COMPANY RESEARCH AND ANALYSIS REPORT

# Sanki Engineering Co., Ltd.

## 1961

Tokyo Stock Exchange First Section

3-Sept.-2019

FISCO Ltd. Analyst

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# Index

# Summary

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

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

**1. In FY3/19, net sales increased 24.8% YoY and operating income rose 61.3% YoY exceeding ¥10bn**

In the FY3/19 results, orders received were ¥217,096mn (up 13.6% year-on-year (YoY)), net sales were ¥212,314mn (up 24.8%), gross profit was ¥31,684mn (up 26.4%), operating income was ¥10,637mn (up 61.3%), ordinary income was ¥11,204mn (up 50.7%), and profit attributable to owners of parent was ¥9,046mn (up 131.6%), and the results were above the target values in the medium-term management plan, "Century 2025" Phase 1. The balance carried forward was also maintained at the high level of ¥149,495mn (up 3.3% from the end of the previous fiscal year). The gross profit margin increased by 0.2 percentage point YoY to 14.9%, including because of the ongoing favorable business environment and as the Company continued to work to thoroughly manage costs prices and strengthen the site support system.

**2. Promoting the targets in "Century 2025" Phase 1, the medium-term management plan**

In March 2016, the Company announced "Century 2025" as its long-term version as a10-year goal toward the 100th anniversary of its foundation. It has positioned the first three years of this plan as "Century 2025" Phase 1, and for FY3/19, which is the final fiscal year of Phase 1, the Company have achieved the numerical targets it had set, which was net sales of ¥195bn and operating income of ¥7.5bn, but it has already achieved these targets. Following on from this, it has announced Phase 2, and while the three key initiatives are a continuation of Phase 1 and there are no major changes, it has added "Disclose financial & capital policies and ESG policies" and "Reinforce Information Transmission" It has also set quantitative management targets for FY3/22, of an ordinary profit margin of 5.0% or above, an annual dividend of ¥60 or above, the acquisition of 5mn or more treasury shares (three years from FY3/20), a ratio of the total return of profits of 70% or above, and ROE of 8.0% or above (final fiscal year).

**3. FY3/20 forecast**

For FY3/20, the Company is forecasting orders received of ¥190,000mn (down 12.5% YoY), net sales of ¥200,000mn (down 5.8%), operating income of ¥8,800mn (down 17.3%), ordinary income of ¥9,000mn (down 19.7%), and profit attributable to owners of parent of ¥6,200mn (down 31.5%). The FY3/19 results were at an outstanding level, so profits are forecast to decrease YoY. But the forecasts are in line with the initial targets in the medium-term management plan "Century 2025" and this is not a cause for concern. Given that there is plentiful construction work at hand and the building construction industry surrounding the Company remains active, it is fully possible it will achieve its targets.

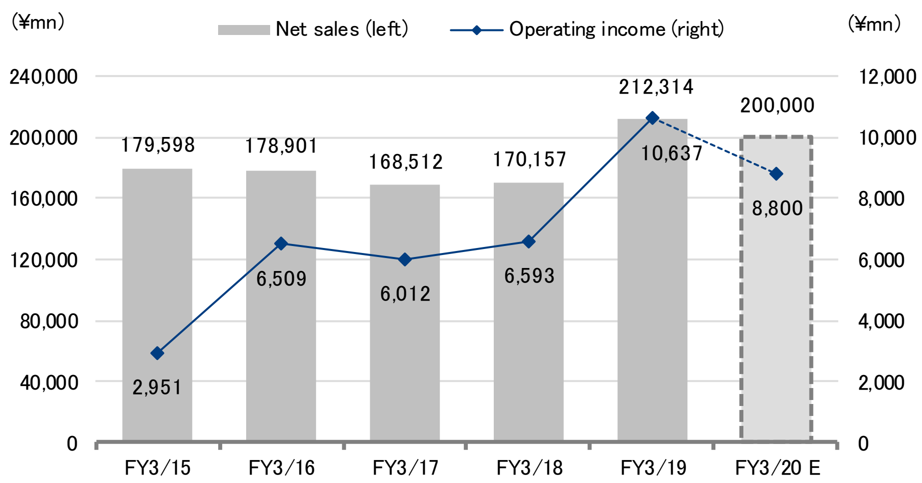
### 4. Going forward, the Company is targeting an annual dividend of ¥60 or above and moreover, to buy back 5mn treasury shares

Up to the present time, the Company has actively returned profits to shareholders through not only stably paying dividends and increasing the dividend in recent years, but also by buying back treasury shares. In FY3/18, in addition to the ordinary dividend, it paid a special dividend of ¥15 for an annual dividend of ¥35.0 (dividend payout ratio, 55.5%), while in FY3/19, it paid an additional special dividend of ¥20 for an annual dividend of ¥60.0 (dividend payout ratio, 40.0%). Going forward, it is targeting an annual dividend of ¥60 or above, and depending on the circumstances, it will also actively acquire treasury shares (around 5mn shares in the next three years). In such ways, the Company can be highly evaluated for actively returning profits to shareholders.

### Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Profits are forecast to decline in FY3/20, but the forecasts are in line with the targets in the medium-term management plan and this is not a cause for concern.
- Actively returns profits to shareholders. Targeting an annual dividend of ¥60 or above and acquiring 5mn treasury shares in the next three years.

Results trends




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

# Company outline

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

### 1. Company outline

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

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

### 2. History

Today, Sanki Engineering is a domestically-leading facilities construction company. In April 2015, prior to the 90th anniversary of its establishment in FY3/16, it appointed Mr. Tsutomu Hasegawa as President and Representative Director. Subsequently, at the end of FY3/16 it announced "Century 2025" as its long-term vision toward the 100th anniversary of its establishment in 2025, which adds President Hasegawa's new strategy to the policy it has taken.

History

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

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

# Business description

## Four main segments, with a focus on the Facilities Construction Business

### 1. Outline of business by segment

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

**(1) Facilities Construction Business**

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

**a) HVAC and plumbing for buildings**

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

**b) Industrial HVAC**

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

**c) Electrical systems**

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

**d) Facility systems**

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

**(2) Machinery Systems Business**

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

**(3) Environmental Systems Business**

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

#### (4) Real Estate Business

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

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

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

### 2. Strengths, distinguishing traits, and competitors

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

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

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

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

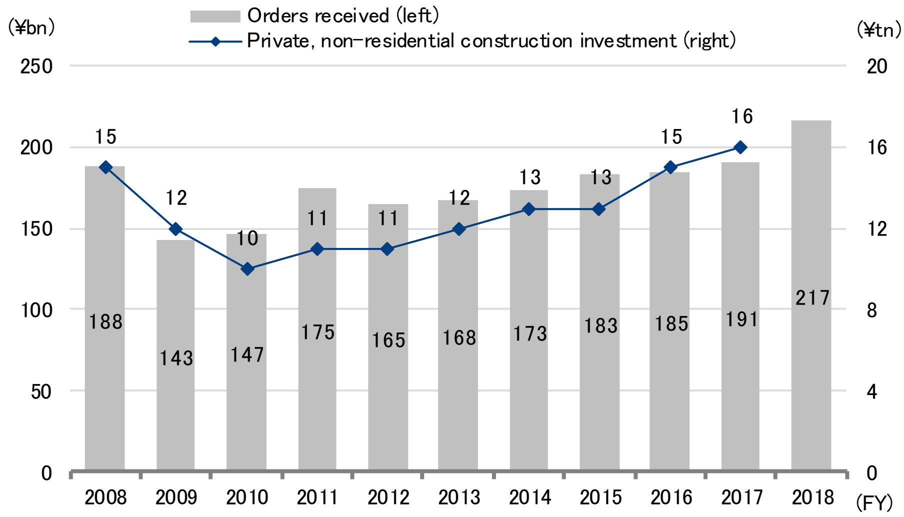
### 3. Main competitors

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

### 4. Trend in orders received and the economic environment

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

Orders received versus Private, non-residential construction investment




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

# Business trends

## In FY3/19, operating income exceeded ¥10bn (up 61.3% YoY). Balance carried forward was also maintained, up 3.3% from the end of the previous fiscal year

### 1. FY3/19 results overview

#### (1) Earnings

In the FY3/19 results, orders received were ¥217,096mn (up 13.6% year-on-year (YoY)), net sales were ¥212,314mn (up 24.8%), gross profit was ¥31,684mn (up 26.4%), operating income was ¥10,637mn (up 61.3%), ordinary income was ¥11,204mn (up 50.7%), and profit attributable to owners of parent was ¥9,046mn (up 131.6%), and the results were above the target values in the medium-term management plan, “Century 2025” Phase 1. The balance carried forward was also maintained at the high level of ¥149,495mn (up 3.3% from the end of the previous fiscal year). The gross profit margin increased by 0.2 percentage point YoY to 14.9%, including because of the ongoing favorable business environment and as the Company continued to work to thoroughly manage costs prices and strengthen the site support system.

In the Facilities Construction Business as a whole, orders received increased 19.0% YoY, with significant increase for industrial HVAC, centered on large-scale projects related to electrical machinery and semiconductors, while they also trended firmly for HVAC and plumbing for buildings and electrical systems. Conversely, orders received in the Plant & Machinery Systems Business declined 7.1%, but this was mainly due to the 10.5% decrease in the Environmental Systems, which recorded large-scale projects in the previous fiscal year. Orders for Machinery Systems were also maintained at around the same level as in the previous fiscal year, including due to orders for large-scale projects.

