COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

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Summary

A comprehensive engineering company conducting the Facilities Construction Business and the Plant & Machinery Systems Business 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. FY3/20: Operating income rose 0.3% despite 2.2% decline in net sales

In FY3/20, the Company reported ¥194,018mn in orders received (down 10.6% YoY), ¥207,684mn in net sales (down 2.2%), ¥32,110mn in gross profit (up 1.3%), ¥10,674mn in operating income (up 0.3%), ¥11,224mn in ordinary income (up 0.2%), and ¥7,576mn in profit attributable to owners of parent (down 16.2%). Balance carried forward totaled ¥136,163mn (down 8.9% YoY), slipping from the previous year-end level though holding at a high level. Gross profit margin improved 0.6ppt YoY to 15.5%, thanks to ongoing thorough cost management and reinforcement of site support systems, thereby enabling the Company to sustain profit increase even on lower sales. COVID-19 did not have much impact on FY3/20 results. The Company attained the targets set for the first fiscal year of "Century 2025" Phase 2 explained below.

2. FY3/21 forecast

For FY3/21, despite uncertainty due to COVID-19 impact the Company forecasts ¥190,000mn in orders received (down 2.1% YoY), ¥200,000mn in net sales (down 3.7%), ¥9,000mn in operating income (down 15.7%), ¥9,500mn in ordinary income (down 15.4%), and ¥6,500mn in profit attributable to owners of parent (down 14.2%) at this point. These levels are on track with original plan targets for the second year of "Century 2025" Phase 2. The Company explains that "we intend to steadily promote the "Century 2025" Phase 2 plan despite possible impact on results if COVID-19 impact spreads further and lasts for a longer period than expected."

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

In March 2016, the Company announced "Century 2025" as its long-term version as a10-year goal toward the 100th anniversary of its foundation. It has positioned the first three years of this plan as "Century 2025" Phase 1, and for FY3/19, which is the final fiscal year of Phase 1, the Company have achieved the numerical targets it had set, which was net sales of ¥195bn and operating income of ¥7.5bn, but it has already achieved these targets. Following on from this, it has announced Phase 2, and while the three key initiatives are a continuation of Phase 1, it has added "Disclose financial & capital policies and ESG policies" and "Reinforce Information Transmission." It has also set management targets in addition to financial performance targets in its quantitative targets for FY3/22, including an ordinary profit margin of 5.0% or above, an annual dividend of ¥60 or above, the acquisition of 5mn or more treasury shares (three years from FY3/20), a ratio of the total return of profits of 70% or above, and ROE of 8.0% or above. Despite uncertainty about COVID-19 impact, the Company has not changed the targets at this point and intends to continue moving forward with plan measures.

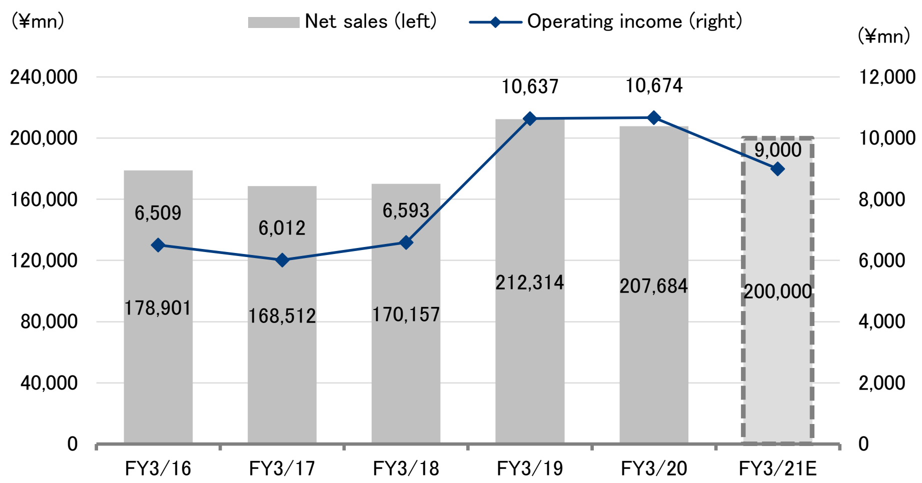
4. Conducted a share buyback and acquired 1,958,000 shares in FY3/20 and kept the FY3/21 dividend target at ¥70

The Company has proactively conducted shareholder return with a stable dividend up to now, dividend hikes in recent years, and share buybacks. It paid a ¥60 dividend in FY3/19 and a ¥95 dividend in FY3/20 (including a ¥25 extra dividend) and intends to pay a ¥70 regular dividend again in FY3/21. It acquired a total of 1,958,000 shares during FY3/20 and retired 2,000,000 treasury shares. These measures put the Company on track to achieving 83.7% average comprehensive return over the past seven years, including FY3/21. We think the Company's proactive shareholder return policy deserves notice.

