COMPANY RESEARCH AND ANALYSIS REPORT

Elematec Corporation

2715

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FISCO Ltd. Analyst
Hiroyuki Asakawa

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Pursuing reforms in anticipation of changes in the business environment
Aims to become a fabless manufacturer

Elematec Corporation <2715> (hereafter, also "the Company") is an electronics trading company that specializes in electronic materials. It was formed through the merger of Takachiho Electric Co., Ltd. and Ohnishi Denki Co., Ltd. in 2009 and entered the Toyota Tsusho Corporation <8015> Group in 2012.

1. Realizing long-term stable growth with numerous business partners and products and excellent adaptability to changes as advantages

The Company has realized stable income growth over the long term by capitalizing on its two main characteristics and strengths of 1) having many business partners (suppliers and customers) and products and 2) possessing excellent adaptability with keen sensitivity to growth markets and products in various times. Even during the Lehman shock, it kept profit decline to just one fiscal year by expanding transactions of products related to smartphones during the rapid expansion phase in this market and has since consistently increased sales and profits while continuously delivering all-time high profits.

2. Aims to become a fabless manufacturer that responds to changes in the business environment

The management, however, is highly concerned about the current situation. With increasingly rapid business environment changes and technology innovation, it worries that past success patterns and company strengths might not work in the future. Its answer to this challenge is moving beyond the trading company model. The Company previously called for "creating and increasing added value," "expansion of modularization transactions," and "strengthening processing service and planning and development functions" as goals. These themes all target the same thing and hold the potential to transform the Company into a fabless manufacturer once realized. We expect the "fabless manufacturer" concept to occupy an important position in the longer-term growth strategy that the Company is likely to be gradually clarifying.

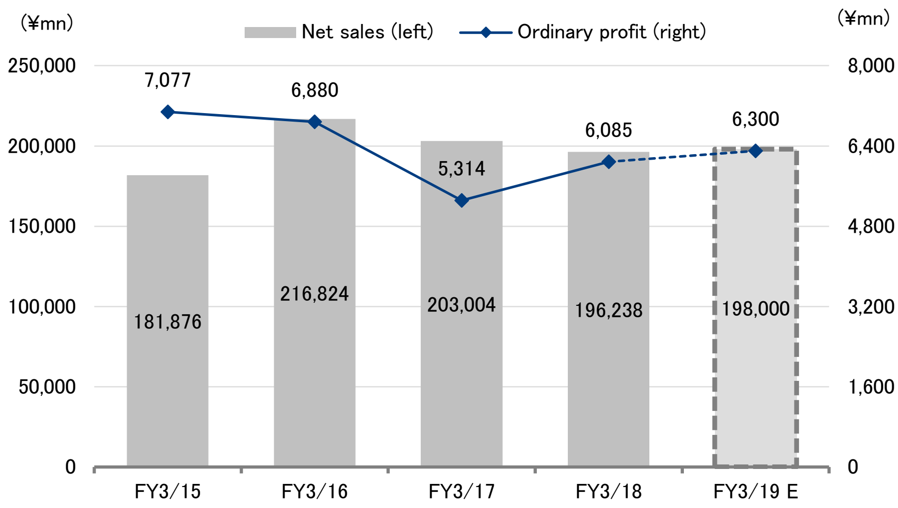
3. Expecting higher sales and profits in FY3/19, likely to leverage strengths to make it through a transition in the growth driver

The Company reported lower sales and profits in 1H FY3/19 on track with the forecast. Smartphone-related product sales fell significantly due to stalled demand for smartphones. However, the Company almost entirely absorbed the profit impact through healthy growth in automotive-related demand and products for general industrial areas that are seen as future growth engines. For FY3/19, the Company maintains the initial outlook and forecasts higher sales and profits based on reaching a bottom in smartphone-related product sales and continued gains in automotive-related products and other areas. It expects automotive-related products to drive overall growth. However, we will also closely monitor how it manages to obtain demand and achieve growth while realizing the role of a fabless manufacturer mentioned above.

Key Points

- Strengthening processing service and planning and development functions and aims to become a fabless manufacturer
- Maintains the initial outlook that forecasts higher sales and profits, expects automotive-related products to drive growth
- Multiple potential business strategies in the Automotive field, focus on whether it can transform into a fabless manufacturer and also grow the business

Results trends



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

Company overview

2 companies with specialties in electronic materials merged in 2009 Has 62 sites in Japan and other countries and caters to 3 main markets - Digital Electronics, Automotive, and Broad Market

1. History and business description

(1) History

The Company's predecessors were Takachiho Electric, established in 1947 in Tokyo, and Ohnishi Denki, founded in 1958 in Kyoto. Both companies began by handling insulation materials, subsequently broadened the scope of their product offerings to electronic materials used in electronic products following technology and development trends, and grew into independent technology trading companies.

These companies merged in 2009 (with Takachiho Electric as the surviving entity) and adopted the Elematec name. The Company has steadily grown since the merger, even though both predecessors mainly handled electronic materials, thanks to complementary geographical positions in Tokyo and Kyoto. It became a subsidiary of Toyota Tsusho through a TOB transaction in 2012.

(2) Business description

In light of this history, the Company handles a wide range of electronic materials and parts used in electronic products and machinery parts. It has 1,179 employees and 62 sites in Japan and other countries in consolidated operations as the business foundation (as of the end of September 2018). The business sites include three operations with processing services (one in Japan and two in China).

While the Company has developed business globally, its overseas activities are mainly in China and Asia because this is where Japanese companies largely operate. Sales breakdown by domestic and overseas categories in FY3/18 was 43.8% in Japan and 56.2% in other countries (Japan's ratio is higher from a location standpoint with disparity reflecting exports from Japan to other countries). Overseas sales breakdown consists of China (including Hong Kong) at 26.0%, the rest of Asia at 26.1%, and others (Europe, US, etc.) at 4.0%.

The Company needs to apply grouping for management purposes because of the large number of business partners it has on procurement and sales sides and wide range of products it handles. While it previously defined groups by handled products (procurement partner basis), it adopted a market approach that reflects products manufactured by customer companies (sales partner basis) in FY3/15. As a result, the Company conducts internal management and information disclosure by three groups – Digital Electronics, Automotive, and Broad Market. Sales ratios using 1H FY3/19 results were Digital Electronics at 50.0%, Automotive at 14.9%, and Broad Market at 35.1%.

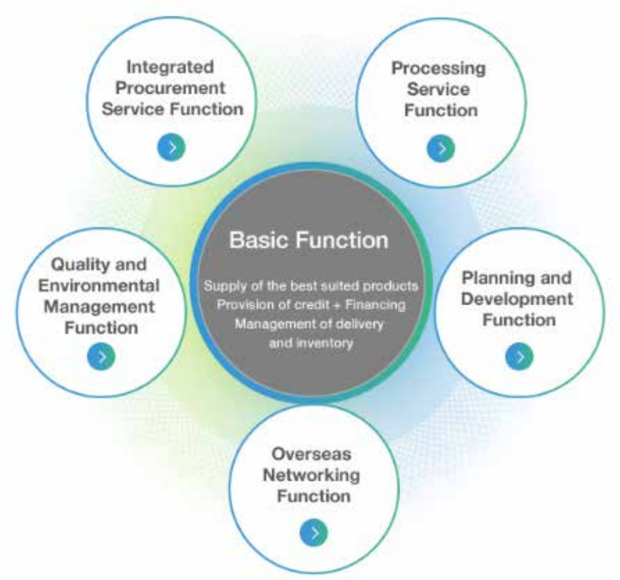
Strength in having many products, customers and the ability to convert these resources into income through organic linkage as five services and functions

2. Company features and strengths

Customer and product diversity is an important feature of Elematec. It operates 62 sites in Japan and overseas and handles a wide range of primarily electronic materials and components among about 7,300 suppliers (manufacturers) and 6,200 sales destinations (users). Another major characteristic is its flexible response to growth markets. We believe that effective interaction of these two traits supports realization of stable earnings growth potential and robust earnings stability.

The Company goes beyond just the basic services and functions of an electronics trading company of optimal supply of parts and materials, credit provision and financing, and management of delivery timing and inventory. It also supplies processing services, planning and development function, and other more advanced services and functions that generate higher added value. The Company highlights five services and functions, and we think the presence of these functions is precisely why it can develop diverse products into businesses and deliver results.

Services and functions the Company provides



Source: The Company's website

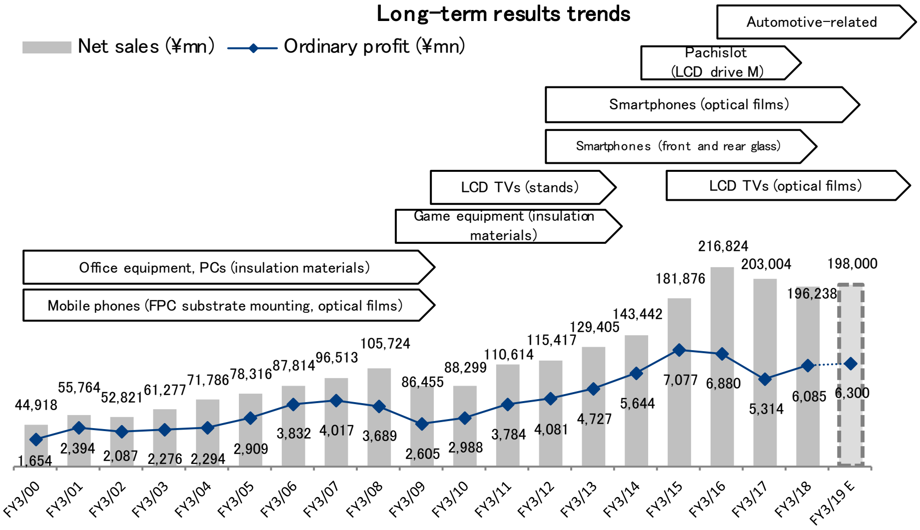
The Company intends to broaden and strengthen these functions and bolster initiatives to create added value. We will review specific initiatives and direction in the items under the longer-term growth strategy. As a direction, the Company aims to move beyond its trading company image and establish itself as a fabless manufacturer.

Organic collaboration and utilization of three strengths, realizing long-term, stable income growth despite encountering various cycles

3. Long-term results trends

The Company's success in realizing stable growth, despite being in the electronics industry with harsh volatility and encountering economic and products cycles, is even more pronounced in a review of its long-term results trends. In the early 2000s, mobile phone business grew with key products such as printed circuit board (FPC) materials, substrate mounting, and optical films. Around 2010, LCD TV-related products were a major business thanks to the transition to terrestrial digital service and other factors. Smartphones and tablets emerged as fast-growing products from 2010. The Company sold various films, glass products, and other items and achieved a rapid recovery from the Lehman shock and set consecutive all-time high profits. While results have flattened in recent years due to maturation of the smartphone market, the automotive-related business is steadily growing as the next driver. The Company is expanding business for markets that differ from previous areas, such as industrial equipment and medical equipment, as well.

Long-term results trends



Source: Prepared by FISCO from the Company's financial results, interviews, etc.

We think the ability to deliver stable growth through these cycles reflects the Company's two main characteristics and strengths explained above of 1) having numerous business partners and extensive range of handled products and 2) flexible and keen adaptability for quickly finding growth markets. While often forgotten, it is important to acknowledge the presence of an organizational structure for organically capitalizing on these characteristics and strengths (this includes corporate culture and executive capabilities). We think this is the third strength and the combination of these three factors is what supports the Company's presence. As discussed below, the Company is trying to break out of the trading-company shell and solidify a unique business model that is close to being a fabless manufacturer as a longer-term strategy. We expect the three characteristics and strengths to play a key role in whether the Company is successful in this challenge.

Business performance

Sales and profits fell YoY as expected, though sales in automotive-related business and other areas with strong growth expectations are steadily rising

1. Overview of 1H FY3/19 results

The Company posted lower sales and profits in 1H FY3/19 with net sales at ¥89,619mn (-13.9% YoY), operating income at ¥3,048mn (-8.9%), ordinary profit at ¥2,926mn (-5.7%), and profit attributable to owners of parent at ¥2,125mn (-2.3%).

We cannot compare 1H results with an initial outlook because of the Company's use of the fiscal-year basis to manage its estimates. As explained later, however, we believe sales slightly missed the plan because of a large dip in sales of smartphone-related products in 1H. Profit, meanwhile, was believed to be in line with the plan because increased sales in Automotive and Broad Market segments with higher profit margins than smartphone-related products limited the impact of sales shortfall on profits.

Summary of 1H FY3/19 results

(¥mn)

	FY3/18	FY3/19			
	1H	1H	YoY	Progress rate vs. full-year forecast	Full-year forecast
Net sales	104,134	89,619	-13.9%	45.3%	198,000
Operating income	3,345	3,048	-8.9%	46.2%	6,600
Operating margin	3.2%	3.4%	-	-	3.3%
Ordinary profit	3,103	2,926	-5.7%	46.4%	6,300
Profit attributable to owners of parent	2,175	2,125	-2.3%	47.2%	4,500

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

Production of electronic parts and other items was healthy in 1H FY3/19, just as in FY3/18, because of increased IoT-related demand and industrial machinery demand and the rising percentage of electric systems usage in automobiles. The smartphone market, meanwhile, had a sluggish trend due in part to maturation of the market symbolized by exhaustion of inroads in China, the world's largest market. In this environment, sales trends at the Company, which handles a wide range of products, resembled the overall market. Additionally, there was an impact from delivery of some products that had been scheduled in 1H FY3/19 slipping to 2H. Sales fell 13.9% (¥14,515mn) YoY as a result.

In profits, meanwhile, gross margin improved 0.9ppt from 9.3% a year ago to 10.2% in 1H FY3/19, but gross profit fell 5.7% (¥556mn) YoY due to weaker sales. SG&A expenses declined 4.1% (¥258mn) YoY in 1H on lower shipping fees related to the drop in sales and smaller inclusions to the bad credit allowance. However, this was not enough to offset the setback in gross profit and operating income shrunk 8.9% (¥297mn) YoY.

Gross margin rose mainly because of healthier product mix. Specifically, this happened because the Automotive and Broad Market segments with relatively high profit margins posted higher sales YoY and moved to larger sales ratios while Digital Electronics, which has lower profitability, booked lower sales and weakened to a lower sales ratio.

We think the content of 1H results was positive because double-digit increases in Automotive and Broad Market sales offset a further 30.3% sales decline in the Digital Electronics segment, which had a major sales setback in the previous fiscal year, and thereby kept profits on track with the plan. The 1H outcome extensively leveraged the Company's strength of having numerous business partners and products as it transitions to the next growth market, as was done in past years, from FY3/18 to FY3/19.

Automotive-related demand and increased sales of a wide range of products offset the impact of sales decline in smartphone-related products

2. Trends by market

Breakdown of net sales trends by market

(¥mn)

Segment by market	1H FY3/18		1H FY3/19				
	Results	Composition	Results	YoY	Composition	Main target markets	Change
Digital Electronics	64,338	61.8%	44,817	-30.3%	50.0%	LCDs, touch panels, and backlights	-19,265
						Home electronics (TVs, monitors, audio, etc.)	-1,565
						Mobile terminals	1,617
						Cameras and camera modules	707
Automotive	11,330	10.9%	13,359	17.9%	14.9%	Automotive	2,029
Broad Market	28,465	27.3%	31,442	10.5%	35.1%	Aftermarket	2,252
						Medical equipment	806
						Infrastructure and energy	152
						Home appliances (washing machines, refrigerators, air conditioners, vacuum cleaners, etc.	-357
Total	104,134	100.0%	89,619	-13.9%	100.0%		

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

Digital Electronics sales dropped 30.3% (¥19,520mn) YoY to ¥44,817mn. In the breakdown, sales of products used in LCDs, touch panels, and backlights, which are predominantly shipped for use in smartphones and tablets as final products, were down by ¥19,265mn and covered almost all of the decline in Digital Electronics segment sales. As mentioned earlier, maturation of the smartphone market has created conditions in which sales are heavily affected by whether products of panel manufacturers that receive parts and materials from the Company are adopted in top-selling smartphones or sales trends of smartphones at the Company's customers. This dynamic was very evident in 1H FY3/19 results. Nevertheless, profitability of LCDs, touch panels, and backlights has been slipping over the past few years and we think there was only a minor impact on profits, in contrast to sales.

Automotive sales rose 17.9% (¥2,029mn) YoY to ¥13,359mn. This segment climbed further to 14.9% of overall sales. The Company handles a wide range of products, including headlight parts and materials, interior parts and materials, sensors, motors, and various electronic parts. Heaters, motors, and sensors were leading sources of stronger sales in 1H FY3/19. There are also numerous parts and materials supplied to automotive products besides parts directly used in automobiles. The Automotive business has a general image of high-volume delivery of certain parts to primary parts manufacturers for use in volume-output models. While the Company is pursuing this business, it is currently at a stage of delivering a variety of product types in many directions as explained above. However, we think these efforts might be supporting the relatively high profitability of this business.

Broad Market sales increased 10.5% (¥2,976mn) YoY to 31,442mn. Viewed by category, the aftermarket business increased sales by ¥2,252mn and provided about three-fourths of the gain in segment sales. Aftermarket is not naming based on a business area or industry and has the same meaning as reference to car navigation systems or other items sold later on by automotive parts sellers as "aftermarket products." We think automotive products hold a substantial share of this business (though it is not limited to automotive). Automotive products and related items posted higher sales in the previous fiscal year, and this trend appears to have continued in 1H FY3/19. Sales of products used in medical equipment increased as well.

Longer-term growth strategy

Promoting the "elematec x (cross)" longer-term strategy with a goal of setting all-time high profit in 2 years

1. Overview of the "elematec x (cross)" longer-term business strategy

The Company does not prepare medium-term business plans with a fixed period, but formulates basic policies for initiatives related to a medium- to long-term strategy and proceeds with business on this basis. It updated the slogan in FY3/18, switching from "elematec + (plus)" to "elematec x (cross)." Compared to the previous "elematec + (plus)" slogan, it emphasizes accelerated pursuit of synergies and timely action.

In annual guidance, the Company discloses targets for the subject fiscal year and goals for two years later. This style resembles a rolling medium-term business plan. Therefore, at the start of FY3/19, the Company presented subject fiscal year target and FY3/21 goals. It hopes to reach ¥250bn in sales and ¥8bn in ordinary profit in FY3/21, setting all-time high profits.

Longer-term strategy "elematec x (cross)"

Source: The Company's results briefing materials

Strengthening processing service and planning and development functions and aims to become a fabless manufacturer

2. Targeted direction

The "elematec x (cross)" strategy is currently in the second year in FY3/19 and has a year and a half remaining. Harnessing its flexibility, meanwhile, the Company is already conducting various reviews for the new medium-term growth strategy scheduled to begin in FY3/21. While the details are unknown, the direction targeted by the Company has become evident in our contacts up to now.

We think the Company's strongest feeling at this point is a "sense of crisis." It leveraged three core strengths to achieve stable growth in past years, but is wondering about the possibility of the same strategy not succeeding in the future and the possibility of changes in the format of transactions between companies due to advances in IT technology (thereby altering the current significance and importance of the trading-company function).

