COMPANY RESEARCH AND ANALYSIS REPORT

Kyokuto Boeki Kaisha, Ltd.

8093

Tokyo Stock Exchange First Section

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Index

Summary

On a re-growth trajectory through three main strategies (new businesses (including M&A), ESG, and capital policies). "Change & Growth" to realize sustainable corporate growth in a transformation period (first half) and development period (second half)

Kyokuto Boeki Kaisha, Ltd <8093> (hereafter, also "the Company") is an engineering trading company that is able to provide one-stop technological support, from providing technology proposals through to introductions and installations, operation and maintenance, by bringing together the capabilities of its Group's companies. The products and materials it handles are diverse, including basic industries-related (machinery equipment for iron and steel mills, oil drilling equipment, etc.), electronics and control systems-related (instrumentation control systems, seismometers, aircraft materials and equipment, etc.), industrial materials-related (resins and coatings, carbon fiber-related materials, and meat processing equipment), and machinery parts-related (special order screws and springs). The regions in which it conducts business activities are Europe, the US, China, Taiwan, India, and South East Asia, and moreover, recently it has established bases in newly emerging countries including Russia, Brazil and Mexico, and it supports global product manufacturing by Japanese companies and others.

1. Started KBK Plus-One 2025, the updated medium-term management plan

The Company progressed KBK Breakthrough 2023, the medium-term management plan it started in FY3/20. However, its FY3/21 results were greatly impacted by factors including the extinguishing of demand and the post-ponements and changes to the investment plans of customers due to the COVID-19 pandemic. Conversely, society and industries are changing rapidly due to factors such as the global promotion of sustainability (ESG), the DX revolution, and workstyle reforms. Based on these conditions, the Company has revised and extended by two years its medium-term management plan and formulated KBK*Plus-One 2025 as its new medium-term management plan, which started in April 2021. Based on the recovery of earnings of the existing businesses and the growth of sales, KBK Plus-One 2025 is a plan to bring about a V-shaped recovery through getting on a re-growth track centered on the three main strategies of 1) develop and grow new businesses, 2) strengthen the Company-wide initiatives for ESG, and 3) a capital strategy that skillfully balances capital efficiency and shareholder return. It has set the first three years of the plan as the "transformation period" to establish a foundation for earnings, and the final two years as "the development period" in which launching new businesses and conducting M&A leads to business expansion. In other words, it has positioned the first half as a period of change and the second half as a period of growth.

* KBK is an abbreviation of the Company's name.

2. Developing and growing new businesses (including M&A) that can become the next-generation business pillars

The main focus of KBK Plus-One 2025 is new businesses (including M&A). The Company is creating projects for initiatives for the five growth fields and strengthening investments of management resources. This is the strong idea of President Yoshiya Okada, who is in the third year since his appointment, and the projects under the direct control of the President are being worked on strategically. The five growth fields are 1) renewable energy, 2) hydrogen and batteries, 3) environmental sanitation, 4) bio-products, and 5) DX and IoT for industry. The Company has been involved in all these five growth fields in some form up to the present time, and they are fields in which it can utilize its knowledge and experience on the markets and technologies. From among them, it plans to launch multiple businesses. The point to focus on here is that the Company possesses the knowledge and expertise for successful M&A. It has conducted more than seven M&A in the past, and the profitability of all these M&A exceeds the in-house average. It has also established an investment limit (M&A) of ¥5bn over five years for new businesses. Even in the current situation of declining earnings, the Company has resolved to grow the next-generation main businesses through the ¥5bn investment limit, even if taking on investment risk. For new business projects, it has formed a cross-division team of more than 30 employees, including from Group companies, mainly consisting of a team of highly skilled young employees, and they are working on tasks including creating business plans and conducting M&A surveys.

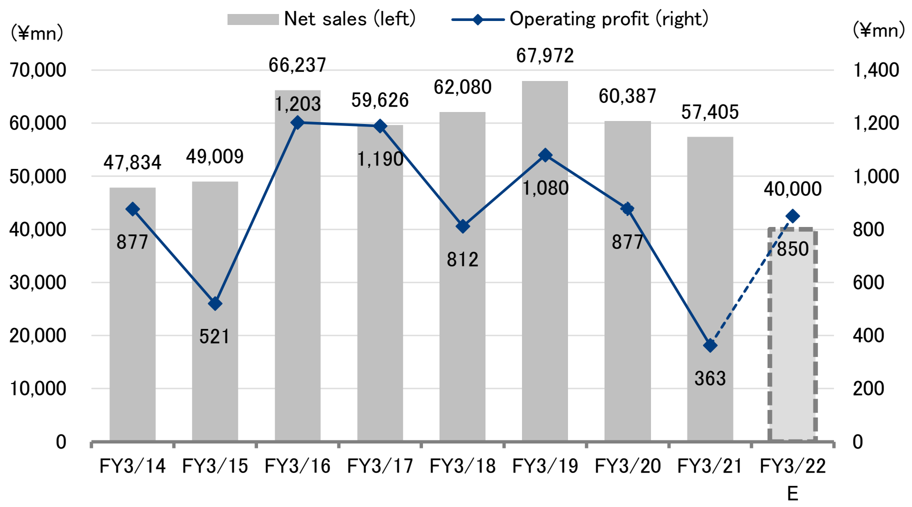
3. A capital strategy to skillfully balance capital efficiency and shareholder return.

In order to improve shareholder value and corporate value, the Company will recover operating profit to close to ¥1,000mn, and is aiming to improve capital efficiency. In KBK Plus-One 2025, toward achieving ROE of 8%, which is the management target for FY3/26, it will conduct the necessary growth investment (investment limit of ¥5bn, etc.), while it is aiming to improve capital efficiency without increasing shareholders' equity. In the background to this is that it currently has excess capital in order to progress its businesses even without increasing shareholders' equity. Moreover, it is even more actively returning profits to shareholders. Specifically, it intends to continuously increase the dividend in the first three years of KBK Plus-One 2025, when it will allocate all of profit attributable to owners of parent to dividends (dividend payout ratio, 100%), and in the last two years, it will return to the ordinary dividend. In KBK Plus-One 2025, the Company intends to implement a capital strategy with an awareness of raising the share price, and it aims to move up a notch to management that prioritizes capital efficiency that is appropriate for the Prime Market (the Tokyo Stock Exchange's new market segment) to acquire the trust of the capital markets and to make sure it is listed on the Prime Market.

Key Points

- Has started KBK Plus-One 2025, the updated version of the medium-term management plan
- Will develop and grow new businesses (including M&A) to become the next-generation main businesses
- A capital strategy that skillfully balances capital efficiency and shareholder return

Consolidated financial results trends



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

Company profile

Has used a management crisis to significantly alter the course of management and the corporate structure

1. History

In November 2017, the Company reached the 70th year since its establishment. After the end of the Second World War, the Mitsui & Co., Ltd. <8031> zaibatsu (business conglomerate) was dissolved, but its machinery division (sales section and trade section) was made independent and the Company was established, and its origin as a machinery trading company can be found here. Subsequently, it imported and sold overseas products, including cutting-edge construction and mining machinery and manufacturing equipment, for basic industries (construction, iron manufacture, chemical plants, electricity, fibers, and electronics) in Japan. It thereby contributed to Japan's economic recovery, and the Company grew and developed alongside Japan's rapid economic growth. While earning the trust and loyalty of many of Japan's major leading companies, it has secured a certain position within the basic industries.