Key Points

- Mitsui-affiliated, domestically-leading facilities company that is currently implementing measures to improve the profit margin
- Projects 15.7% decline in FY3/21 operating income, though this level is on track with the medium-term plan and in line with expectations
- Proactively implements shareholder return, targets a ¥70 annual dividend and is considering share buybacks for FY3/21

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

2. History

In April 2015, prior to the 90th anniversary of its establishment in FY3/16, the Company appointed Mr. Tsutomu Hasegawa as President and Representative Director. The Company subsequently announced the "Century 2025" long-term vision headed toward its 100th anniversary in 2025 in March 2016. It completed Phase 1 in FY3/19, the first step, reaching initial targets. Furthermore, since April 2020, it is promoting Phase 2 under Hirokazu Ishida as the new President.

History

1925	Sanki Engineering Co., Ltd. established as a spin-off of the machinery division of the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branches, 6 sub-branch offices, 3 affiliated companies, and around 300 employees
1958	Capital exceeded ¥1,000mn
1963	Completed the Sagami Plant (currently, the Yamato Plant)
1964	Participated in projects relating to the Tokyo Olympic Games, including the Yoyogi National Gymnasium, and the NHK Broadcast Center
1982	Newly established Technical R&D Institute in Yamato City, Kanagawa Prefecture, equipped with facilities for basic research and for large-scale experiments
2000	Opened the Shonan Training Center (Yokosuka City, Kanagawa Prefecture) and strengthened human resource development
2011	Relocated its head office to the current location in the Tsukiji area of Tokyo
2016	90th anniversary of its establishment. Announced its long-term vision "Century 2025"
2018	Opened Sanki Techno Center, a comprehensive training and research facility (Yamato City, Kanagawa Prefecture)
2019	Opened the Yamato Product Center, and completed the STeP (Sanki Techno Park) project

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

Business description

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

1. Outline of business by segment

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

(1) Facilities Construction Business

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

a) HVAC and plumbing for buildings

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

b) Industrial HVAC

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

c) Electrical systems

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

d) Facility systems

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

(2) Machinery Systems Business

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

(3) Environmental Systems Business

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

(4) Real Estate Business

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

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

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

2. Strengths, distinguishing traits, and competitors

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

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

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

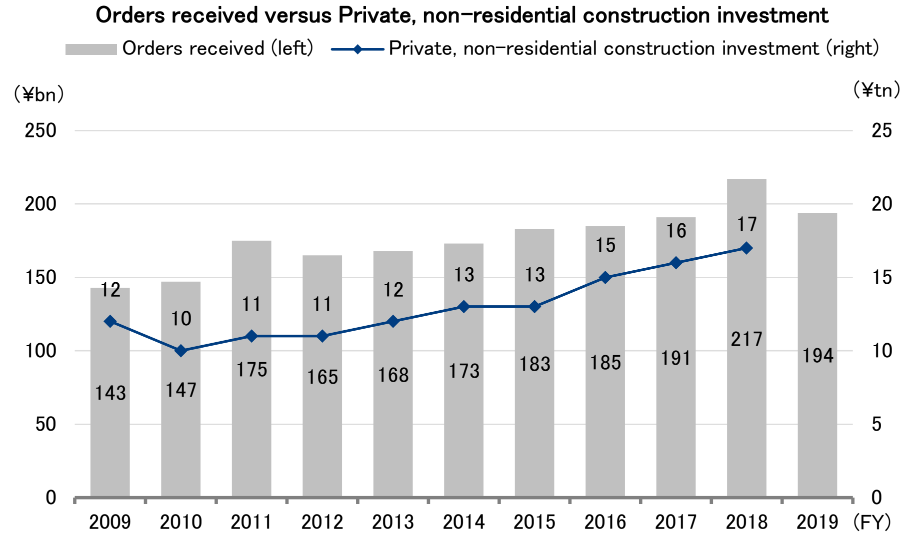
One of the Company's main strengths is the advanced technology it has accumulated since before World War II. Moreover, this top-class technology spans a wide range of fields. Furthermore, Sanki Engineering has earned a reputation for reliability over decades of business, which underpins its extensive,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

3. Main competitors

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

4. Trend in orders received and the economic environment

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



Source: Prepared by FISCO from the Company's financial results and Ministry of Land, Infrastructure, Transport and Tourism materials

Business trends

Operating income rose on lower sales, balance carried forward stayed at a high level of ¥136.1bn in FY3/20

1. FY3/20 results overview

(1) Earnings

In the FY3/20 results, orders received were ¥194,018mn (down 10.6% year-on-year (YoY)), net sales were ¥207,684mn (down 2.2%), gross profit was ¥32,110mn (up 1.3%), operating income was ¥10,674mn (up 0.3%), ordinary income was ¥11,224mn (up 0.2%), and profit attributable to owners of parent was ¥7,576mn (down 16.2%). Balance carried forward totaled ¥136,163mn (down 8.9%), slipping from the previous year-end level though holding at a high level.