**FY3/19 results**

(¥mn, %)

| | FY3/18 | | FY3/19 | | | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | YoY change | % change |
| Orders received | 191,113 | - | 217,096 | - | 25,983 | 13.6 |
| Balance carried forward | 144,712 | - | 149,495 | - | 4,782 | 3.3 |
| Net sales | 170,157 | 100.0 | 212,314 | 100.0 | 42,157 | 24.8 |
| Gross profit | 25,060 | 14.7 | 31,684 | 14.9 | 6,624 | 26.4 |
| SG&A expenses | 18,466 | 10.8 | 21,046 | 9.9 | 2,580 | 14.0 |
| Operating income | 6,593 | 3.9 | 10,637 | 5.0 | 4,044 | 61.3 |
| Ordinary income | 7,434 | 4.4 | 11,204 | 5.3 | 3,769 | 50.7 |
| Profit attributable to owners of parent | 3,906 | - | 9,046 | 4.3 | 5,140 | 131.6 |

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

On the other hand, the SG&A expenses increased ¥2,580mn, or 14.0%YoY, to ¥21,046mn, but the SG&A expenses ratio fell from 10.8% in the same period of the previous fiscal year to 9.9%, due to the increase in net sales. The main factors behind the increase were the rise in normal expenses, the rise in costs related to the Yamato site redevelopment, the increase in R&D expenses, the increase in personnel hired, and a rise in personnel costs in conjunction with workstyle reforms, but each was within the expected range. However, these were absorbed by the higher gross profit, and operating income increased significantly YoY.

### (2) Earnings by segment

**Net sales and ordinary income by segment**

(¥mn, %)

| | FY3/18 | | FY3/19 | | | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | YoY change | % change |
| Net sales | 170,157 | 100.0 | 212,314 | 100.0 | 42,157 | 24.8 |
| HVAC and plumbing for buildings | 63,782 | 37.5 | 71,558 | 33.7 | 7,776 | 12.2 |
| Industrial HVAC | 46,556 | 27.4 | 73,493 | 34.6 | 26,936 | 57.9 |
| Electrical systems | 20,653 | 12.1 | 23,214 | 10.9 | 2,561 | 12.4 |
| Facility systems | 8,695 | 5.1 | 11,033 | 5.2 | 2,337 | 26.9 |
| Facilities Construction Business | 139,688 | 82.1 | 179,300 | 84.5 | 39,611 | 28.4 |
| Machinery Systems Business | 9,254 | 5.4 | 11,791 | 5.6 | 2,536 | 27.4 |
| Environmental Systems Business | 19,909 | 11.7 | 20,471 | 9.6 | 562 | 2.8 |
| Real Estate Business | 1,755 | 1.0 | 1,926 | 0.9 | 170 | 9.7 |
| Others | 578 | 0.3 | 718 | 0.3 | 139 | 24.2 |
| Adjustments | -1,030 | - | -1,893 | - | -863 | - |
| Ordinary income | 7,434 | 4.4 | 11,204 | 5.3 | 3,769 | 50.7 |
| Facilities Construction Business | 6,010 | - | 9,905 | - | 3,895 | 64.8 |
| Machinery Systems Business | -40 | - | 238 | - | 279 | - |
| Environmental Systems Business | 575 | - | 312 | - | -263 | -45.8 |
| Real Estate Business | 476 | - | 471 | - | -4 | -1.0 |
| Others | 49 | - | 52 | - | 2 | 6.0 |
| Adjustments | 362 | - | 223 | - | -139 | -38.4 |

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

In the Facilities Construction Business, net sales were ¥179,300mn (up 28.4% YoY). By sub-segment, in HVAC and plumbing for buildings, net sales increased 12.2% YoY to ¥71,558mn. In industrial HVAC, which is a field in which the Company specializes, orders were favorable mainly from the electrical machinery and semiconductor industries, so net sales were strong recording ¥73,493mn (up 57.9%). The excellent sales were also maintained for electrical systems, up 12.4% to ¥23,214mn, while in facility systems, they increased 26.9% to ¥11,033mn. Historically, HVAC and plumbing for buildings has been the largest sub-segment in the Facilities Construction Business, but in FY3/19 the significant increase in industrial HVAC caused it to overtake the building HVAC and plumbing sub-segment.

In the Plant & Machinery Systems Business, total net sales increased 10.6% YoY to ¥32,263mn. Machinery Systems Business net sales were ¥11,791mn (up 27.4%) and Environmental Systems Business net sales were ¥20,471mn (up 2.8%). Other than these facilities work segments, net sales in the Real Estate Business increased 9.7% YoY to ¥1,926mn due to factors including the start of leasing of part of the former Yamato Plant site to Nippon Life Insurance Company. As a result of the above, sales increased in every sub-segment.

In ordinary income and loss by segment, the Company recorded ¥9,905mn (up 64.8% YoY) in the Facilities Construction Business, ¥238mn in the Machinery Systems Business (versus a loss of ¥40mn in FY3/18), and an ordinary loss of ¥312mn (down 45.8% YoY) in the Environmental Systems Business. Also, the Real Estate Business and Others recorded ordinary income of ¥471mn (down 1.0%) and ¥52mn (up 6.0%), respectively.

