance targets. We should not that consider this as one of the risk factors that needs to be closely observed.

The Company expects higher sales in all regional segments – Japan, Asia, and Europe/US. In Japan, it anticipates continuation of healthy sales to the automotive industry, mainly in vehicle products, from the previous fiscal year as the driver of sales increase. In Asia, it forecasts a recovery from 2H on a rebound and improved demand as one year has passed from the shift in orders from the factory automation and industrial machinery industry to negative growth.

In earnings, the Company projects a 9.1% YoY decline in operating profit to ¥3,100mn, based on a ¥374mn rise in Asian profit versus declines of ¥505mn in Japan and ¥143mn in Europe/US. The profit setback in Japan, despite a boost from higher sales, reflects anticipated pressure from higher personnel costs related to employee additions and increase in packaging and transport costs. Main projected drivers of profit changes are higher gross margin in Asia and lower gross margin in Europe/US.

Breakdown of FY3/20 guidance by regional segments

(¥mn)

		FY3/19			FY3/20
		1H	2H	Full year	Full year
Japan	Net sales	57,653	58,340	115,993	122,000
	YoY	10.1%	-6.7%	0.9%	5.2%
	Operating income	1,065	874	1,939	1,400
	YoY	13.9%	-37.5%	-16.9%	-27.8%
	Operating margin	1.8%	1.5%	1.7%	1.1%
Asia	Net sales	18,646	18,542	37,188	41,600
	YoY	5.1%	-14.8%	-5.8%	11.9%
	Operating income	778	430	1,208	1,600
	YoY	15.4%	-47.2%	-18.8%	32.5%
	Operating margin	4.2%	2.3%	3.2%	3.8%
Europe/US	Net sales	4,204	3,880	8,084	8,400
	YoY	11.9%	-24.0%	-8.8%	3.9%
	Operating income	275	-21	254	100
	YoY	69.8%	-	-18.3%	-60.6%
	Operating margin	6.5%	-0.5%	3.1%	1.2%

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

We review detailed trends for business segment below. In overall terms, the Company expects higher electrical machinery and general machinery sales, but a YoY decline in sales for the electronics segment, which holds the largest percentage of sales. We think the outlook for lower electronics sales in FY3/20 is somewhat conservative in light of the FY3/19 result with a just a slight drop as increased sales to the automotive industry largely offset a slump in industrial machinery industry sales.

The Company targets ¥29,000mn in electrical machinery sales (+18.0% YoY). It mainly expects a rise in sales driven by continued upbeat demand for equipment from the automotive industry (servo motors and other compact products rather than large systems such as manufacturing plants).

The Company forecasts a decline in electronics segment sales to ¥107,000mn (-2.2% YoY). While automotive business (mainly electronic parts used in vehicle products) remains upbeat in this outlook, management anticipates decline in sales to control equipment manufacturers and a resulting drop in overall sales.

The Company projects sharply higher sales in the general machinery at ¥14,000mn (+22.1% YoY), including a large boost from a major deal for the food industry that it previously planned to book in FY3/19 slipping into FY3/20. It also expects support for increased sales from higher orders related to new demand, such as facilities used to manufacture vehicle LCDs.

Breakdown of FY3/20 guidance by business segments

(¥mn)

	FY3/19			FY3/20
	1H	2H	Full year	Full year
Electrical machinery	13,332	11,237	24,569	29,000
YoY	7.6%	-24.0%	-9.6%	18.0%
Electronics	53,553	55,817	109,370	107,000
YoY	6.4%	-7.1%	-1.0%	-2.2%
General machinery	5,278	6,192	11,470	14,000
YoY	14.3%	36.5%	25.3%	22.1%
Total net sales	72,164	73,246	145,410	150,000
YoY	7.2%	-7.8%	-0.9%	3.2%

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

Summary income statement

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20	
					1H E	Full year E
Net sales	105,748	116,611	146,759	145,410	74,000	150,000
YoY	-5.0%	10.3%	25.9%	-0.9%	2.5%	3.2%
Gross profit	13,256	14,255	16,883	16,318	-	-
Gross margin	12.5%	12.2%	11.5%	11.2%	-	-
SG&A expenses	10,812	11,240	12,747	12,908	-	-
YoY	2.8%	4.0%	13.4%	1.3%	-	-
SG&A expenses ratio	10.2%	9.6%	8.7%	8.9%	-	-
Operating income	2,444	3,014	4,135	3,410	1,500	3,100
YoY	-29.6%	23.3%	37.2%	-17.5%	-29.5%	-9.1%
Operating margin	2.3%	2.6%	2.8%	2.3%	2.0%	2.1%
Ordinary income	2,645	3,215	4,349	3,627	1,600	3,300
YoY	-29.7%	21.6%	35.3%	-16.6%	-30.8%	-9.0%
Net income attributable to owners of the parent	1,690	1,584	3,085	2,628	1,150	2,400
YoY	-31.5%	-6.3%	94.8%	-14.8%	-30.3%	-8.7%
EPS (¥)	117.76	113.64	222.65	164.08	71.68	149.60
Dividend (¥)	28.00	28.00	30.00	34.00	17.00	34.00