Gross profit margin improved 0.6ppt YoY to 15.5%, thanks to healthy business conditions and benefits from ongoing thorough cost management, reinforcement of site support systems, and other profit improvement measures, putting gross profit at ¥32,110mn (up 1.3%). We think the Company's success in substantially overshooting the 15.0% gross profit target for the first fiscal year (FY3/20) of "Century 2025" Phase 2 explained below deserves notice.

Meanwhile, SG&A expenses totaled ¥21,436mn (up 1.9% or ¥389mn YoY) mainly because of a rise in depreciation costs related to completion of STeP <Sanki Techno Park> project. While the ratio to net sales increased form 9.9% in the previous fiscal year to 10.3% due to the sales decline, operating income sustained a YoY increase thanks to stronger gross profit.

Orders received for facilities construction fell slightly YoY, but remained at a high level in absolute terms. In orders received for the Plant & Machinery Systems Business, the Machinery Systems Business declined YoY, but the Environmental Systems Business saw orders received increase by 11.7% YoY thanks to orders for large-scale projects. Even though total orders received fell 10.6% YoY to ¥194,018mn as a result, this is still a high level. Furthermore, while balance carried forward was down 8.9% YoY to ¥136,163mn, the Company retains robust outstanding project value.

FY3/20 results

(¥mn)

	FY3/19		FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	217,096	-	194,018	-	-23,077	-10.6%
Balance carried forward	149,495	-	136,163	-	-13,332	-8.9%
Net sales	212,314	100.0%	207,684	100.0%	-4,629	-2.2%
Gross profit	31,684	14.9%	32,110	15.5%	426	1.3%
SG&A expenses	21,046	9.9%	21,436	10.3%	389	1.9%
Operating income	10,637	5.0%	10,674	5.1%	36	0.3%
Ordinary income	11,204	5.3%	11,224	5.4%	20	0.2%
Profit attributable to owners of parent	9,046	4.3%	7,576	3.6%	-1,469	-16.2%

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

(2) Earnings by segment

Net sales and gross profit by segment

(¥mn)

	FY3/19		FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	212,314	100.0%	207,684	100.0%	-4,629	-2.2%
HVAC and plumbing for buildings	71,558	33.7%	70,756	34.1%	-802	-1.1%
Industrial HVAC	73,493	34.6%	67,736	32.6%	-5,756	-7.8%
Electrical systems	23,214	10.9%	21,889	10.5%	-1,325	-5.7%
Facility systems	11,033	5.2%	11,119	5.4%	85	0.8%
Facilities Construction Business	179,300	84.5%	171,501	82.6%	-7,798	-4.3%
Machinery Systems Business	11,791	5.6%	11,169	5.4%	-621	-5.3%
Environmental Systems Business	20,471	9.6%	23,261	11.2%	2,789	13.6%
Real Estate Business	1,926	0.9%	2,210	1.1%	284	14.7%
Others	718	0.3%	931	0.4%	213	29.7%
Adjustments	-1,893	-	-1,389	-	503	-
Gross profit	31,684	14.9%	32,110	15.5%	426	1.3%
Building HVAC, industrial HVAC, electrical systems	23,712	14.1%	23,610	14.7%	-102	-0.4%
Facility systems	1,877	17.0%	2,170	19.5%	293	15.6%
Facilities Construction Business	25,590	14.3%	25,781	15.0%	190	0.7%
Machinery Systems Business	2,136	18.1%	2,316	20.7%	180	8.4%
Environmental Systems Business	3,622	17.7%	3,314	14.2%	-308	-8.5%
Real Estate Business	567	29.4%	673	30.5%	106	18.8%
Others	178	-	200	-	22	12.4%
Adjustments	-411	-	-176	-	234	-

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

The Facilities Construction Business posted ¥171,501mn in net sales (down 4.3% YoY). In sub-segments, HVAC and plumbing for buildings was down 1.1% to ¥70,756mn, and industrial HVAC fell 7.8% to ¥67,736mn. The latter decline included substantial impact from booking a large project in the previous fiscal year, and sales actually stayed at a high level versus the result from two years earlier (¥46,556mn in FY3/18). Electrical systems were down 5.7% YoY to ¥21,889, though remained upbeat with the absolute level holding at just over ¥20,000mn. Facility systems rose 0.8% to ¥11,119mn.