### (3) Orders received by segment

Orders received by segment

(¥mn, %)

| | FY3/18 | | FY3/19 | | | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Orders received | 191,113 | 100.0 | 217,096 | 100.0 | 25,983 | 13.6 |
| HVAC and plumbing for buildings | 62,274 | 32.6 | 65,639 | 30.2 | 3,364 | 5.4 |
| Industrial HVAC | 58,907 | 30.8 | 82,729 | 38.1 | 23,821 | 40.4 |
| Electrical systems | 22,675 | 11.9 | 23,342 | 10.8 | 667 | 2.9 |
| Facility systems | 9,585 | 5.0 | 10,821 | 5.0 | 1,236 | 12.9 |
| Facilities Construction Business | 153,443 | 80.3 | 182,533 | 84.1 | 29,089 | 19.0 |
| Machinery Systems Business | 12,100 | 6.3 | 12,049 | 5.6 | -50 | -0.4 |
| Environmental Systems Business | 24,247 | 12.7 | 21,705 | 10.0 | -2,541 | -10.5 |
| Real Estate Business | 1,755 | 0.9 | 1,926 | 0.9 | 170 | 9.7 |
| Others | 587 | 0.3 | 960 | 0.4 | 372 | 63.5 |
| Adjustments | -1,020 | - | -2,078 | - | -1,057 | - |

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

In the Facilities Construction Business as a whole, orders received were ¥182,533mn (up 19.0% YoY). By sub-segment, the Company secured the level above the previous year in HVAC and plumbing for buildings at ¥65,639mn (up 5.4%). In industrial HVAC, the Company acquired large-scale projects relating to electrical machinery and semiconductors, and orders during the period also increased, so orders received grew significantly to ¥82,729mn (up 40.4%). Orders were also solid in electrical systems at ¥23,342mn (up 2.9%) and facility systems at ¥10,821mn (up 12.9%).

In the Plant & Machinery Systems Business, orders received for Machinery Systems were mostly flat YoY at ¥12,049mn (up 0.4%), but this was a good result considering the high- level result in the year-earlier period (orders received in FY3/18 totaled ¥8,130mn) with large-scale orders received. On the other hand, for Environmental Systems, orders declined by 10.5% to ¥21,705mn, but this was not a bad result considering the fact that orders received in the year-earlier period were abnormally high due to a large-scale DBO* project. As a result, in the Plant & Machinery Systems Business as a whole, orders received were ¥33,755mn (down 7.1%), and combined with Facilities Construction Business, in facilities work segments as a whole, orders were ¥216,288mn (up 14.0%).

* DBO (Design Build Operate) is a method for publicly-built, privately-operated projects with a collective order made to private companies (such as the Company) for design, building, and operations and maintenance management.

In areas other than facilities work segments, orders received in Real Estate Business totaled ¥1,926mn (up 9.7%), and in Others totaled ¥960mn (up 63.5%). Total orders received in FY3/19 (including adjusted amounts) was ¥217,096mn (up 13.6%), and a high level was maintained. As a result, the balance carried forward at the end of the fiscal period was ¥149,495mn (up 3.3% versus the end of the year-earlier period), staying at a high level.

The Company received a total of 23 large-scale projects (orders exceeding ¥1,000mn) worth ¥55,118mn. Compared to the previous fiscal years, both the number of orders and the amount increased (20 orders worth ¥40,822mn in FY3/18 and 15 orders worth ¥40,057mn in FY3/17).

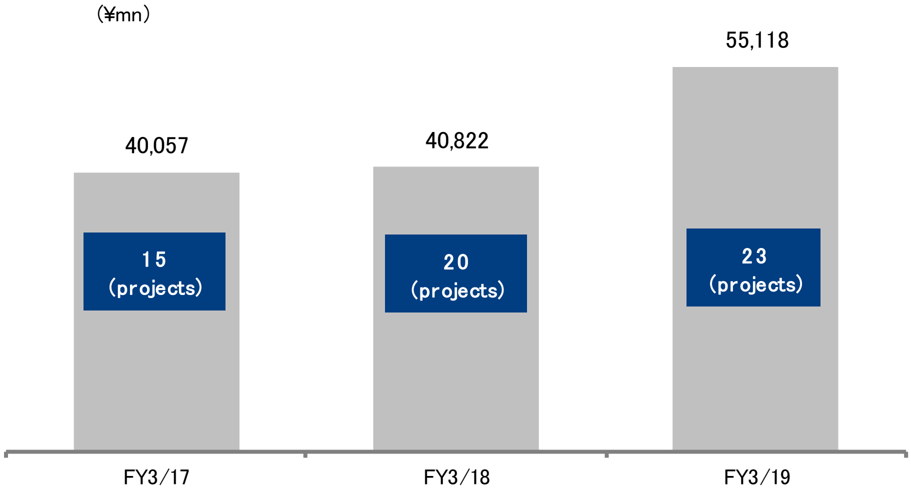
**Breakdown of large-scale projects with orders exceeding ¥1,000mn**

(projects)

| | FY3/17 | FY3/18 | FY3/19 |
|---|---|---|---|
| Offices | 4 | 2 | 2 |
| Retail outlet | 1 | - | - |
| Commercial facility | - | - | 1 |
| Hotels | - | 1 | 1 |
| Factories | 4 | 6 | 10 |
| Logistics Center | - | - | 1 |
| Multiple-dwelling complex | - | 2 | 1 |
| Hospitals/convalescence institutions | 1 | 1 | 1 |
| Research institutes | 1 | 1 | 1 |
| General government buildings | - | - | 1 |
| Gymnasiums | - | 1 | 1 |
| Others | - | 3 | 1 |
| Railway and airport facilities | - | 1 | 1 |
| Power stations, substations | 1 | - | - |
| Waste processing facilities | 1 | 2 | 1 |
| Water treatment and sewage plants | 2 | - | - |
| Total | 15 | 20 | 23 |
| Total (¥mn) | 40,057 | 40,822 | 55,118 |