The Company's response to this concern is raising added value it supplies. It is specifically eyeing reinforcement of processing service and planning and development capabilities as a way of getting this done. As discussed in the company overview section of this report, while the Company has already been providing these functions to customers, it did not sufficiently capitalize on their presence due to being hidden behind traditional trading company business of selling products. However, the Company plans to bolster these functions and highlight them as characteristics and strengths and thereby aims to expand income and improve profitability. Below we review specific content of processing service and planning and development capabilities. The explanations cover the image presented by the Company at this stage. Content and naming might change in the future in accordance with the business environment and actual transaction conditions.

(1) Processing services

The Company is a trading company and not a manufacturer. However, customers (sales destinations) often request delivery of processed items. To accommodate these needs, the Company has its own processing sites – one in Japan and two in China.

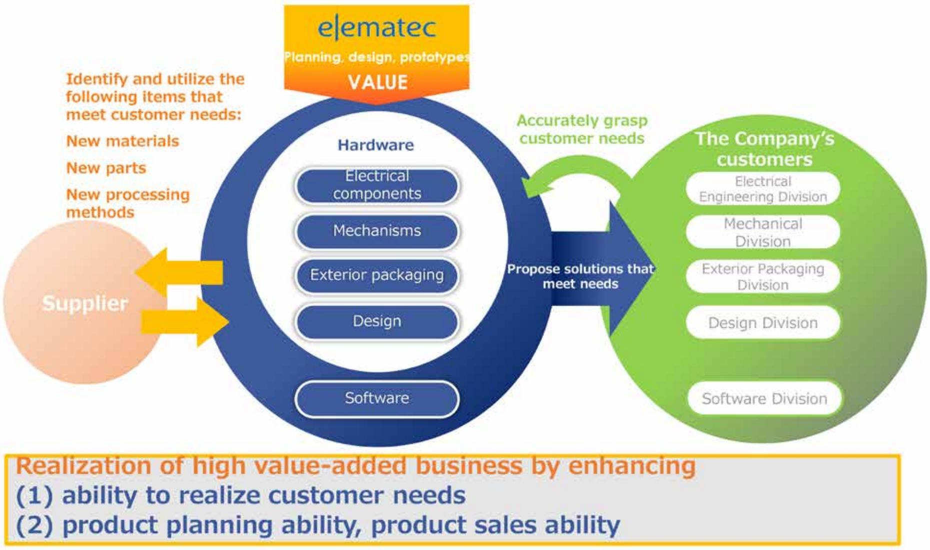
In Japan, Elematec Logi Serve Corporation (based in Yokohama) processes and manufactures electric materials and other products, conducts acceptance inspections, and handles environment-related material measurements. In China, Elematec Electronics (Dalian) Co., Ltd. implements surface mounting of parts into electronic circuit boards and Elematec Wuxi Technology Co., Ltd. handles silk-screen printing for plastic panels, cutting and processing, and assembly.

(2) Planning and development function

Planning and development begins with appropriate understanding of customer needs. Basic flow in this business involves the Company identifying optimal parts and materials from its roughly 7,300 domestic and overseas suppliers to meet the wide-ranging needs of customers for electronics, mechatronics, exteriors, design, and other aspects; planning products that satisfy requirements (even creating product prototypes in some cases); and submitting proposals to customers.

Two essential capabilities in this business are grasping and realizing needs. Not many rival companies have both of these capabilities, and we believe this function is another source of differentiation for the Company versus other companies. Additionally, adoption of new products based on the Company's plans and designs means that it becomes unique for corporate customers. We think this is a very effective way of strengthening relationships with customers. As explained above, these new products should generate high profitability due to the Company's role of modularization for delivery.

Conceptual diagram of the planning and development function



Source: The Company's results briefing materials

Provision of the above-mentioned processing services outsources “burden” for customers, kind of like a procurement agent service. The Company shoulders the task of finding companies to conduct processing, instead of it being done by the customer. Just handling the burden, however, runs the risk of being a low-margin business or even taken for granted as a free “service.” We think the only way for the Company to generate added value and raise profitability is through provision of customized products that it has planned and designed using new product development information and information on the latest technology trends in its possession. Its calls for promoting “modularization” in the past refer to this activity. In other words, processing service and planning and development capabilities are essential technologies (functions) for realizing modularization.

As seen above, the direction targeted by the Company is “expansion of modularization transactions” in terms of the transaction format, “bolstering processing service and planning and development capabilities” from the standpoint of strengthening its own functions, and “creating and increasing added value” in the context of income. These are all referring to the same thing.

While the Company currently has three production and processing sites as noted earlier, it is not adamant on needing to manufacture and process at its own processing sites in future initiatives. This is because modular business of delivering materials that it sells as intermediate or semi-finished products with a certain extent of processing obtains added value from planning and development and solutions proposal capabilities, rather than the processing itself. The Company therefore is likely to cultivate a business model that actively utilizes external manufacturers for processing. We could describe this as a “fabless manufacturer” operation.