Total net sales in the Plant & Machinery Systems Business climbed 6.7% YoY to ¥34,431mn. While Machinery Systems Business reported ¥11,169mn (down 5.3%), Environmental Systems Business had ¥23,261mn (up 13.6%) mainly on progress in a major DBO * project booked as an order previously. Besides these facility business segments, the Real Estate Business recorded ¥2,210mn in net sales (up 14.7%), including the boost from starting rental of a portion of the former Yamato Plant site to Nippon Life Insurance Company, and Others posted ¥931mn in net sales (up 29.7%).

* 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.

The Company discloses gross profit and ordinary income as segment profit values from FY3/20. Our report uses gross profits. This amounted to ¥25,781mn for the Facilities Construction Business (up 0.7% YoY), breaking down into ¥23,610mn (down 0.4%) for HVAC and plumbing for buildings, industrial HVAC and electrical systems, and ¥2,170mn (up 15.6%) for facilities systems. In the Plant & Machinery Systems, the Machinery Systems Business reached ¥2,316mn (up 8.4%), with the Environmental Systems Business at ¥3,314mn (down 8.5%). In the Real Estate Business and Others, gross profits were ¥673mn (up 18.8%) and ¥200mn (up 12.4%), respectively.

(3) Orders received by segment

Orders received by segment

(¥mn)

	FY3/19		FY3/20			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	217,096	100.0%	194,018	100.0%	-23,077	-10.6%
HVAC and plumbing for buildings	65,639	30.2%	62,095	32.0%	-3,543	-5.4%
Industrial HVAC	82,729	38.1%	58,391	30.1%	-24,338	-29.4%
Electrical systems	23,342	10.8%	25,000	12.9%	1,658	7.1%
Facility systems	10,821	5.0%	12,171	6.3%	1,349	12.5%
Facilities Construction Business	182,533	84.1%	157,659	81.3%	-24,874	-13.6%
Machinery Systems Business	12,049	5.6%	10,351	5.3%	-1,698	-14.1%
Environmental Systems Business	21,705	10.0%	24,247	12.5%	2,542	11.7%
Real Estate Business	1,926	0.9%	2,210	1.1%	284	14.7%
Others	960	0.4%	917	0.5%	-42	-4.4%
Adjustments	-2,078	-	-1,367	-	-	-

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

The Facilities Construction Business booked ¥157,659mn in orders received (down 13.6% YoY). While orders dropped YoY, this can be attributed to the extraordinarily strong FY3/19 level and FY3/20 orders received remained high versus the ¥153,443mn reported two years earlier (FY3/18). Sub-segment orders were HVAC and plumbing for buildings at ¥62,095mn (down 5.4%), and industrial HVAC at ¥58,391mn (down 29.4%). Industrial HVAC had a large decline due to the impact of having booked a major semiconductor-related project in FY3/19, though orders remained healthy at roughly on par with FY3/18 (¥58,907mn). Other areas posted upbeat orders too with electrical systems at ¥25,000mn (up 7.1%) and facility systems business at ¥12,171mn (up 12.5%).

In the Plant & Machinery Systems Business, orders received for the Machinery Systems Business reached ¥10,351mn (down 14.1% YoY), but these are relatively strong results considering that the high levels in FY3/19 and FY3/18 reflected orders for large-scale projects. Meanwhile, the Environmental Systems Business maintained favorable results with ¥24,247mn (up 11.7%) in orders received on capturing two large-scale projects. As a result, orders received in the Plant & Machinery Systems Business totaled ¥34,599mn (up 2.5%), and together with the Facilities Construction Business, orders received for the facilities work segments overall reached ¥192,258mn (down 11.1%).

In areas other than facilities work segments, orders received in the Real Estate Business totaled ¥2,210mn (up 14.7%), and in Others totaled ¥917mn (down 4.4%). Total orders received in FY3/20 (including adjusted amounts) was ¥194,018mn (down 10.6%). Balance carried forward at the end of FY3/20 hence worked out to ¥136,163mn (down 8.9%).

Orders for large-scale projects (orders exceeding ¥1,000mn) totaled ¥31,945mn with 13 projects. While both orders volume and value dropped versus the previous fiscal year, value per project rose to ¥2,457mn (vs. FY3/19's ¥2,396mn). Future results for the Environmental Systems Business in particular will likely be driven by large-scale projects that differ in type from waste and water and sewage treatment plants.