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

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




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

### 2. Financial condition

The financial condition at the end of FY3/19 was that current assets were ¥141,342mn (up ¥18,441mn YoY), which was due to factors including a ¥20,784mn increase in notes and accounts receivable on completed construction contracts and others. Noncurrent assets were ¥53,979mn (down ¥133mn), which was primarily because of an increase in tangible noncurrent assets of ¥3,667mn on the fully-fledged redevelopment of the Yamato site, and a decrease in investments and other assets of ¥3,675mn, and other factors. As a result, total assets at the end of FY3/19 were ¥195,321mn (up ¥18,307mn).

Current liabilities were ¥91,317mn (up ¥17,530mn), mainly due to a ¥18,431mn increase in notes and accounts payable on construction contracts and others. Noncurrent liabilities were ¥14,232mn (down ¥2,803mn), with the main factors including decreases of ¥1,390mn in long-term loans and ¥2,147mn in deferred tax liabilities. As a result, total liabilities at the end of FY3/19 were ¥105,549mn (up ¥14,726mn). Total net assets were ¥89,772 (up ¥3,581mn). This was mainly due to factors including a ¥5,406mn increase in retained earnings from the recording of profit attributable to owners of parent and a ¥2,237mn decrease in valuation difference on other securities.

### Condensed balance sheet

(¥mn)

| | FY3/18 | FY3/19 | Change |
|---|---|---|---|
| Cash and deposits | 43,866 | 42,612 | -1,254 |
| Notes and accounts receivable on completed construction contracts and others | 64,458 | 85,243 | 20,784 |
| Current assets | 122,901 | 141,342 | 18,441 |
| Tangible noncurrent assets | 10,662 | 14,329 | 3,667 |
| Intangible noncurrent assets | 813 | 688 | -124 |
| Investments and other assets | 42,636 | 38,961 | -3,675 |
| Noncurrent assets | 54,112 | 53,979 | -133 |
| Total assets | 177,014 | 195,321 | 18,307 |
| Notes and accounts payable on construction contracts and others | 49,854 | 68,286 | 18,431 |
| Short-term loans | 6,894 | 6,874 | -19 |
| Payments received for work in progress | 3,439 | 3,395 | -43 |
| Current liabilities | 73,787 | 91,317 | 17,530 |
| Long-term loans | 6,610 | 5,220 | -1,390 |
| Liability for retirement benefits | 2,884 | 3,120 | 235 |
| Deferred tax liabilities | 2,187 | 40 | -2,147 |
| Noncurrent liabilities | 17,035 | 14,232 | -2,803 |
| Total liabilities | 90,822 | 105,549 | 14,726 |
| Total net assets | 86,191 | 89,772 | 3,581 |

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

### 3. Cash flow conditions

In FY3/19, cash flow provided by operating activities was ¥6,786mn, with the main cash inflow items being profit before income taxes, etc., of ¥11,326mn, and an ¥18,912 increase in trade payables, and the main cash outflow item being a ¥21,467mn increase in trade receivables. Cash flow used in investing activities was ¥3,775mn, due mainly to ¥6,447mn in purchase of property, plant and equipment and ¥2,198mn in proceeds from sales of investment securities. Cash flow used in financing activities was ¥5,215mn, with the main cash outflow items including ¥1,409mn in net decrease in short- and long-term borrowings, ¥1,191mn in purchase of treasury shares, and ¥2,423mn in dividends paid.

As a result, the balance of cash and cash equivalents at the end of FY3/19 had decreased ¥2,254 mn from the end of the previous fiscal year to ¥42,612 mn.

### Condensed statement of cash flows

(¥mn)

| | FY3/18 | FY3/19 |
|---|---|---|
| Cash flows from operating activities | 6,306 | 6,786 |
| Profit before income taxes | 6,454 | 11,326 |
| Decrease (increase) in trade receivables | -3,546 | -21,467 |
| Increase (decrease) in trade payables | 1,092 | 18,912 |
| Cash flows from investment activities | -2,510 | -3,775 |
| Purchase of property, plant and equipment | -2,290 | -6,447 |
| Cash flows from financing activities | 1,814 | -5,215 |
| Net increase (decrease) in short- and long-term borrowings | 7,849 | -1,409 |
| Purchase of treasury shares | -3,679 | -1,191 |
| Dividends paid | -2,195 | -2,423 |
| Net increase (decrease) in cash and cash equivalents | 5,679 | -2,254 |
| Cash and cash equivalents at end of period | 44,866 | 42,612 |