Subsequently, the Company expanded the scope of its business areas, including to electronic equipment for the aviation and defense industries and resins and coatings for the automotive industry. In particular, its aviation- and defense-related business came to handle a fairly significant volume and became the main pillar of the Company's business. Around 1987 when it was listed on the Tokyo Stock Exchange (TSE), its core businesses were industrial machinery (iron and steel mills, electricity, etc.), industrial materials, and aviation- and defense-related. Around 2000, its annual sales exceeded ¥100bn and it steadily grew and expanded as a company. It also handled semiconductors for optical communications, but this market lacks transparency and is uncertain, and it is also highly volatile (the market price fell as low as 1/100), and there have been phases in which business management was difficult. But it has overcome such difficult phases and while still only small, the Company has developed a diverse range of businesses, and built a "comprehensive trading company" business structure.

However, in January 2008 a major incident occurred that shook the Company, involving overcharging the Ministry of Defense. This incident was reported on in newspapers at that time and resolution of the issue took about two years. Naturally, the occurrence of this scandal resulted in the annulment and cancellation of a contract with a US supplier that it imported from, and as a result the Company recorded a major loss, including repayment of the amount overcharged as a penalty, causing its results to deteriorate significantly. Consequently, the aviation- and defense-related business suffered a catastrophic blow and the Company lost one of its core businesses. Also, its effects include a review of the accounting system (change to the method of recording sales), the Company's non-consolidated net sales have contracted from more than ¥100bn to less than half that. Therefore, it has been working on corporate reforms and re-growth and has conducted a wide-ranging restructuring, including eliminating cash on hand and cutting costs. As a result, it has escaped from its "worst situation."

Using this management crisis as an opportunity, the Company has greatly changed the course of management. It has rebuilt the business structure, in which one of the core businesses was lost (aviation- and defense-related) and acquired new businesses through M&A. Fortunately, it allocated a part of its cash on hand to measures to deal with the scandal and restructuring, and it still had enough capital to conduct M&A.

Starting with Z.R.C. JAPAN Co., Ltd., in January 2011, over a period of eight years up to 2018, the Company continuously conducted seven M&A. In terms of results, all have been a success (the gross profit margin of all the acquired companies has exceed the Company-wide average gross profit margin). The most successful M&A has been of ETO Co., Ltd., which was made a wholly owned subsidiary in September 2015. ETO handles special order screws and other products for automotive parts, construction machinery, home equipment, home appliances parts, etc. Of the FY3/21 consolidated gross profit of ¥7,580mn, it earned ¥2,444mn (percentage of total, 32.2%) and it became the main earnings-generating business. Other than this company, Sunco Spring Co., Ltd., has developed constant force springs that cannot be imitated by other companies and has created many products with globally leading market shares and unique products, and it is contributing through high added-value and high profitability (gross profit margin, 32.1%).

Also, in April 2018, the Company made an export trading company, Plant Maintenance Corporation, a wholly owned subsidiary. This has strengthened sales expansion in Japan and overseas through synergies with the Company's heavy electric machinery facilities business. Moreover, in Germany it plans to establish a joint venture company for a power supply system, such as for industrial vehicles that use LiB batteries, with the aim of strengthening the manufacturing and sales of a power supply system for industrial forklifts in European countries.

History

July 1947	Subsequent to the dissolution of Mitsui & Co. by the order of GHQ's Memorandum of Understanding, the Company was established on November 27, 1947, being mainly composed of members of the machinery and trade divisions of the former Mitsui & Co.
November 1947	The Company started its operations under the name Kyokuto Boeki Kaisha Ltd. (capitalized at ¥5mn, with head office located at 2-2, Marunouchi, Chiyoda-ku, Tokyo) as a trading company specializing in machinery.
March 1987	Listed on the Second Section of the Tokyo Stock Exchange
March 2000	Listed on the First Section of the Tokyo Stock Exchange
April 2009	Established KBK Steel Products Co., Ltd. as a subsidiary
January 2011	Acquired the shares of Z.R.C. Japan Corporation, making it a wholly owned subsidiary
November 2011	Acquired the shares of Sunco Spring Co., Ltd., making it a wholly owned subsidiary
November 2012	Acquired the shares of Vahle Japan Co., Ltd., making it a wholly owned subsidiary
April 2013	Acquired the shares of Automax Co., Ltd., making it a wholly owned subsidiary
April 2015	Acquired the shares of ETO Co., Ltd., making it a subsidiary
September 2015	Acquired additional shares of ETO Co., Ltd, while ETO Co., Ltd. also acquired treasury shares, making it a wholly owned subsidiary
April 2018	Acquired the shares of Plant Maintenance Corporation, making it a wholly owned subsidiary

[Establishments and name changes of overseas subsidiaries]

April 1956	Established Far East Mercantile Corp., as a local subsidiary in New York
October 1958	Established Far East Mercantile GmbH as a local subsidiary in Frankfurt
October 1964	Established the London Branch Office
September 1984	Changed the trade name of the Far East Mercantile Corp. to KBK Inc.
October 1984	Changed the trade name of Far East Mercantile GmbH to Kyokuto Boeki Kaisha (KBK) GmbH
September 1994	Established the Taipei Branch Office
May 1997	Established Kyokuto Trading (Shanghai) Co., Ltd., in Shanghai
December 2003	Closed the London Branch Office and integrated it with Kyokuto Boeki Kaisha (KBK) GmbH, changing the trade name to KBK Europe GmbH
April 2008	Established Kyokuto Trading (India) Private Limited as a local subsidiary in India
March 2011	Established KBK do Brasil Comercio de Maquinas Ltda., as a local subsidiary in Brazil
April 2015	Established Kyokuto Boeki Kaisha Mexico, S.A. de C.V. as a local subsidiary in Mexico
March 2020	Changed the trade name of the subsidiary Kyokuto Trading (India) Private Limited to Kyokuto Boeki India Private Limited