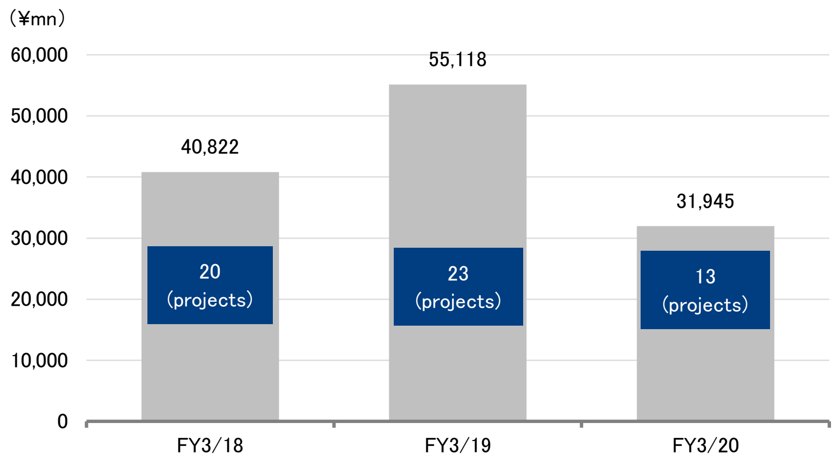
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(projects)

	FY3/18	FY3/19	FY3/20
Office	2	2	1
Complex building	-	1	-
Hotel	1	1	-
Factory	6	10	3
Logistics Center	-	1	-
Multiple-dwelling complex	2	1	-
Hospital and Clinics	1	1	1
Research institute	1	1	2
General government buildings	-	1	1
Gymnasium	1	1	-
Other building interiors	3	1	2
Railway, Airport	1	1	-
Power station, Substation	-	-	1
Waste processing facility	2	1	1
Water treatment plants and sewage plants	-	-	1
Total	20	23	13
Total (¥mn)	40,822	55,118	31,945

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

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



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

2. Financial condition

In financial conditions at the end of FY3/20, current assets totaled ¥130,765mn (down ¥10,576mn YoY) with main changes of a ¥2,334mn increase in cash and deposits and a ¥13,503mn decline in notes and accounts receivable on completed construction contracts and other Noncurrent assets were ¥50,040mn (down ¥3,939mn), which was primarily because of a decrease in investments and other assets of ¥3,558mn, while an increase in property, plant and equipment have settled down following the completion of the Yamato sites and other factors. As a result, total assets at the end of FY3/20 were ¥180,805mn (down ¥14,516mn).

Current liabilities were ¥79,705mn (down ¥11,612mn), mainly due to a ¥15,796mn decrease in notes and accounts payable on construction contracts and others. Noncurrent liabilities were ¥13,735mn (down ¥496mn), with the main factors including a decrease of ¥1,370mn in long-term loans payable and an increase of ¥344mn in liability for retirement benefits. As a result, total liabilities at the end of FY3/20 were ¥93,440mn (down ¥12,108mn). Total net assets totaled ¥87,364mn (down ¥2,407mn) with declines of ¥487mn in treasury stock and ¥2,176mn in valuation difference on available-for-sale securities.

Condensed balance sheet

(¥mn)

	FY3/19	FY3/20	Change
Cash and deposits	42,612	44,946	2,334
Notes and accounts receivable on completed construction contracts and others	85,243	71,739	-13,503
Current assets	141,342	130,765	-10,576
Tangible noncurrent assets	14,329	13,957	-372
Intangible noncurrent assets	688	679	-8
Investments and other assets	38,961	35,403	-3,557
Noncurrent assets	53,979	50,040	-3,939
Total assets	195,321	180,805	-14,516
Notes and accounts payable on construction contracts and others	68,286	52,489	-15,796
Short-term loans	6,874	6,869	-5
Payments received for work in progress	3,395	7,493	4,097
Current liabilities	91,317	79,705	-11,612
Long-term loans	5,220	3,850	-1,370
Liability for retirement benefits	3,120	3,465	344
Noncurrent liabilities	14,232	13,735	-496
Total liabilities	105,549	93,440	-12,108
Total net assets	89,772	87,364	-2,407

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

3. Cash flow conditions

Net cash provided by operating activities was ¥11,940mn. The main inflows were ¥11,114mn in income before taxes and other adjustments and a ¥15,321mn decline in trade receivables, and the main outflow was a ¥16,009mn decline in trade payables. Net cash used in investment activities was ¥303mn. The main outflows were ¥1,839mn in purchase of property, plant and equipment and ¥1,041mn in proceeds from sales of investment securities. Net cash used in financing activities was ¥8,955mn. The main outflows were a net decrease of ¥1,376mn in long-term and short-term borrowings, ¥2,899mn in purchase of treasury shares and ¥4,469mn in dividend paid.

Cash and cash equivalents hence rose ¥2,636mn in FY3/20 to a period-end balance of ¥45,946mn.