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

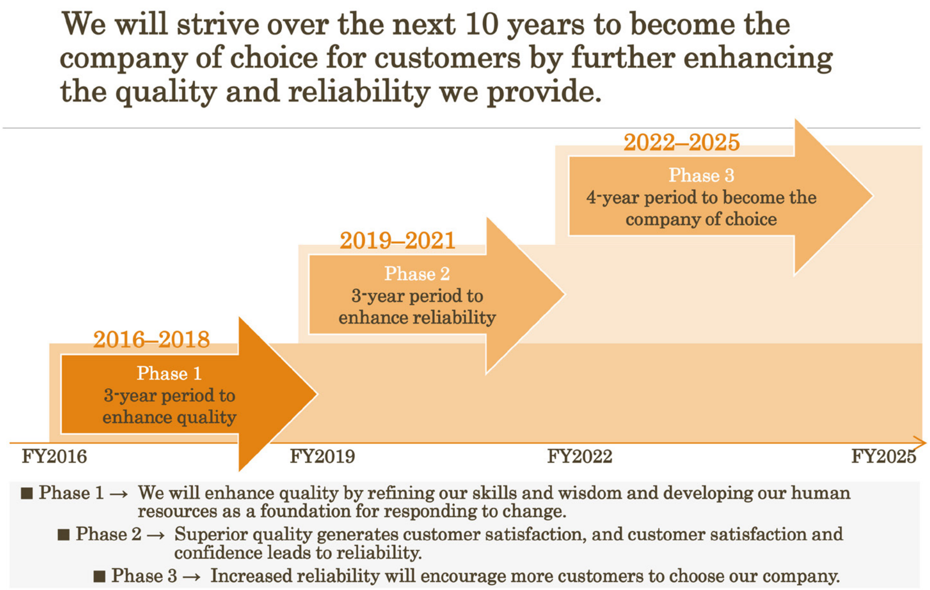
# Medium-term management plan

## Century 2025 Plan, Phase 2 from FY3/20

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

The Company has announced a 10-year long-term vision "Century 2025" that covers from fiscal 2016 to fiscal 2025, the 100th anniversary of its establishment. The ultimate goal of this long-term vision is to be "The Company of Choice." The Company has divided the 10 years into three phases described below in order to achieve this goal and the Company's policy is to implement business strategies promoted in each phase of medium-term management plan.

Long-term vision "Century 2025"




Source: From the Company's materials

The Company has already achieved the quantitative targets for Phase 1 of the medium-term management plan, which were net sales of ¥195bn and operating income of ¥7.5bn in FY3/19. It also had set qualitative targets (key initiatives); "Strengthen Core Businesses," "Promote Growth Strategies," and "Enhance the Sanki Brand," and it can be said to have basically achieved these targets as well.

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

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

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

(2) and in addition, promote understanding of the Company by "Disclosing financial and capital policies and the ESG policy" and "Strengthening the ability to communicate information."

By working on these initiatives, it is aiming to increase "reliability" to become "The Company of Choice" from the next phase, Phase 3.

### 3. Phase 2: Strengthening core businesses

It will implement initiatives to "Improve component technologies and achieve stable growth." From FY3/20, the Facility Systems Business will be separated from the Facilities Construction Business segment and become a new segment.

Improve component technologies and achieve stable growth

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

Source: Prepared by FISCO from the Company's materials

### 4. Phase 2: Initiatives to promote growth strategy

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

**Pursue future growth in the areas of technology and business**

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

Source: Prepared by FISCO from the Company's materials

### 5. Phase 2: Initiatives to enhance the Sanki Brand

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

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

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

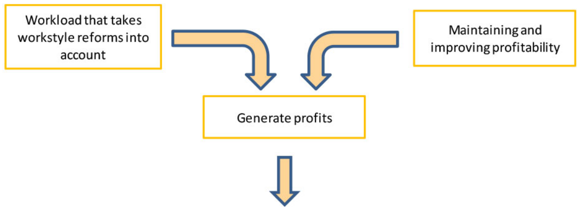
*: The Company's own guidelines which provide tips on how to promote diverse work styles

Source: Prepared by FISCO from the Company's materials

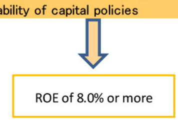
### 6. Phase 2: Financial and capital policies

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

**Raising medium- and long-term corporate value**




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




Source: Prepared by FISCO from the Company's materials

### 7. Phase 2: ESG policies

Implement initiatives to create sustainable social value.

**ESG Policies**

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

Source: Prepared by FISCO from the Company's materials

### 8. Phase 2: Strengthen the ability to communicate information

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

**Proactive transmission of information**

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

Source: Prepared by FISCO from the Company's materials

### 9. Financial performance targets: The top priority is achieving the management targets

During the "Century 2025" Phase 2 period, the Company is implementing various initiatives, such as those described above, and it has set financial performance targets for this period.