The Company has been gradually making advances toward becoming a fabless manufacturer for some time. A concrete example is strengthening personnel in its technology group directly related to planning, design, and development. These measures bolster its ability to understand customer needs and provide prototypes. There has also been steady expansion of efforts to encourage clients to adopt the Company’s specifications in Automotive and Broad Market areas. Such activities are often the first step in beginning transactions in these businesses. Expansion of such activities boosts expectations for future actual transactions. Conversely, the Company’s growing interest in becoming a fabless manufacturer might be the background to the widening trend of encouraging clients to adopt the Company’s specifications, leading to real transactions.

Aiming for income growth with Automotive and Broad Market segments as drivers
Focus also on progress in business development as a fabless manufacturer

3. Direction of results

As mentioned earlier, the Company does not formulate medium-term plans with a fixed period structure and instead discloses outlooks for the subject fiscal year and two years later at the start of each year. The medium-term outlook disclosed at the start of FY3/19 (April 2018) targets ¥250bn in sales and ¥8bn in operating income for FY3/21.

These medium-term targets are not that significant because they vary with results from the previous fiscal year and the global economic outlook at the time and other factors. However, we can see market areas and product categories where the Company has expectations through chronological analysis of the breakdown by markets. This process is also likely to increase the precision of forecasts for the Company's results.

Compared to the outlook from a year ago, there has been a decline in the Digital Electronics business sales share and gains in Automotive and Broad Market sales. Looking at growth rates from results posted three years ago, Digital Electronics has slowed considerably and is likely to stay in a flat range, while the Automotive business has sustained 80.2% growth and Broad Market sales increased substantially to 52.2%. We think the growth driver from a medium-term perspective has completely switched from Digital Electronics to the Automotive and Broad Market segments.

Market breakdown of the medium-term outlook

(¥mn, %)

Segment by market	FY3/17		FY3/18		FY3/20				FY3/21			
	Results	Composition	Results	Composition	Forecast	vs. FY3/17		Composition	Forecast	vs. FY3/18		Composition
						YoY	Change			YoY	Change	
When formulated	-		-		April 2017				April 2018			
Digital Electronics	129,226	63.7%	112,123	57.1%	142,000	9.9%	12,774	56.8%	115,000	2.6%	2,877	46.0%
Automotive	18,357	9.0%	24,966	12.7%	33,000	79.8%	14,643	13.2%	45,000	80.2%	20,034	18.0%
Broad Market	55,420	27.3%	59,148	30.1%	75,000	35.3%	19,580	30.0%	90,000	52.2%	30,852	36.0%
Total	203,004	100.0%	196,238	100.0%	250,000	23.2%	46,996	100.0%	250,000	27.4%	53,762	100.0%

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

As explained in the review of 1H FY3/19 results, the Digital Electronics business has been steadily shrinking, while Automotive and Broad Market growth has been accelerating. The Company expects sales in the Digital Electronics business (namely, smartphone-related products) to bottom out in 2H FY3/19. However, we do not expect a change in the recent pattern of the Automotive and Broad Market being greater than Digital Electronics in a comparison of relative growth rates.

We explained our view of the medium-term outlook by markets in our report issued on July 9, 2018. Below we offer updates in light of subsequent market changes through 1H FY3/19.

(1) Digital Electronics

We do not expect the presence of smartphones and tablets to fade in this area, despite market maturation, because of massive volumes. Yet the possibility of the medium-term average annual growth rate being negative cannot be ruled out due to heavy impact from sales trends for final products for customers given the Company's position as a supplier of parts and materials (we suggested in our previous report that the average annual growth rate estimate for Digital Electronics was too conservative, but take a more cautious view this time). While there is currently not an alternative product capable of replacing smartphone-related demand on its own, we will be closely monitoring demand expansion scenarios for smartphones, such as the transition from LCDs to OLEDs for the display and the move to 5G for the communications format.

(2) Automotive

Our primary focus in the Automotive business is whether the demand structure changes. Existing segment sales mainly reflect commercial flow from prior to becoming part of the Toyota Tsusho Group. We think transactions with automotive manufacturers related to Toyota Motor Corporation <7203> that have been developed since entering the group are likely to start expanding. Since the Company will be supplying parts and materials for volume-output products in these transactions, we expect much larger transaction volume and amounts than previously.

This reflects our main scenario. However, we think there could be a different growth scenario too that involves broadening business scope in automotive transactions that currently exist. While sales are likely to expand more efficiently in the main scenario, the current transaction structure might attain higher profitability (when viewed in terms of earnings). A key point is whether the Company is capable of expanding the modularization business (operating as a fabless manufacturer) in light of its position within the group.

We definitely expect the Automotive area to serve as a growth driver and will be closely monitoring the business initiatives through which the Company achieves this growth.

(3) Broad Market

The Broad Market segment covers a variety of customer industries, though industrial equipment and aftermarket businesses have relatively large scale and strong potential growth rates. The aftermarket business contains many automotive-related parts and materials. So the sales ratio of products supplied to the automotive-related industry might be in the 20% range, substantially higher than the sales ratio of the Automotive business alone. This means attention should be given to automotive industry trends in assessing the Broad Market business. There are also many industries and customers that require built-in specification activities. We thus will be watching the Company's initiatives in activities as a fabless manufacturer for this segment as well, similar to the Automotive segment.

Outlook

Maintains the initial outlook that forecasts higher sales and profits
Expects automotive-related products to drive growth

The Company forecasts slight increase in sales and profits of ¥198,000mn in net sales (+0.9% YoY), ¥6,600mn in operating income (+1.8%), ¥6,300mn in ordinary profit (+3.5%), and ¥4,500mn in profit attributable to owners of parent (+2.8%) in FY3/19.

Overview of FY3/19 outlook

(¥mn)

	FY3/18			FY3/19				
	1H	2H	Full year	1H	2H E	YoY	Full year E	YoY
Net sales	104,134	92,104	196,238	89,619	108,381	17.7%	198,000	0.9%
Operating income	3,345	3,135	6,480	3,048	3,552	13.3%	6,600	1.8%
Operating margin	3.2%	3.4%	3.3%	3.4%	3.3%	-	3.3%	-
Ordinary profit	3,103	2,982	6,085	2,926	3,374	13.1%	6,300	3.5%
Profit attributable to owners of parent	2,175	2,201	4,376	2,125	2,375	7.9%	4,500	2.8%

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

The Company retained its overall sales target, but revised market segment breakdown. It reduced Digital Electronics by ¥7,595mn from the initial level with almost all of the revision from further sales decline for LCD, touch panel, and backlight products. Meanwhile, it lifted Automotive and Broad Market targets by ¥424mn and ¥7,170mn respectively. The Broad Market addition covers a wide range of areas, including aftermarket business along with industrial equipment and medical equipment. The Automotive revision itself seems small, but Broad Market's aftermarket business includes many parts and materials for the automotive industry and automotive-related products actually account for a large share of the upward revision.

Sales breakdown by market for FY3/19

(¥mn)

Segment by market	FY3/18	FY3/19				
		Full year				
	Full year	Initial forecast	Revised forecast	YoY	Main target market	Change
Digital Electronics	112,123	104,571	96,976	-13.5%	LCDs, touch panels, and backlights	-18,408
					Home electronics (TVs, monitors, audio, etc.)	-2,614
					Electronic components	2,408
					Cameras and camera modules	1,614
Automotive	24,966	28,690	29,114	16.6%	Automotive	4,148
Broad Market	59,148	64,738	71,908	21.6%	Aftermarket	4,452
					Industrial machinery, etc.	1,851
					Medical equipment	1,460
Total	196,238	198,000	198,000	0.9%		

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

We think the Company can attain its FY3/19 sales target if sales effectively rise by about 10% YoY in 2H after adjusting for above-mentioned delay in sales recognition to 2H (estimated at about ¥5-10bn). Considering progress in various new deal opportunities in Automotive and Broad Market areas, we believe the Company should be capable of reaching the FY3/19 target.

Nevertheless, it is important to recognize that risk still exists. The Company projects a decline of ¥18,408mn in LCD, touch panel, and backlight sales under Digital Electronics in FY3/19 (while the actual 1H decline was ¥19,265mn) and thus is factoring in a bottom in LCD, touch panel, and backlight sales in 2H. Its basis for the anticipated bottom appears to be that Digital Electronics sales are already down by roughly ¥30bn from the FY3/17 peak through FY3/19 with the bulk from LCD, touch panel, and backlight sales. Yet we advise caution because sales trends in final products heavily affect outcomes in the smartphone-related business.

In profits, the Company projects a consecutive rise in operating income with a 1.8% YoY increase to ¥6,600mn. We think this target is feasible, similar to sales, because of likely continued improvement in profit margin on changes in product mix in 2H as well and the 2H forex-rate assumption of ¥105/$ (and ¥107.63/$ for the full year).

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19	
					1H	Full year E
Net sales	181,876	205,370	203,004	196,238	89,619	198,000
YoY	26.8%	12.9%	-1.2%	-3.3%	-13.9%	0.9%
Gross profit	18,443	17,947	17,127	18,886	9,144	-
Gross margin	10.1%	8.7%	8.4%	9.6%	10.2%	-
SG&A expenses	11,068	11,407	11,720	12,405	6,096	-
SG&A expenses ratio	6.1%	5.6%	5.8%	6.3%	6.8%	-
Operating income	7,375	6,540	5,406	6,480	3,048	6,600
YoY	40.6%	-11.3%	-17.3%	19.9%	-8.9%	1.8%
Operating margin	4.1%	3.2%	2.7%	3.3%	3.4%	3.3%
Ordinary profit	7,077	6,538	5,314	6,085	2,926	6,300
YoY	25.4%	-7.6%	-18.7%	14.5%	-5.7%	3.5%
Profit attributable to owners of parent	5,105	4,794	1,342	4,376	2,125	4,500
YoY	32.2%	-6.1%	-72.0%	226.0%	-2.3%	2.8%
EPS (¥)	249.38	246.58	65.57	213.76	103.82	219.80
Dividend (¥)	75	75	20	65	30	66.00
Net assets per share (¥)	2,095.95	2,170.74	2,175.80	2,346.79	2,432.05	-