Condensed statement of cash flows

(¥mn)

	FY3/19	FY3/20
Cash flows from operating activities	6,786	11,940
Profit before income taxes	11,326	11,114
Change in trade notes and accounts receivable (- indicates increase)	-21,467	15,321
Change in trade notes and accounts payable (- indicates decrease)	18,912	-16,009
Cash flows from investment activities	-3,775	-303
Purchase of property, plant and equipment	-6,447	-1,839
Cash flows from financing activities	-5,215	-8,955
Change in short- and long-term borrowings (- indicates decrease)	-1,409	-1,376
Dividends paid	-2,423	-4,469
Change in cash and cash equivalents (- indicates decrease)	-2,254	2,636
Cash and cash equivalents at end of period	42,612	45,946

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

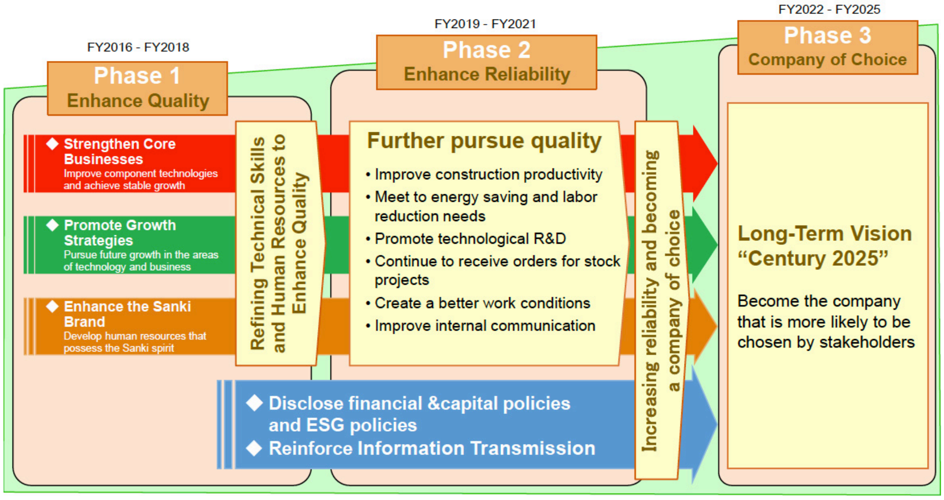
Medium-term management plan

Promoting “Century 2025” Phase2

1. What is the “Century 2025” long-term vision?

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

Long-term vision “Century 2025”



Source: Company’s Status of Business Progress in the Medium-Term Management Plan

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

“Century 2025” entered Phase 2 in FY3/20. Measures taken in Phase 1 are steadily showing results. The Company defined the following basic policies and is moving forward with the plan.

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

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

3. Phase 2: Strengthen core businesses

It will implement initiatives to "Improve component technologies and achieve stable growth. The Company separated facility systems business from the Facilities Construction Business as a core business from FY3/20.

Improve component technologies and achieve stable growth

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

Source: Prepared by FISCO from the Company's materials

4. Phase 2: Initiatives to promote growth strategy

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

Pursue future growth in the areas of technology and business

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

Source: Prepared by FISCO from the Company's materials

5. Phase 2: Initiatives to enhance the Sanki Brand

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

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

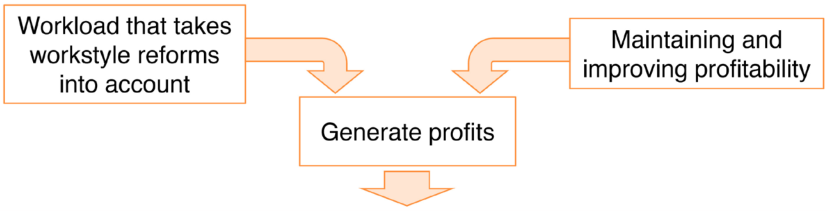
Item	Initiatives
Enhancing quality of human resources and technology	Utilizing the "Sanki Techno Center" to provide through education and training on topics such as technology, safety, ethics, management, and manners for everyone from new employees to veteran employees, including subcontractors
	Establishing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

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

6. Phase 2: Financial and capital policies

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

Raising medium- and long-term corporate value



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

ROE of 8.0% or more

Source: Prepared by FISCO from the Company's materials

7. Phase 2: ESG policies

Implement initiatives to create sustainable social value.

ESG Policies

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

Source: Prepared by FISCO from the Company's materials

8. Phase 2: Strengthen the ability to communicate information

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

Proactive transmission of information

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

Source: Prepared by FISCO from the Company’s materials

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

Financial performance targets

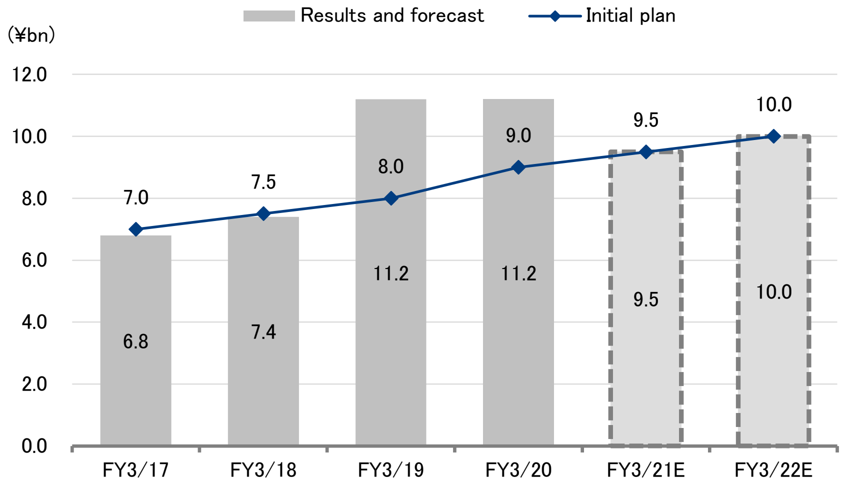
(¥bn)

	FY3/18	FY3/19	FY3/20	FY3/20	FY3/21	FY3/22
	Actual value	Actual value	Target value	Actual value	Target value	Target value
Net sales	170.1	212.3	200.0	207.6	200.0	200.0
Gross profit	25.0	31.6	30.0	32.1	31.0	32.0
Gross profit margin	14.7%	14.9%	15.0%	15.5%	15.5%	16.0%
Ordinary income	7.4	11.2	9.0	11.2	9.5	10.0
Ordinary income margin	4.4%	5.3%	4.5%	5.4%	4.8%	5.0%

Source: Prepared by FISCO from the Company’s materials

In consideration of the promotion of employees’ work-style reforms, it is targeting total net sales for the three years of ¥200bn, while targeting gross profit margin, which the Company holds in the highest importance, of 16.0% and an ordinary profit margin of 5.0% for FY3/22. The Company achieved all targets for the first fiscal year of Phase 2 in FY3/20.

Ordinary Income Results and Forecasts



Source: Prepared by FISCO from the Company's materials

Management Targets

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

Source: Prepared by FISCO from the Company's materials

Outlook

FY3/21 targets are on track with the initial plan

● **FY3/21 outlook**

For FY3/21, the Company forecasts ¥200,000mn in net sales, ¥9,000mn in operating income, ¥9,500mn in ordinary income, and ¥6,500mn in profit attributable to owners of parent. It also projects ¥190,000mn in orders received and ¥126,163mn in balance carried forward. These are targets originally set for the second year of the Phase 2 plan, but also factor in COVID-19 impact that can be envisioned at this point. However, the Company might revise targets if COVID-19 impact worsens.

Breaking down net sales, in the Facilities Construction Business, they are forecast to be ¥162,000mn. By sub-segment, sales are expected to be ¥60,000mn for HVAC and plumbing for buildings. Sales are expected to be ¥66,000mn for industrial HVAC, reflecting the return to a normal level in FY3/20 after a particularly high level in FY3/19. Sales of electrical systems are forecast to be slightly increased YoY at ¥25,000mn, and those of facility systems to increase to ¥11,000mn. In the Plant & Machinery Systems Business, net sales for Machinery Systems are forecast to decrease slightly to ¥11,000mn, while sales are expected to be ¥25,000mn for Environmental Systems Business that factors in existing project conditions

For orders received, the Company forecasts ¥155,000mn in the mainstay Facilities Construction Business, roughly on par with the previous fiscal year. By sub-segment, orders are expected to be ¥65,000mn for HVAC and plumbing for buildings, ¥57,000mn for the industrial HVAC business, ¥22,000mn for electrical systems, and ¥11,000mn for facility systems. In the Plant & Machinery Systems Business, orders are expected to be ¥12,000mn for the Machinery Systems Business and ¥21,000mn for the Environmental Systems Business. As a result, overall orders received including the Real Estate Business and Others are forecast to be ¥190,000mn.

FY3/21 forecast

(¥mn)

	FY3/20		FY3/21 E			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	194,018	100.0%	190,000	100.0%	-4,018	-2.1%
HVAC and plumbing for buildings	62,095	32.0%	65,000	34.2%	2,905	4.7%
Industrial HVAC	58,391	30.1%	57,000	30.0%	-1,391	-2.4%
Electrical systems	25,000	12.9%	22,000	11.6%	-3,000	-12.0%
Facility systems	12,171	6.3%	11,000	5.8%	-1,171	-9.6%
Facilities Construction Business	157,659	81.3%	155,000	81.6%	-2,659	-1.7%
Machinery Systems Business	10,351	5.3%	12,000	6.3%	1,649	15.9%
Environmental Systems Business	24,247	12.5%	21,000	11.1%	-3,247	-13.4%
Real Estate Business	2,210	1.1%	2,000	1.1%	-210	-9.5%
Others	917	0.5%	500	0.3%	-417	-45.5%
Adjustments	-1,367	-	-500	-	867	-
Net sales	207,684	100.0%	200,000	100.0%	-7,684	-3.7%
HVAC and plumbing for buildings	70,756	34.1%	60,000	30.0%	-10,756	-15.2%
Industrial HVAC	67,736	32.6%	66,000	33.0%	-1,736	-2.6%
Electrical systems	21,889	10.5%	25,000	12.5%	3,111	14.2%
Facility systems	11,119	5.4%	11,000	5.5%	-119	-1.1%
Facilities Construction Business	171,501	82.6%	162,000	81.0%	-9,501	-5.5%
Machinery Systems Business	11,169	5.4%	11,000	5.5%	-169	-1.5%
Environmental Systems Business	23,261	11.2%	25,000	12.5%	1,739	7.5%
Real Estate Business	2,210	1.1%	2,000	1.0%	-210	-9.5%
Others	931	0.4%	500	0.3%	-431	-46.3%
Adjustments	-1,389	-	-500	-	889	-
Gross profit	32,110	15.5%	31,000	15.5%	-1,110	-3.5%
Operating income	10,674	5.1%	9,000	4.5%	-1,674	-15.7%
Ordinary income	11,224	5.4%	9,500	4.8%	-1,724	-15.4%
Profit attributable to owners of parent	7,576	3.6%	6,500	3.3%	-1,076	-14.2%

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

Despite uncertainty related to COVID-19, we think it should be possible to attain the targets mentioned above because the Company already has some projects. Besides paying attention to COVID-19 impact, another key point is avoiding unexpected unprofitable projects by rigorously managing progress. We believe the Company is capable of attaining the orders target too, even with the COVID-19 situation, because of favorable conditions in the construction and HVAC facilities industry, including the Company, and extensive work volume.

Gross profit margin was high level in FY3/20 at 15.5%. Nevertheless, the Company expects to at least secure the FY3/20 level of 15.5%, by continuing to establish and reinforce site support systems, particularly strengthen bargaining power in materials procurement activities through the Procurement Division, and implement profit improvement measures such as continued support for front-line purchasing via integrated management. We think the Company should report ¥31,000mn in gross profit and ¥9,000mn in operating profit if it reaches the net sales target. Given a breather in the rise in extraordinary expenses (human resource investments, pay revisions, etc.), SG&A expenses may not rise as much as expected, and if net sales and gross profit margins perform to plan, operating income going forward may be revised upward.

Shareholder return policy

Proactive stance toward shareholder return with dividend hikes and share buybacks/retirement, positive approach to other stakeholders too

The Company actively returns profits to shareholders. While its basic annual dividend was ¥15 through FY3/14, a change in profit structure prompted a dividend increase beginning in FY3/15. Due to strong results in FY3/19, the Company implemented a extra year-end dividend of ¥20 in addition to the normal ¥40 dividend, for a total annual dividend of ¥60 (a dividend payout ratio of 40.0%). In FY3/20, the Company had an initial annual dividend target of at least ¥60 and raised the dividend to ¥95 (¥35 interim, ¥60 year-end) including a ¥25 extra dividend to reflect robust earnings. In FY3/21, it currently plans to sustain the regular dividend at ¥70.

The Company actively purchases its own shares in the market and retires them as part of the shareholder redemption strategy. It acquired 1,958,000 shares and retired 2,000,000 treasury shares during FY3/20. Its share buybacks and dividend payments totaled ¥29,120mn in FY3/14-20, and this works out to a very high 83.7% gross return ratio (weighted average) versus the combined ¥34,777mn in profit attributable to owners of parent for these years. The Company stated in the Phase 2 plan that it is targeting a gross payout ratio of at least 70% in the three years from FY3/20, including purchases of roughly 5mn shares (it already acquired 1,958,000 shares) and dividends.

The Company also has a positive approach toward other stakeholders besides shareholders. Specifically, it revised payment terms for partner companies with full cash payments to those with less than ¥40mn in capital. It intends to conclude a commitment-line contract that readies it to address changes in societal conditions, including COVID-19 impact, secures funds to assist partner companies, and prepares it for temporary working capital demand. We think the Company should be favorably assessed for its positive stance in shareholder return and relationships with various stakeholders.

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)			
FY3/20	1,958,000	2,899	5,543	8,442	7,576
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	29,120	34,777
			Total return ratio (weighted average)		83.7%

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

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