**Financial performance targets**

(¥bn)

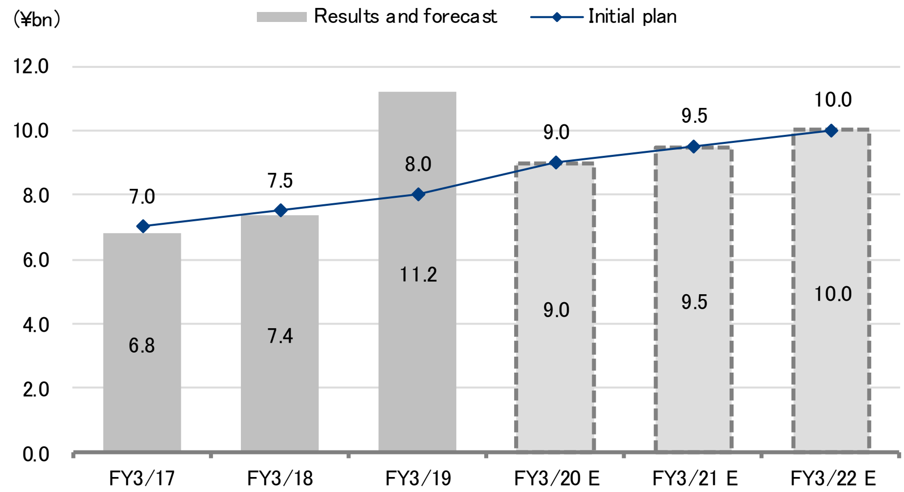
| | Phase1 | | | Phase 2 | | |
|---|---|---|---|---|---|---|
| | FY3/17 | FY3/18 | FY3/19 | FY3/20 | FY3/21 | FY3/22 |
| Net sales | 1,685 | 1,701 | 2,123 | 2,000 | 2,000 | 2,000 |
| Gross profit | 225 | 250 | 316 | 300 | 310 | 320 |
| (gross profit margin, %) | 13.4 | 14.7 | 14.9 | 15.0 | 15.5 | 16.0 |
| Ordinary income | 68 | 74 | 112 | 90 | 95 | 100 |
| (ordinary income margin, %) | 4.1 | 4.4 | 5.3 | 4.5 | 4.8 | 5.0 |

Source: Prepared by FISCO from the Company's materials

In consideration of the external environment and employees' styles of working, it is targeting total net sales for the three years of ¥200bn, while targeting gross profit margin, which the Company holds in the highest importance, of 16.0% and an ordinary profit margin of 5.0% for the final fiscal year.

The forecast is for profits to decline YoY in FY3/20, but in this regard, the Company has stated that this is because profits in FY3/19 were unusually good, and forecasts do not deviate from the initial assumptions in the medium-term management plan.

Ordinary Income Results and Forecasts




Source: Prepared by FISCO from the Company's materials

Management targets

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

Source: Prepared by FISCO from the Company's materials

# Outlook

## Profits are forecast to decline, but the forecasts are in line with the initial targets and this is not a cause for concern

● FY3/20 outlook

For the FY3/20 full year results, the Company is forecasting net sales of ¥200,000mn (down 5.8% YoY), operating income of ¥8,800mn (down 17.3%), ordinary income of ¥9,000mn (down 19.7%), and profit attributable to owners of parent of ¥6,200mn (down 31.5%). These forecasts assume orders received of ¥190,000mn (down 12.5%) and balance carried forward of ¥139,495mn (down 6.7% from the end of the previous fiscal year).

Breaking down net sales, in the Facilities Construction Business, they are forecast to be ¥163,000mn (down 9.1% YoY). By sub-segment, sales are expected to be ¥66,000mn (down 7.8%) for HVAC and plumbing for buildings and ¥63,000mn (down 14.3%) for industrial HVAC. Both are due to the outstanding results achieved in FY3/19. Sales of electrical systems are forecast to be basically unchanged YoY at ¥24,000mn (up 3.4%), and those of facility systems to increase to ¥10,00mn (down 9.4%). In the Plant & Machinery Systems Business, net sales for Machinery Systems are forecast to increase slightly to ¥12,000mn (up 1.8%) while Environmental Systems is projected to increase to ¥23,000mn (up 12.4%) from construction work at hand.

In the mainstay Facilities Construction business, orders received are forecast to decline to ¥155,000mn (down 15.1%) due to the favorable performance in FY3/19. By sub-segment, in HVAC and plumbing for buildings, orders are expected to be ¥62,000mn (down 5.5%), in industrial HVAC, ¥59,000mn (down 28.7%), in electrical systems, ¥23,000mn (down 1.5%), and in facility systems, ¥1,100mn (up 1.7%). In the Plant & Machinery Systems Business, orders are expected to be ¥12,000mn (down 0.4%) for Machinery Systems and ¥21,000mn (down 3.2%) for Environmental Systems, both mostly unchanged YoY. As a result, overall orders received including Real Estate Business and Others are forecast to decrease 12.5% to ¥190,000mn.