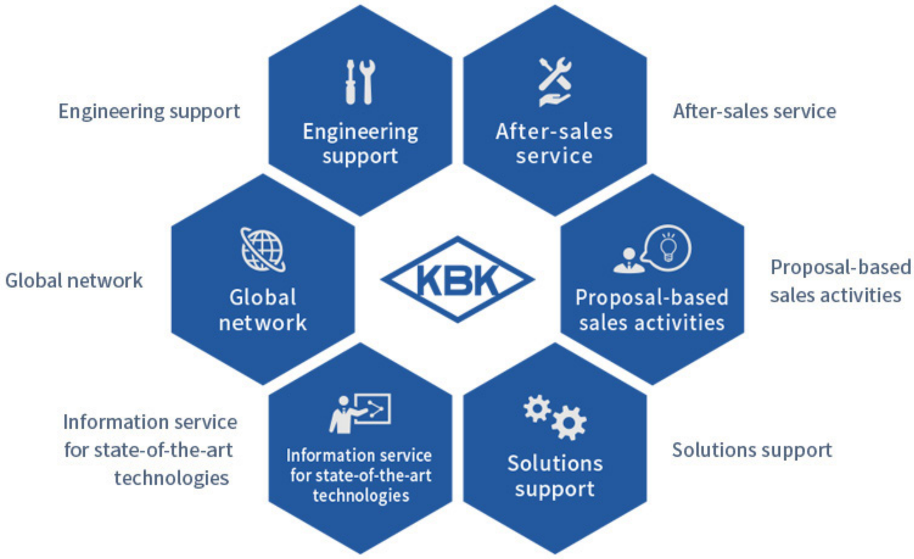
[Openings of Branch Offices in Japan]

January 1948	Established the Sapporo Branch Office
January 1949	Established the Osaka Branch Office
January 1951	Established the Nagoya Branch Office and the Fukuoka Branch Office
January 1976	Established the Sendai Branch Office
April 1982	Established the Hiroshima Branch Office
March 2021	Closed the Sendai Sub-Branch office (formerly the Sendai Branch Office)

Source: Prepared by FISCO from the Company's securities reports

As a technology-oriented trading company (it is currently called an engineering trading company), 1) the Company's mission statement is "bridging needs and seeds" and 2) its corporate philosophy is "personnel, technology, and confidence," and it places importance on being a trading company that is able to respond to all types of high-level requests from customers, and to achieve this, will not only provide products, but also provide technological support and the best products to companies.

As a technology-oriented trading company, aims to be its customers' best partner



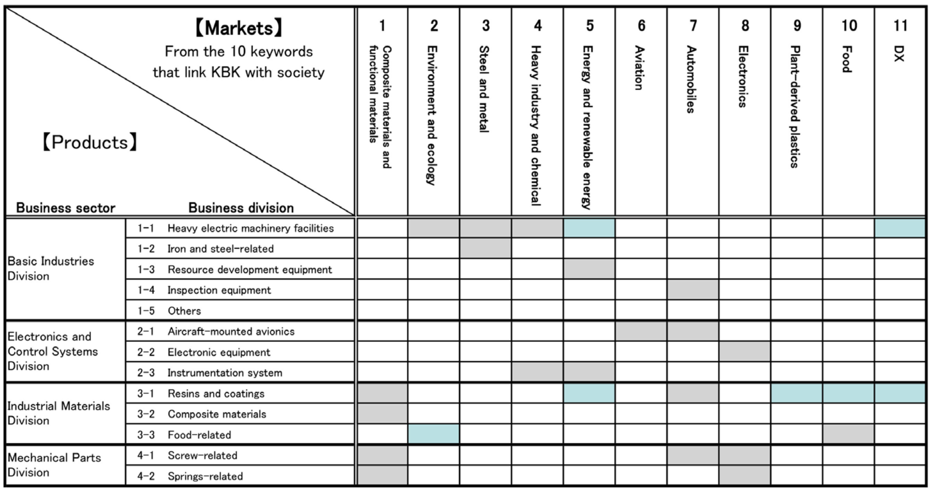
Source: Reprinted from the Company's website

2. Business description

Generally, medium-sized trading companies that lack corporate strength compared to major trading companies develop businesses as specialized trading companies, focusing on the fields in which they are strong. The Company has a history of 70 years since its establishment, and during this time, it has targeted a wide range of industries, from basic industries through to infrastructure, and moreover cutting-edge fields such as carbon fiber and methane hydrate.

Even when viewed from the perspective of its business portfolio, the Company's businesses have an earnings structure that is not easily influenced by economic conditions. It conducts various businesses including a basic industries business for heavy electric machinery facilities, iron and steel, and chemical plants, which is not expected to have high growth potential, but contributes to stable orders and earnings, and an automotive-related business (resins and coatings, etc.), which is expected to obtain orders stably in three to five years if adoptions of products for specified vehicles are determined. Conducting individual businesses absorbs the various type of business risk like demand-supply fluctuations and price fluctuations, and they supplement each other if one business is not performing strongly. So it is a business structure that is stable and that maintains a good balance. For the energy market-related business as well, recently the instrumentation system business for thermal power plants has contracted based on ESG trends, and going forward, it seems that the Company intends to shift its focus to the seismometer business, which is a growth field.

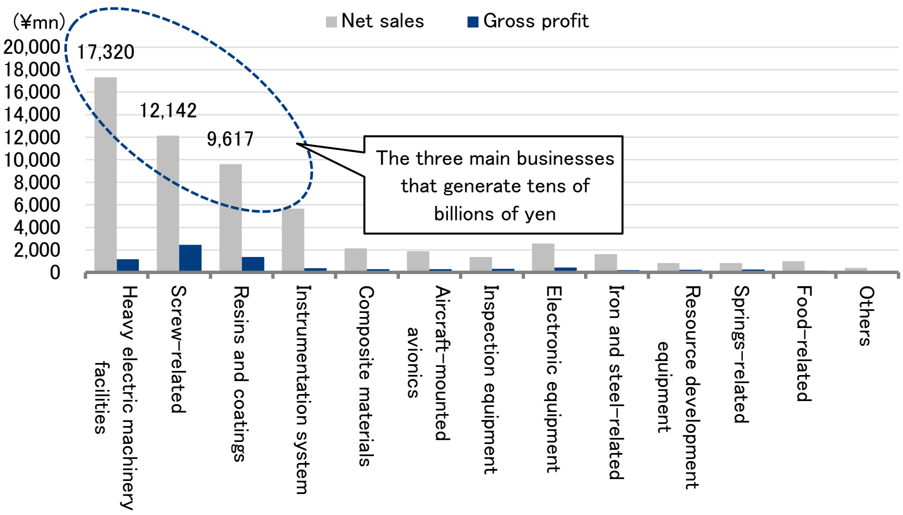
The Company's business domains, and its products and market structure



Note: Gray indicates existing products and blue indicates new products
Source: Prepared by FISCO from materials provided by the Company

Among its diverse range of businesses, the core businesses that generate tens of billions of yen and support its stable business foundation are the heavy electric machinery facilities business (FY3/21 net sales ¥17,320mn, gross profit ¥1,160mn, gross profit margin, 6.7%), the screw-related business (¥12,142mn, ¥2,444mn, 20.1%), and the resins and coatings business centered on the automotive field (¥9,617mn, ¥1,360mn, 14.1%).

Net sales and gross profit by business (FY3/21)



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

Regionally, the Company has established 14 bases of local subsidiaries and branch offices in various countries around the world. Also, including the 11 local subsidiaries and overseas branch offices with expatriate employees of ETO, which became the Company's subsidiary in FY3/16, the Group has global network of a total of 24 bases and is able to provide accurate high-quality business information on the right timing to its suppliers and customers dispersed in various regions around the world.

Overseas bases

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

3. Features and strengths

(1) More than 70% of the sales and technology sales staff have a science background

Normally, many of the staff in the sales workplaces of trading companies have a background (studied at university, etc.) in the humanities, while staff with a background in the sciences constitute around 20% to 30% at the most. But in the case of the Company, more than 70% of the sales staff have a background in the sciences. For its personnel policy, the Company prioritizes recruiting people with a background in the sciences. In the backdrop to this is the fact that the Company's sales staff are intended to be familiar with engineering as a whole, starting from technology sales through to introductions and installations, operations, and maintenance, so they do not overly rely on overseas manufacturers as suppliers and are able to provide customers with independent technological support when they need it. Specifically, the Company's sales staff themselves are able to provide simple machinery designs (design drawings) and technology proposals, respond quickly to technological inquiries from customers, and in the event that a delivered device temporarily stops working or breaks down, they can conduct an inspection and maintenance to a certain level. When a device delivered to a customer stops working or breaks down due to an unknown reason, it takes time to inquire to an overseas manufacturer, and therefore the Company's sales staff seem to have earned a large amount of trust from customers. Moreover, in order to respond in a timely manner for inspections and maintenance, the Company has established a specialist maintenance subsidiary (Nippon System Industries Corp.) that manages these tasks.

The Company also has a resources drilling-related department, and it actively recruits students who conducted research into geotechnology and natural energy resources at university. The staff in this department spend around three months on a marine resources exploration vessel together with engineers from overseas drilling manufacturers, and they are involved in motion tests and witnessed tests of the drilling equipment.

(2) Many of its customers are major leading companies from which it has acquired strong relations of trust and loyalty

As seen from the Company's history, it has been deeply involved with Japan's basic industries (construction, mines, iron and steel mills, chemical plants, electricity, fibers, electronics, automotive parts, etc.) and this enables it to conduct business with many major leading companies. Since its establishment, it has continuously conducted business with major iron manufacturers and others, from which it has acquired relations of trust and loyalty. In the overseas markets as well, including Europe, the US, and Asia, it conducts business with the Big Three automotive companies in the US and with German automotive manufacturers. Even compared to other technology-oriented trading companies in the same industry, it has an excellent customer structure. For this reason, "bad debt," which is a problem for many medium-sized trading companies, has hardly ever occurred at the Company.

Also, the Company has branch offices (Muroran, Kimitsu, Chiba, Chita, Hirohata, Mizushima, Hiroshima, Kokura, and Oita) located at the sites of all the leading iron and steel mills in Japan, and it has aimed to differentiate itself through sales services attentive to every detail that major trading companies are incapable of performing. It can be said that the Company plays a role for process solutions, including for equipment in the field of steelmaking specific processes.

(3) Highly evaluated by customers for its honesty and tenacity

The factors in the background to the Company acquiring the strong trust of major leading companies are its honesty and intense seriousness. Even in negotiation scenes with customers, it seems that customers have said that "At that price, is this going to be any good for your business?" Even in negotiation scenes with customers, it seems that customers have said that "At that price, are you are going to make anything from it?" It is also said that the Company has many tenacious people and that for new products and new businesses, they do not give up even when faced with major obstacles along the way. A good example of this is a lightweight cable. Around 12 years ago, the aircraft-mounted avionics sales department found it overseas and tenaciously repeated proposals and followed-up for a domestic light aircraft that is currently a topic of conversation. At the same time, it repeated a sales proposal for lightweight cables for luxury cars from 7 years previously, and in 2016, it was finally adopted. The Company has many of these kinds of sales staff, and they are its greatest strength as a technology-oriented trading company. It would seem possible to say that this is related to the fact that many of them have a science background.

Result trends

During the COVID-19 pandemic, the main customers' business and investment activities have been suspended, so the Company's sales and profits have also declined

1. Overview of FY3/21 results

In the FY3/21 full year results, sales and profits declined, with net sales of ¥57,405mn (down 4.9% year-on-year (YoY)), gross profit of ¥7,580mn (down 12.5%), operating profit of ¥362mn (down 58.7%), ordinary profit of ¥734mn (down 11.6%), and profit attributable to owners of parent of ¥278mn (up 25.7%).

Due to the impact of COVID-19, in the Basic Industries Division, there occurred delays in deliveries for large-scale projects in the resource development equipment business. In addition, by the end of FY3/21 results had not recovered and declined significantly in the domestic and global resins and coatings business in the Industrial Materials Division, and the screw-related business in the Mechanical Parts Division. Net sales declined ¥2,982mn YoY to ¥57,405mn, while gross profit declined ¥1,086mn to ¥7,580mn. This was due to the decline in the screw-related business, and also the industry-wide slumps of the automotive and aviation industries resulting from COVID-19, therefore profits fell in the Electronics and Control Systems Division's aircraft-mounted avionics business and in the Industrial Materials Division's composite materials business. Operating profit also declined ¥515mn to ¥362mn, due to the impact of a decrease in gross profit despite a decrease in SG&A of ¥571mn.

Overview of FY3/21 results

(¥mn)

	FY3/20		FY3/21		
	Result	YoY	Forecast	Result	YoY
Net sales	60,387	-11.2%	58,000	57,405	-4.9%
Gross profit	8,667	-2.3%	7,560	7,580	-12.5%
Gross profit margin	14.4%		13.0%	13.2%	
Operating profit	877	-18.8%	300	362	-58.7%
Operating profit margin	1.5%		0.5%	0.6%	
Ordinary profit	830	-59.0%	650	734	-11.6%
Ordinary profit margin	1.4%		1.1%	1.3%	
Profit attributable to owners of parent	221	-82.6%	250	278	25.7%
Profit attributable to owners of parent margin	0.4%		0.4%	0.5%	

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

2. FY3/21 results by business segment

(1) Basic Industries Division

Due to the impact of COVID-19, earnings declined in the resource development equipment business, affected by delays in deliveries, and the inspection equipment business affected by the slump in the automotive industry as a whole. However, in the heavy electric machinery facilities business, in which delays in deliveries had occurred, deliveries of major projects were successfully completed, so net sales increased ¥852mn YoY to ¥21,539mn. Gross profit decreased ¥454mn to ¥1,922mn, resulting in increased sales although profits decreased.

(2) Electronics and Control Systems Division

In the electronic equipment business. results trended strongly in the lithium-ion batteries business and also in the seismometer business, which was in the process of business transfer. However, because of the slumps in the automotive and aviation industries due to COVID-19, earnings declined greatly in the aircraft-mounted avionics business. Therefore, net sales increased ¥322mn YoY to ¥10,142mn, but gross profit declined ¥211mn to ¥1,127mn, resulting in increased sales although profits decreased.

(3) Industrial Materials Division

Due to the impact of COVID-19, sales of resins and coatings for the automotive industry in Japan and overseas declined, while in the composite materials business as well, sales of carbon fiber-related products for the aviation industry were sluggish. So net sales declined ¥2,748mn YoY to ¥12,753mn and gross profit fell ¥85mn to ¥1,820mn, resulting in decreased sales and profits.

(4) Mechanical Parts Division

In the screw-related business, which is the core business, a recovery was seen at the end of FY3/21, but in the 1H, sales for construction machinery and industrial machinery declined greatly due to the impact of COVID-19, while sales in the springs-related business were also sluggish. Therefore, net sales decreased ¥1,407mn YoY to ¥12,970mn. Gross profit also declined ¥334mn to ¥2,710mn, resulting in decreased sales and profits.

FY3/21 results trends by business segment

(¥mn)

		FY3/20	FY3/21		
		Result	Result	YoY	Change
Net sales	Heavy electric machinery facilities	14,640	17,320	18.3%	2,679
	Iron and steel-related	2,101	1,618	-23.0%	-483
	Resource development equipment	1,678	824	-50.8%	-853
	Inspection equipment	2,132	1,363	-36.1%	-768
	Others	135	413	205.9%	278
	Basic Industries Division	20,687	21,539	4.1%	852
	Aircraft-mounted avionics	2,073	1,887	-9.0%	-185
	Electronic equipment	2,148	2,577	19.9%	428
	Instrumentation system	5,598	5,677	1.4%	79
	Electronics and Control Systems Division	9,820	10,142	3.3%	322
	Resins and coatings	11,615	9,617	-17.2%	-1,998
	Composite materials	2,969	2,129	-28.3%	-839
	Food-related	916	1,005	9.7%	89
	Industrial Materials Division	15,501	12,753	-17.7%	-2,748
	Screw-related	13,490	12,142	-10.0%	-1,348
	Springs-related	887	828	-6.7%	-59
	Mechanical Parts Division	14,378	12,970	-9.8%	-1,407
	Consolidated net sales	60,387	57,405	-4.9%	-2,982
Consolidated gross profit	Heavy electric machinery facilities	1,200	1,160	-3.3%	-40
	Iron and steel-related	218	195	-10.6%	-23
	Resource development equipment	392	222	-43.1%	-169
	Inspection equipment	550	316	-42.5%	-234
	Others	14	27	92.9%	13
	Basic Industries Division	2,376	1,922	-19.1%	-454
	(Consolidated gross profit)	11.5%	8.9%		
	Aircraft-mounted avionics	427	305	-28.3%	-121
	Electronic equipment	523	438	-16.3%	-85
	Instrumentation system	387	383	-1.0%	-4
	Electronics and Control Systems Division	1,338	1,127	-15.8%	-211
	(Consolidated gross profit)	13.6%	11.1%		
	Resins and coatings	1,226	1,360	10.9%	134
	Composite materials	525	299	-43.0%	-226
	Food-related	153	160	3.9%	6
	Industrial Materials Division	1,906	1,820	-4.5%	-85
	(Consolidated gross profit)	12.3%	14.3%		
	Screw-related	2,766	2,444	-11.6%	-321
	(Consolidated gross profit)	20.5%	20.1%		
	Springs-related	279	266	-4.7%	-13
	(Consolidated gross profit)	31.5%	32.1%		
	Mechanical Parts Division	3,045	2,710	-11.0%	-334
	(Consolidated gross profit)	21.2%	20.9%		
	Consolidated net sales	8,667	7,580	-12.5%	-1,086
	(Consolidated gross profit)	14.4%	13.2%		

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

3. Financial condition

At the end of FY3/21, total assets increased ¥3,904mn on the end of the previous period to ¥51,790mn, which was mainly due to an increase in notes and accounts receivable-trade. Total liabilities increased ¥3,785mn to ¥29,532mn, primarily because of an increase in notes and accounts payable-trade. Total net assets increased ¥118mn to ¥22,258mn, with the main factors being an increase in valuation difference on available-for-sale securities and a decrease in retained earnings.

Simplified consolidated balance sheet

(¥mn)

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21
Current assets	34,964	37,679	40,880	35,887	39,473
Cash and deposits	7,970	8,204	8,741	9,571	9,010
Notes and accounts receivable-trade	18,969	21,600	25,248	17,674	21,635
Inventories	4,158	3,411	3,746	5,223	4,435
Non-current assets	14,192	14,439	13,454	11,998	12,317
Property, plant and equipment	2,304	2,187	2,199	2,402	2,268
Intangible assets	266	227	562	395	477
Investments and other assets	11,621	12,023	10,692	9,200	9,571
Total assets	49,156	52,118	54,334	47,886	51,790
Current liabilities	22,262	24,265	26,854	22,459	26,366
Notes and accounts payable-trade	14,461	17,627	20,318	15,027	18,310
Short-term borrowings	2,830	2,680	1,597	3,285	2,843
Non-current liabilities	5,202	4,598	4,215	3,287	3,165
Long-term borrowings	1,817	1,569	1,352	786	490
Shareholders' equity	19,887	21,447	22,456	21,841	21,071
Share capital	5,496	5,496	5,496	5,496	5,496
Capital surplus	7,424	7,974	7,942	7,942	7,942
Retained earnings	7,016	8,257	9,276	9,133	8,338
Treasury shares	-48	-281	-258	-730	-704
Accumulated other comprehensive income	1,164	1,706	808	298	1,186
Non-controlling interests	638	100	-	-	-
Total net assets	21,690	23,254	23,264	22,139	22,258
Total liabilities and net assets	49,156	52,118	54,334	47,886	51,790

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

Cash flow statement

(¥mn)

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21
Cash flows from operating activities	2,033	1,112	2,080	928	648
Cash flows from investing activities	144	377	88	-765	-7
Cash flows from financing activities	-1,694	-1,020	-2,061	-105	-1,449
Effect of exchange rate changes on cash and cash equivalents	-64	173	-129	104	206
Net increase (decrease) in cash and cash equivalents	420	643	-23	162	-601
Cash and cash equivalents at beginning of period	6,555	6,975	7,619	7,643	7,886
Cash and cash equivalents at end of period	6,975	7,619	7,643	7,886	7,303

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

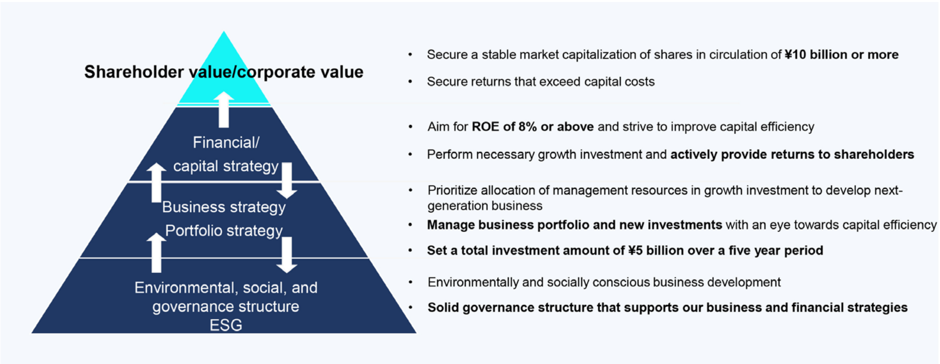
Medium-term management plan and growth strategy