Note: The FY3/16 financial statements consolidated 15 months for 9 overseas subsidiaries due to changes in the fiscal year. This table presents values on a 12-month basis that adjusts results for all fiscal years to 12 months (though EPS values are shown on a reporting basis). The FY3/17 growth rates (YoY) have also been calculated using the 12-month basis.
Source: Prepared by FISCO from the Company's financial results

Balance sheet summary

(¥mn)

	As of March 31, 2015	As of March 31, 2016	As of March 31, 2017	As of March 31, 2018	As of September 30, 2018
Current assets	79,170	74,935	87,662	86,073	93,537
Cash and deposits	10,004	12,551	10,282	25,893	28,930
Notes and accounts receivable	57,575	50,599	66,955	49,673	53,528
Fixed assets	5,021	5,636	5,621	5,761	5,653
Tangible fixed assets	2,627	2,465	2,398	2,363	2,363
Intangible fixed assets	236	1,349	1,115	886	768
Investments, etc.	2,156	1,821	2,107	2,511	2,521
Total assets	84,191	80,572	93,284	91,835	99,190
Current liabilities	40,931	35,892	48,521	43,597	49,168
Notes and accounts payable	36,199	33,419	42,734	40,829	45,697
Short-term loans, etc.	1,598	466	2,884	53	45
Fixed liabilities	349	238	217	191	230
Shareholders' equity	39,672	42,980	43,401	47,061	48,367
Capital	2,142	2,142	2,142	2,142	2,142
Capital surplus	3,335	3,335	3,335	3,335	3,335
Retained earnings	34,888	38,196	38,618	42,278	43,584
Treasury shares	-694	-694	-694	-694	-694
Accumulated other comprehensive income	3,238	1,462	1,143	984	1,423
Net assets	42,910	44,442	44,545	48,046	49,791
Total liabilities and net assets	84,191	80,572	93,284	91,835	99,190

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

Cash flow statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	1H FY3/19
Cash flow from operating activities	-5,942	7,573	-3,309	19,257	3,564
Cash flow from investing activities	-290	-1,387	-85	-51	-96
Cash flow from financing activities	318	-2,837	1,504	-3,547	-827
Effect of exchange rate change on cash and cash equivalents	1,109	-876	-305	-48	395
Net increase (decrease) in cash and cash equivalents	-4,805	2,473	-2,195	15,611	3,036
Cash and cash equivalents at beginning of period	14,809	10,004	12,477	10,282	25,893
Cash and cash equivalents at end of period	10,004	12,477	10,282	25,893	28,930

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

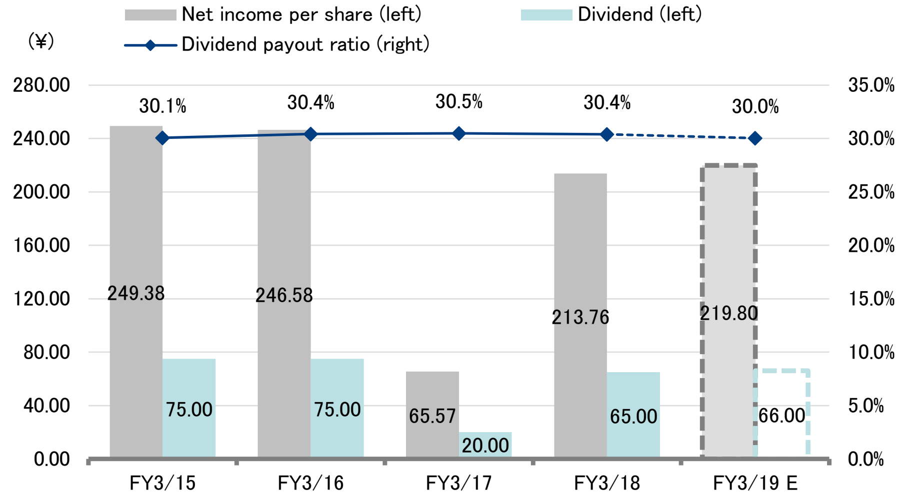
Shareholder return policy

Plans a dividend of ¥66 in FY3/19, an increase of ¥1

The Company primarily pays dividends as its shareholder return policy and aims to keep the dividend payout ratio at 30% while taking into account the earnings outlook (short term and medium term), growth investments, cash flow, and other factors.

The Company announced a dividend target of ¥66 for FY3/19 (¥30 interim dividend and ¥36 period-end dividend). It maintained the dividend target following 1H results, just as it did with FY3/19 targets. We think it arrived at the ¥66 dividend based on its ¥219.80 FY3/19 net income per share target and dividend policy of adhering to 30% payout ratio. There is a possibility of fluctuation in FY3/19 profits depending on business environment changes. Given the Company's basic dividend policy explained above, it might revise the dividend if the fluctuation margin exceeds a certain level.

Trends in net income per share, dividend, and dividend payout ratio



Source: Prepared by FISCO from the Company's materials

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