**FY3/20 forecast**

(¥mn, %)

| | FY3/19 | | FY3/20 E | | | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | YoY change | % change |
| Orders received | 217,096 | 100.0 | 190,000 | 100.0 | -27,096 | -12.5 |
| HVAC and plumbing for buildings | 65,639 | 30.2 | 62,000 | 32.6 | -3,639 | -5.5 |
| Industrial HVAC | 82,729 | 38.1 | 59,000 | 31.1 | -23,729 | -28.7 |
| Electrical systems | 23,342 | 10.8 | 23,000 | 12.1 | -342 | -1.5 |
| Facility systems | 10,821 | 5.0 | 11,000 | 5.8 | 179 | 1.7 |
| Facilities Construction Business | 182,533 | 84.1 | 155,000 | 81.6 | -27,533 | -15.1 |
| Machinery Systems Business | 12,049 | 5.6 | 12,000 | 6.3 | -49 | -0.4 |
| Environmental Systems Business | 21,705 | 10.0 | 21,000 | 11.1 | -705 | -3.2 |
| Real Estate Business | 1,926 | 0.9 | 2,000 | 1.1 | 74 | 3.8 |
| Others | 960 | 0.4 | 600 | 0.3 | -360 | -37.5 |
| Adjustments | -2,078 | -1.0 | -600 | -0.3 | 1,478 | -71.1 |
| Net sales | 212,314 | 100.0 | 200,000 | 100.0 | -12,314 | -5.8 |
| HVAC and plumbing for buildings | 71,558 | 33.7 | 66,000 | 33.0 | -5,558 | -7.8 |
| Industrial HVAC | 73,493 | 34.6 | 63,000 | 31.5 | -10,493 | -14.3 |
| Electrical systems | 23,214 | 10.9 | 24,000 | 12.0 | 786 | 3.4 |
| Facility systems | 11,033 | 5.2 | 10,000 | 5.0 | -1,033 | -9.4 |
| Facilities Construction Business | 179,300 | 84.5 | 163,000 | 81.5 | -16,300 | -9.1 |
| Machinery Systems Business | 11,791 | 5.6 | 12,000 | 6.0 | 209 | 1.8 |
| Environmental Systems Business | 20,471 | 9.6 | 23,000 | 11.5 | 2,529 | 12.4 |
| Real Estate Business | 1,926 | 0.9 | 2,000 | 1.0 | 74 | 3.8 |
| Others | 718 | 0.3 | 600 | 0.3 | -118 | -16.4 |
| Adjustments | -1,893 | - | -600 | - | 1,293 | - |
| Gross profit | 31,684 | 14.9 | 30,000 | 15.0 | -1,684 | -5.3 |
| SG&A expenses | 21,046 | 9.9 | 21,200 | 10.6 | 154 | 0.7 |
| Operating income | 10,637 | 5.0 | 8,800 | 4.4 | -1,837 | -17.3 |
| Ordinary income | 11,204 | 5.3 | 9,000 | 4.5 | -2,204 | -19.7 |
| Profit attributable to owners of parent | 9,046 | 4.3 | 6,200 | 3.1 | -2,846 | -31.5 |

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

Overall, the Company has set a conservative forecast due to the outstanding results achieved in FY3/19. Given that currently there is ample work in hand, we feel there is every likelihood that the Company will achieve the above targets. Going forward, the point to pay attention to is avoiding unexpectedly unprofitable projects by rigorous progress management. In respect of orders also, the environment surrounding the construction and HVAC industries is good, and given that there is expected to be an ample volume of works, it is felt that it is possible for the Company to secure their target for orders received.

The gross profit margin in the previous fiscal year was at a high level (14.9%), but the Company plans to ensure a slightly higher level (15.0%) this fiscal year. It will do so by continuing to implement measures to improve profits, including establishing and enhancing site support system, particularly by strengthening negotiating capabilities for the procurement of materials, and supporting on-site purchasing operations through ongoing integrated management by the Procurement Division. As a result of the above, if net sales are as expected, gross profit of ¥30.000mn (down 5.3% YoY) is expected. Meanwhile, SG&A expenses are expected to increase by 0.7% YoY to ¥21,200mn, partly due to the leveling off of higher-than-normal expense increases. As a result, the Company is expecting operating income of ¥8,800mn (down 17.3%).

Ordinary income is forecast to decline, but this was because of the outstanding result achieved in the previous fiscal year, and moreover, as can be seen from the graph, Ordinary Income Results and Forecasts, it is line with the initial target of ¥9bn (in the long term vision, “Century 2025.” So in consideration of these points, it can be said that this FY3/20 forecast is not a cause for concern.

# Shareholder return policy

## Actively returns profits to shareholders by increasing the dividend and acquiring and retiring treasury shares

The Company actively returns profits to shareholders. Its basic dividend policy up to FY13 was to pay an annual dividend of ¥15, but from FY14, the profit structure changed and it increased the dividend. The FY3/19 results were excellent, so in addition to an ordinary dividend of ¥40, it paid a special, period-end dividend of ¥20, and as a result the annual dividend was ¥60 (dividend payout ratio, 40.0%). It has stated that it intends to pay an annual dividend of ¥60 or above from FY3/20 onwards.

Also, as part of its measures to return profits to shareholders, the Company has actively acquired its treasury shares on the stock market and retired them. On November 16, 2018, the Company retired 1 million of the treasury shares it held and newly acquired 1 million treasury shares.

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

Shareholder return policy

### Shareholder returns

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

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

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## Disclaimer




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