“Change & Growth” to realize sustainable corporate growth in the transformation period (first half) and the development period (second half)

The FY3/21 results were not only significantly less than the forecast values, but the Company was also forced to revise KBK Breakthrough 2023, the medium-term management plan with FY3/20 as its first fiscal year. The changes to the global business environment were not only the impact of COVID-19, but also include a major reform to the awareness of industry taking into account the paradigm shift among various industries to becoming carbon neutral, utilizing DX as a measure for futurization and responding to environmental destruction. Based on these changes, the Company revised and extended by two years KBK Breakthrough 2023, the medium-term management plan. Also, as the plan for initiatives that will contribute to the Company’s development in the medium to long term that is based more on the current reality, it formulated the new medium-term management plan KBK Plus-One 2025, with FY3/22 as its first fiscal year. Continuing on from the previous medium-term management plan KBK Breakthrough 2023, KBK Plus-One 2025 aims to strengthen profitability by optimizing the business portfolio and by selecting the business areas that should be focused on. Also, the Company will create new sources of earnings by developing businesses and conducting investment in new fields in order to realize a sustainable society.

1. Summary of the new medium-term management plan KBK Plus-One 2025

KBK Plus-One 2025’s basic concept



Source: Reprinted from the Company’s results briefing materials

The TSE will change its market classification (to be transferred all together on April 4, 2022), and as the key concept for KBK Plus-One 2025, the Company has declared that it will “seek to solidly maintain its listing on the Prime Market.” Since the FY3/21 results announcement (May 10), its share price has risen and exceeded ¥2,000, and if using the share price at the current time, it would clear the standard to be listed on the Prime Market. But the base date for the transition is June 30 and it is not necessarily at a level that allows optimism, so the Company will be required to implement flexible capital policies while observing the share price.

(1) Environment, social, governance (ESG) structure

In order to realize a sustainable society, the Company is utilizing the technologies it cultivated and customer assets to develop a diverse ESG business and thereby raise enterprise value.

(2) Business strategy (business portfolio strategy)

The Company has established a project team to create new businesses horizontally across its four business divisions. It has also established an investment limit (M&A) with a total amount of ¥5bn over 5 years. It has sown seeds that will develop over 5 to 10 years to be its new business pillars (multiple businesses earning over ¥10bn).

(3) Financial and capital strategy

The Company is aiming for ROE at a level of 8% or above and to improve capital efficiency. It will not increase shareholders' equity over three years, and while taking into consideration capital efficiency, it will also actively work to return profits to shareholders (dividend payout ratio of 100% in the first three years of the plan).

(4) Improving shareholder value and corporate value

Along with securing returns that exceed capital costs, the Company intends to satisfy the conditions to be listed on the TSE's Prime Market (market capitalization of tradable shares of at least ¥10bn). Its capital efficiency management target (ROE of 8% in FY3/26) is not a stretch target, but it will be difficult to achieve considering the current ROE of 1.3% (FY3/21). It is currently in a flexed state, but going forward it is aiming to achieving ROE of 8% through making a small jump ("Change & Growth").

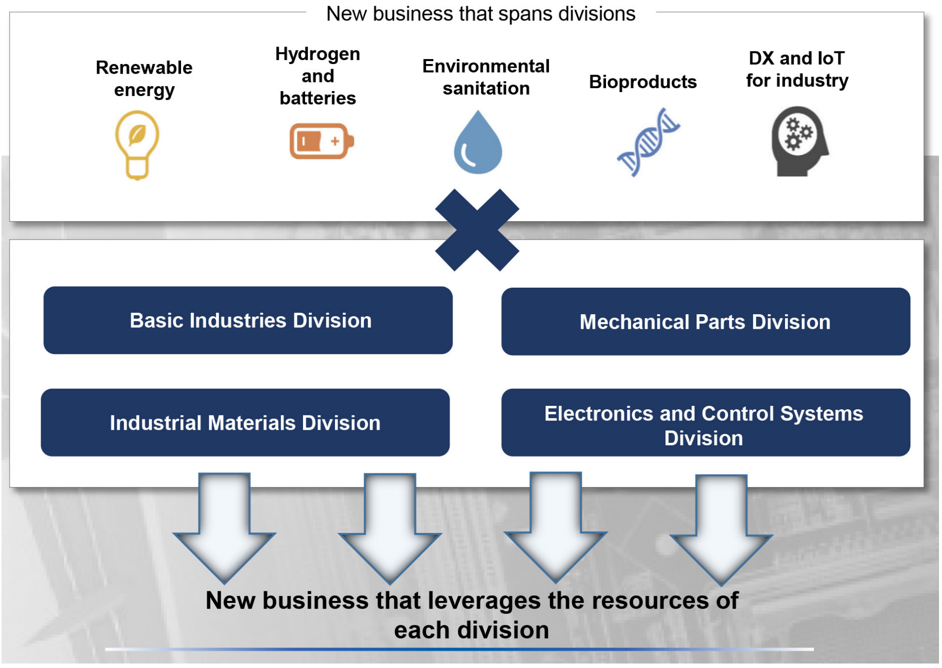
The main management targets in FY3/26 are shown below.

- Consolidated ordinary profit ¥2.5bn
- ROE 8%
- Dividend payout ratio In the first three years of the plan as the "transformation period" (FY3/22 to FY3/24), maintained at 100%
- Treasury stock acquisition Carry out flexibly according to circumstances

2. Develop and grow new businesses (including M&A)

The main focus of KBK Plus-One 2025 is new businesses (including M&A). The Company is creating projects for initiatives for the five growth fields and strengthening investments of management resources. This is the strong idea of President Okada, who is in the third year since his appointment, and the projects under the direct control of the President are being worked on strategically. The five growth fields are 1) renewable energy, 2) hydrogen and batteries, 3) environmental sanitation, 4) bio-products, and 5) DX and IoT for industry. The Company has been involved in all these five growth fields in some form up to the present time, and they are fields in which it can utilize its knowledge and expertise on the markets and technologies. From among them, it plans to launch multiple businesses. The point to focus on here is that the Company possesses the knowledge and expertise for successful M&A. It has conducted more than seven M&A in the past, and the profitability of all these M&A exceeds the in-house average. It has also established an investment limit (M&A) of ¥5bn over five years for new businesses. Even in the current situation of declining earnings, the Company has resolved to grow the next-generation main businesses through the ¥5bn investment limit, even if taking on investment risk. For new businesses projects, it has formed a cross-division team of more than 30 employees, including from Group companies, consisting mainly of a team of highly skilled young employees, and they are working on tasks including creating business plans and conducting M&A surveys.

New businesses and M&A



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(1) Renewable energy field (Basic Industries Division and Industrial Materials Division)

In the renewable energy business field, the Company is focusing on areas focusing on constructing and ensuring the safety of wind power facilities. In particular it has knowledge of and experience in the marine-related field, so it is progressing the development of an offshore wind power generation business. It is currently traveling to candidate sites for the construction of offshore wind power facilities (offshore of Aomori, Akita, Choshi, Nagasaki, etc.) and listening to customers about their needs. The Company will not construct the wind turbines (which will be the role of the main contractor), but it will focus on peripheral equipment including related maintenance equipment, drilling equipment for construction, and marine cables. Japanese manufacturers have little experience in constructing offshore wind power facilities, such as not having knowledge of marine topography, and the current situation is that each company is standing on the starting line. Therefore, there are more than enough sales opportunities for the Company. In addition, it has already started sales of carbon fiber for the turbine blades used for wind power generation.

(2) Hydrogen and batteries field (Industrial Materials Division)

The Company is strengthening initiatives for a business related to infrastructure facilities such as fuel cell vehicles and hydrogen stations for a carbon neutral society. In the hydrogen stations field, it is procuring carbon fiber from materials manufacturers and designing and installing hydrogen tanks. In the electricity and fuel cell field, it is combining fuel cells with lithium-ion batteries (LiB) and progressing their development for an application in fuel cell vehicles. Already in Europe, buses and trucks installed with the Company's LiB are being used. For example, in Moscow, the number of buses installed with its batteries increased from 2019 to 2020.

(3) Environmental sanitation field (Industrial Materials Division)

For the treatment of industrial wastewater and sewage, the Company uses cleaning agents that utilize bio- (micro-organism) and are environment-friendly. Generally, food plants require a major investment in equipment to treat wastewater into which oil has been mixed. But a feature of the Company's wastewater treatment technologies is that food plants' oil is made wastewater, then that wastewater is decomposed into clean water and oil, and then the clean water remains as drainage water and the oil is reused as boiler fuel. This technology has been attracting the attention of people involved with food plants and there have been many visitors to the plants where it has been introduced. The Company is currently applying for a patent for it. It already has a track record of introductions at the food plants of existing customers (the meat industry, including ham and sausage manufacturers). Going forward, it is progressing its horizontal development for other industries such as the pharmaceutical and chemical industries. In addition, in the field of control devices for thermal power plants, the Company has deep relations with electricity companies and has sold special devices and management devices to the energy industry, while it is investigating developments in markets such as waste gas management.

(4) Bio-products field (Industrial Materials Division)

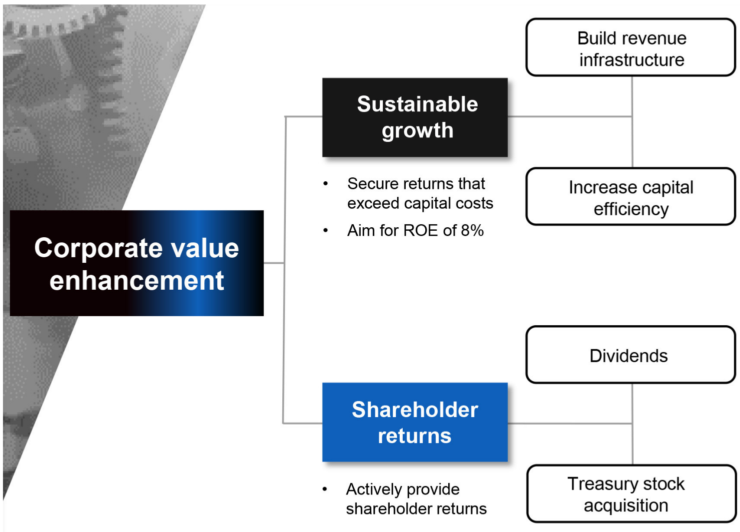
Toward realizing a sustainable society, attention is focused on the bio-product fields in which the keywords include spider thread fibers, plant-derived algae biofuel, and artificial synthetic proteins. The Company is also working on products that use plant-derived materials and re-use. Currently it is progressing a joint development with a resin compound manufacturer of a teabag for use with "Oi Ocha" (ITO EN). Although the Company's customers have expressed interest in the new plant-derived materials and additives, it will take some time before they are practically applied, so it intends to take time and develop them to be a major business.

(5) DX and IoT field for industry (Basic Industries Division, etc.)

Drones' industrial applications (maintenance inspections, controls at remote locations, monitoring, etc.) are spreading. The Company is also progressing business development in the drone-related field. Based on the experience acquired through its deep connections with the equipment industries (electricity, automotive, etc.), it also has experience and knowledge of customer companies' work processes and worksite management, and it has the solutions capabilities to use drones to solve the problems facing its customer companies (shifting to unmanned operations, constant monitoring at remote locations, etc.). Its competitive advantages include its understanding of the needs of its customer companies' worksites (concerns and issues) and that it can solve problems from the customer's perspective. Other than drones, it is also working on products like IoT devices and self-propelled robots for plants.

3. Capital strategy that contributes to improving shareholder value and corporate value

Capital strategy



Source: Reprinted from the Company's results briefing materials

To improve shareholder value and corporate value, the key is to improve capital efficiency in addition to the Company recovering operating profit to close to ¥1,000mn. In KBK Plus-One 2025, toward achieving ROE of 8%, which is the management target for FY3/26, it will conduct the necessary growth investment (investment limit of ¥5bn, etc.), while on the other hand it is aiming to improve capital efficiency without increasing shareholders' equity. In the background to this is that it currently has excess capital in order to progress its businesses even without increasing shareholders' equity. Moreover, it is even more actively returning profits to shareholders. Specifically, it intends to continuously increase the dividend in the first three years of KBK Plus-One 2025, when it will allocate all of profit attributable to owners of parent to dividends (dividend payout ratio, 100%), and in the last two years, it will return to the ordinary dividend. In KBK Plus-One 2025, the Company intends to implement a capital strategy with an awareness of raising the share price, and it aims to move up a notch to management that prioritizes capital efficiency that is appropriate for the Prime Market in order to acquire the trust of the capital markets and to make sure it is listed on the Prime Market.

Outlook

Expects a rebound effect for demand that has been pushed back, mainly due to COVID-19

1. FY3/22 outlook

The outlook for the FY3/22 results is for net sales of ¥40,000mn, operating profit of ¥850mn, ordinary profit of ¥1,250mn, and profit attributable to owners of parent ¥850mn. This is because due to the Accounting Standard for Revenue Recognition and the Implementation Guidance on Accounting Standard for Revenue Recognition, which will be applied starting from FY3/22, agency revenue, which was previously displayed as the gross revenue, will be displayed as the net revenue.

Outlook for FY3/22

(¥mn)

	FY3/21		FY3/21
	Result	YoY	Initial forecast
Net sales	57,405	-4.9%	40,000
Gross profit	7,580	-12.5%	8,500
Gross profit margin	13.2%		21.3%
Operating profit	362	-58.7%	850
Operating profit margin	0.6%		2.1%
Ordinary profit	734	-11.6%	1,250
Ordinary profit margin	1.3%		3.1%
Profit attributable to owners of parent	278	25.7%	850
Profit attributable to owners of parent margin	0.5%		2.1%

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

2. FY3/22 results outlook by business segment

(1) Basic Industries Division

In the heavy electric machinery facilities business, the desire to invest in equipment of the major industry customers is being kept down, so earnings are forecast to be unchanged YoY (gross profit, ¥1,200mn). Net sales will be affected by the change to the Accounting Standard for Revenue Recognition. In the resource development equipment business, the forecast is for profits to increase (gross profit, ¥350mn) due to the deliveries of major projects that were previously postponed, and the strong performances of geothermal- and drilling devices-related business.

(2) Electronics and Control Systems Division

The forecast is for profits to increase, (gross profit, ¥1,220mn) due to the expected growth of imaging devices and projected strong performance of the battery business for buses and trucks in Russia. Net sales will be affected by the change to the Accounting Standard for Revenue Recognition. In the electronic equipment business, the semiconductors-related business will contract, but on the other hand, an M&A was conducted for the seismometer business (in October 2020, the Company's consolidated subsidiary Nippon System Industries Corp. acquired Mitutoyo Corporation's seismometer-related business), and while up to the present time sales have been limited to a specific market (nuclear power plants), going forward, sales will be to the full seismometer market (railway companies, the Japan Meteorological Agency, etc.) and the full-fledged expansion of this market is expected from FY3/23 onwards.

(3) Industrial Materials Division

The mainstay automotive industry market is still being impacted by the shortage of semiconductors, and although the resins and coatings business' domestic market has been recovering since July 2021, the overseas market is sluggish and decreased profits are projected. For the medium- to long-term outlook, the Company's resins and coatings business is being used such as for in-vehicle accessories and lamps and going forward, even if there is a rapid shift in the automotive industry away from the internal combustion engine to other types of engines, (electric vehicles, fuel cell vehicles, etc.), it is thought that demand will not change significantly and that there is no market risk.

(4) Mechanical Parts Division

In the screw-related business, results are forecast to continue to be strong for construction and industrial machineries, which recovered from the end of FY3/21, while demand from overseas is also expected to recover. In the springs-related business as well, mass production orders are forecast for constant force springs for vehicles. Therefore, the forecasts are for net sales of ¥15,000mn and gross profit of ¥3,290mn (while further increases are possible), so it seems that sales and profits will recover to pre-COVID-19 levels.

FY3/22 results outlook by business segment

(¥mn)

		FY3/21		FY3/22
		Result	YoY	Forecas
Net sales	Heavy electric machinery facilities	17,320	18.3%	6,000
	Iron and steel-related	1,618	-23.0%	1,100
	Resource development equipment	824	-50.8%	950
	Inspection equipment	1,363	-36.1%	1,500
	Others	413	205.9%	30
	Basic Industries Division	21,539	4.1%	9,580
	Aircraft-mounted avionics	1,887	-9.0%	1,400
	Electronic equipment	2,577	19.9%	2,500
	Instrumentation system	5,677	1.4%	420
	Electronics and Control Systems Division	10,142	3.3%	4,320
	Resins and coatings	9,617	-17.2%	8,500
	Composite materials	2,129	-28.3%	1,500
	Food-related	1,005	9.7%	1,100
	Industrial Materials Division	12,753	-17.7%	11,100
	Screw-related	12,142	-10.0%	14,000
	Springs-related	828	-6.7%	1,000
	Mechanical Parts Division	12,970	-9.8%	15,000
	Consolidated net sales	57,405	-4.9%	40,000
Consolidated gross profit	Heavy electric machinery facilities	1,160	-3.3%	1,200
	Iron and steel-related	195	-10.6%	200
	Resource development equipment	222	-43.1%	350
	Inspection equipment	316	-42.5%	380
	Others	27	92.9%	30
	Basic Industries Division	1,922	-19.1%	2,160
	(Consolidated gross profit)	8.9%		22.5%
	Aircraft-mounted avionics	305	-28.3%	500
	Electronic equipment	438	-16.3%	420
	Instrumentation system	383	-1.0%	300
	Electronics and Control Systems Division	1,127	-15.8%	1,220
	(Consolidated gross profit)	11.1%		28.2%
	Resins and coatings	1,360	10.9%	1,200
	Composite materials	299	-43.0%	400
	Food-related	160	3.9%	230
	Industrial Materials Division	1,820	-4.5%	1,830
	(Consolidated gross profit)	14.3%		16.5%
	Screw-related	2,444	-11.6%	2,900
	(Consolidated gross profit)	20.1%		20.7%
	Springs-related	266	-4.7%	390
	(Consolidated gross profit)	32.1%		39.0%
	Mechanical Parts Division	2,710	-11.0%	3,290
	(Consolidated gross profit)	20.9%		21.9%
	Consolidated net sales	7,580	-12.5%	8,500
	(Consolidated gross profit)	13.2%		21.3%

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

Shareholder returns

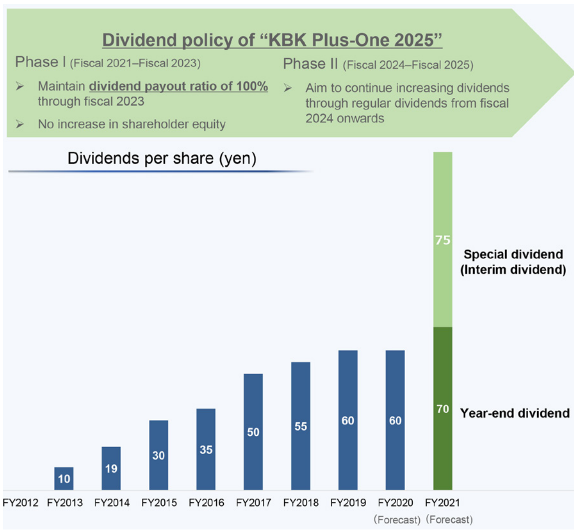
Will maintain a dividend payout ratio of 100% up to FY3/24. After that, will continue to increase the ordinary dividend and actively return profits to shareholders

In FY3/21, the Company decided on a dividend of ¥60, the same as in the previous period. Although earnings slumped (profit attributable to owners of parent, ¥278mn), it still paid ¥368mn for the period-end dividend (period-end dividend payout ratio, 132.2%).

As the dividend policy in KBK Plus-One 2025, in the plan's first three years up to FY3/24, the Company will not increase shareholders' equity and maintain a dividend payout ratio of 100%. In the plan's final two years, it appears it will work to actively return profits to shareholders, aiming to continuously increase the ordinary dividend.

The Company set a target for acquiring treasury stock (equivalent to 10% of issued shares) in the previous medium-term management plan (KBK Breakthrough 2023) but did not achieve its goal. For the portion it did not acquire, it plans to return profits to shareholders through paying a special dividend of ¥75 (FY3/22 interim dividend), with September 30, 2021, as the base date. In FY3/22, it will pay an interim dividend of ¥75 and a period-end dividend of ¥70 for an annual dividend of ¥145, so it can be said to be boldly returning profits to shareholders even as earnings are still in the course of recovery.

Dividend forecast



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