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

Summary balance sheet

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Current assets	49,239	46,857	55,507	65,852	64,209
Cash and deposits	7,584	6,359	6,759	8,596	10,005
Notes and accounts receivable	35,145	34,554	41,168	46,077	42,256
Non-current assets	9,509	8,581	9,309	11,401	9,905
Property, plant and equipment	3,879	3,788	3,056	3,005	2,861
Intangible assets	243	240	222	168	143
Investments and other assets	5,386	4,553	6,030	8,227	6,900
Total assets	58,748	55,439	64,816	77,254	74,114
Current liabilities	32,370	28,691	36,596	43,077	37,199
Notes and accounts payable – trade	27,496	24,732	31,182	34,298	31,427
Short-term loans payable, etc.	2,782	2,317	2,489	5,722	3,805
Non-current liabilities	4,426	4,484	4,581	6,182	4,970
Long-term loans payable	2,100	2,400	2,300	3,500	2,900
Shareholders' equity	18,929	20,217	21,034	23,731	29,056
Capital stock	2,553	2,553	2,553	2,553	3,727
Capital surplus	1,958	1,958	1,958	1,958	3,548
Retained earnings	14,472	15,761	16,950	19,647	21,781
Treasury shares	-54	-54	-427	-428	-0
Total accumulated other comprehensive income	3,022	2,045	2,603	4,262	2,888
Net assets	21,951	22,263	23,637	27,993	31,944
Total liabilities and net assets	58,748	55,439	64,816	77,254	74,114

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

Cash flow statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Cash flow from operating activities	1,353	-60	1,679	-2,221	1,636
Cash flow from investing activities	-444	-384	-235	29	-153
Cash flow from financing activities	-470	-654	-818	3,962	28
Effect of exchange rate change on cash and cash equivalents	209	-125	-224	66	-103
Net increase (decrease) in cash and cash equivalents	647	-1,225	400	1,837	1,408
Cash and cash equivalents at beginning of period	6,453	7,100	5,875	6,275	8,112
Cash and cash equivalents at end of period	7,100	5,875	6,275	8,112	9,521

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

Shareholder return policy

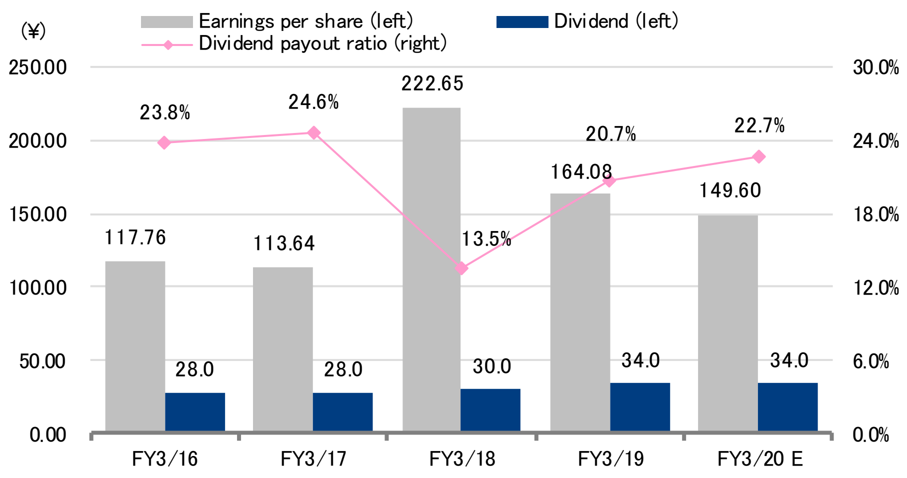
Plans to pay a ¥34 dividend (+¥4 YoY) in FY3/19

The Company's basic policy is to provide returns to shareholders in the form of dividends. Management prioritizes providing stable, continuous dividends, as demonstrated in its track record to date. While the Company does not sharply raise dividends in response to temporary rapid profit expansion, it has steadily increased them in keeping with earnings growth.

The Company decided to pay a ¥34 dividend (¥17 interim dividend, ¥17 period-end dividend) for FY3/19, an increase of ¥4 YoY, on track with the period-start outlook. This works out to a 20.7% dividend payout ratio. Even though profit fell in FY3/19, as explained above, we attribute the stance to emphasis on a stable dividend, particularly because profit exceeded the revised outlook and the dividend payout ratio is not that high.

In FY3/20 guidance, the Company forecasts a ¥34 dividend (¥17 interim dividend, ¥17 period-end dividend), which is flat YoY. This represents a 22.7% dividend payout ratio based on the ¥149.60 EPS outlook. While the Company currently expects lower profit on increased sales in FY3/20, we think it opted for a flat dividend YoY in light of the dividend payout level and a fundamental policy of paying a stable dividend.

Earnings per share, dividend and payout ratio



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

FISCO

Disclaimer

■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp