

Sun-Wa Technos Corporation

8137

Tokyo Stock Exchange First Section

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FISCO Ltd.

<http://www.fisco.co.jp>

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Summary

Making healthy progress with the medium-term management plan, focus on new distribution channels in the engineering business

Sun-Wa Technos Corporation <8137> (hereinafter, also “the Company”) is an independent trading company that specializes in technology products. One of the strengths of the Company is that it has three business divisions of electrical machinery, electronics, and general machinery. Another strength is the Company’s two-way trade in which it sells equipment and materials for manufacturers’ production lines and then buys and sells the products made by these manufacturers to other companies. By utilizing these strengths, Sun-Wa Technos has expanded its businesses.

1. Posted upbeat FY3/17 results beating initial guidance

Sun-Wa Technos reported higher sales and profits in FY3/17 with net sales at ¥116,611mn (+10.3% YoY) and operating income at ¥3,014mn (+23.3%), beating period-start guidance. Key drivers were recovery in demand from the smartphone industry in China and vibrant capital investment demand from semiconductor and display industries. Demand was also upbeat in India and other emerging markets. Sun-Wa Technos, a leading sales distributor, benefited from an environment that generally lifted Japanese FA-related manufacturers.

2. Healthy expansion of engineering business; opportunities in growing direct transactions with end users

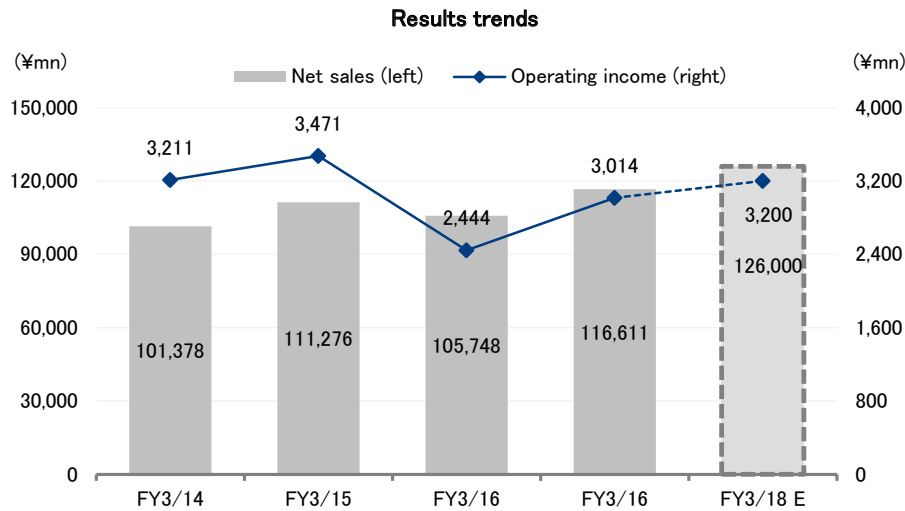
Steady implementation of the medium-term management plan is the growth strategy. Engineering business and global SCM (supply chain management) solutions business are core strategic initiatives in Challenge 1500, the current medium-term management plan. These are both advancing at healthy paces. In particular, the engineering business has seen a new distribution channel through direct transactions with end users. While potential varies by industry and customer size, success in the first project raises expectations for repeat orders by delivering similar equipment to the subject customer’s other production lines and plants.

3. Fundamentals support an outlook for continuing healthy momentum, expecting higher sales and profits

Sun-Wa Technos guides for higher sales and profits in FY3/18 at ¥126,000mn in net sales (+8.1% YoY) and ¥3,200mn in operating income (+6.2%). Momentum continuing from 2H FY3/17 has not slowed thus far, and we think the Company’s confidence in 1H has risen. Regarding 2H, however, the stance is cautious because of uncertainties, such as the forex rate and geopolitical risks. This is the basis for the current outlook. Earnings might have room to overshoot in FY3/18, absent an unforeseen situation, given robust fundamentals.

Key Points

- Sales increased by about the same extent in electric machinery, electronics, and general machinery divisions in FY3/17; higher sales and profit gains in primary market Japan
- Engineering business growing at a healthy pace; expectations building for distribution channels of direct transactions with end users
- Sales and profits likely to expand during FY3/18 in line with the initial medium-term plan; upside opportunity too barring unforeseen situations



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

Company profile

Achieving growth as a leading distributor for electrical machinery and general machinery manufacturers, established a position as a unique, independent trading company that specializes in technology products

1. Background

The Company traces its roots to a self-run business created by the late Tokuro Yamada in July 1946 that leveraged his experience selling electrical machinery in China during the war. It was incorporated in November 1949 as YAMADA KOGYO CORPORATION and concluded a distributor contract with YASKAWA Electric Manufacturing Co., Ltd. (currently, YASKAWA Electric Corporation <6506>), marking the full-fledged start of the Company's history. While the Company grew as a major sales distributor of YASKAWA Electric, it went beyond this relationship to conclude sales distributor contracts with other leading electric equipment and machinery manufacturers as an independent trader of technology products, expanding products that it handled and the customer base, and broadening business scope. We discuss the details below, but Sun-Wa Technos established a position as a unique trading company that specializes in technology products, handling three different types of products (electric machinery, electronics, and general machinery) that it continues to hold today.

In overseas activities, Sun-Wa Technos rapidly broadened its network of local entities from the 1990s in response to offshore moves by customer firms spurred by yen appreciation, elimination of trade friction, and other factors. Following the launch of entity in Singapore in 1995, it proceeded to build an overseas subsidiary network in major Asian countries, Europe, and North America. It recently established local entities in Indonesia, Vietnam, Mexico and the Philippines as countries with strong growth potential.

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Sun-Wa Technos listed its shares on the OTC market in May 1982, moved to the Second Section of the Tokyo Stock Exchange in April 2003, and advanced to the First Section in March 2005.

History

Domestic business development		Overseas business development
November 1949	Established YAMADA KOGYO CORPORATION	
December 1952	Sales agent contract with Osaka Transformer Co., Ltd. (now DAIHEN Corporation)	
November 1960	Sales agent contract with NIPPON GEAR Co., Ltd.	
October 1966	Agent contract with Origin Electric Co., Ltd.	
March 1969	Distributor contract with Toyo Carrier Engineering Co., Ltd (now Toshiba Carrier Corporation)	
July 1970	Exclusive contract with Tateisi Electric Manufacturing Co. (now, OMRON Corporation)	
November 1970	Established Yamada Kucho Co., Ltd. (now SUN-WA-TRINITY CORPORATION)	
September 1971	Sales agent contract with NIKKISO CO., LTD.'s equipment sales division	
June 1974	Started sales of YE DATA INC. products	
November 1977	Established Yamada Kogyo Kenkyusho	
May 1978	Agent contract with Sumitomo 3M Limited	
July 1978	Special agent contract with STANLEY ELECTRIC CO., LTD.	
November 1979	Special agent contract with Nemic-Lambda Co., Ltd. (now TDK-Lambda Corporation)	
May 1981	Sales agent contract with SANKI ENGINEERING CO., LTD.	
May 1982	Listed shares on the OTC market	
June 1990	Established Yamada Butsuryu Co., Ltd. (now SUN-WAN LOGISTICS CO., LTD.)	
April 1993	Changed to the current company name	
May 1995	Established SUN-WA TECHNOS (SINGAPORE) PTE. LTD.	
December 1997	Established SUN-WA TECHNOS (HONG KONG) CO., LTD.	
April 1998	Established Sun-Wa Technic Europe Co., Ltd. (now SUN-WA TECHNOS EUROPE GmbH; Dusseldorf)	
July 1998	Established SUN-WA TECHNOS AMERICA, INC. (Chicago)	
November 1998	Established SUN-WA TECHNOS TAIWAN CO., LTD. (joint venture)	
April 2000	Established SUN-WA TECHNOS (MALAYSIA) SDN. BHD.	
January 2001	Dissolved SUN-WA TECHNOS TAIWAN CO., LTD. (joint venture) and established SUN-WA TECHNOS TAIWAN CO., LTD. (subsidiary)	
December 2001	Established SHANGHAI SUN-WA TECHNOS CO., LTD.	
September 2002	Opened the Shenzhen Representative Office	
April 2003	Listed on the TSE Second Section	
March 2005	Listed on the TSE First Section	
October 2006	Established SUN-WA TECHNOS ASIA (THAILAND) CO., LTD.	
January 2009	Established SUN-WA TECHNOS (SHENZHEN) CO., LTD.	
August 2013	Opened the Hanoi Representative Office of SUN-WA TECHNOS (HONG KONG) in Vietnam	
October 2013	Opened the Hong Kong Logistics Center	
March 2014	Opened Taichung Representative Office of SUN-WA TECHNOS TAIWAN	
October 2014	Established PT. SUN-WA TECHNOS INDONESIA	
September 2015	Established SUN-WA TECHNOS MEXICO S.A. DE C.V. and SUN-WA TECHNOS (PHILIPPINES), INC.	
December 2015	Moved the head office to 3-chome Kyobashi, Chuo Ward	
January 2016	Merged the electronics division into the headquarters	
May 2016	Opened the Los Angeles Branch of SUN-WA TECHNOS (AMERICA), INC.	
April 2017	Established SUN-WA TECHNOS (VIETNAM) CO.,LTD.	
April 2017	Opened the Nagoya Office (upgraded from a branch) and Yokohama Branch (upgraded from a sales site)	

Source: Prepared by FISCO from Company materials

Covers three fields (electric machinery, electronics, and general machinery), though excels in deep understanding of each one

2. Business overview

Sun-Wa Technos is an independent trading company that specializes in technology products and stands out in its coverage of three product fields – electric machinery, electronics, and general machinery. Product information and understanding tends to be broad and superficial when a single company handles three separate fields because of the differences in users and demand drivers. However, Sun-Wa Technos derives its strength from pursuit of “broad and deep” interactions. This approach stems from having numerous employees with engineering backgrounds as a technology-oriented trading firm. It also began in general machinery and electrical machinery fields as a sales agent for YASKAWA Electric and DAIHEN <6622> and then added electronic components as “two-way transactions.” Sun-Wa Technos has accumulated knowledge and experience in each of the three fields through processes over a lengthy period, supporting this model.

The electrical machinery division handles AC servo motors, programmable controllers, linear motors and other motors, inverters, and vacuum chamber robots. General machinery business covers semiconductor production equipment, industrial robots, clean room robots for conveying liquid crystal displays (LCDs), and medical equipment. Electronics business handles connectors, semiconductors, sensors, LEDs, LCDs, and CPU boards.

List of products handled by Sun-Wa Technos by business divisions

Electrical machinery	AC servo motors, programmable controllers, linear motors and various other motors, inverters, power conditioners, clean room robots and vacuum chamber robots for semiconductor manufacturing equipment, power substations and other products, and electrical engineering work
General machinery	Semiconductor manufacturing equipment, industrial robots, clean room robots for conveying liquid crystal panels, valve control devices, conveyors, wind- and hydro-power equipment, air conditioners and kitchen equipment, various inspection devices, medical equipment, and other products
Electronics	Power supplies, connectors, semiconductors, sensors, miniature fans, LEDs, LCDs, personal computers for industrial use, circuit boards for central processing units, memory modules, and other products

Source: Prepared by FISCO from Company materials

We can use LCDs as a way of explaining the relationship among the three divisions. LCD plants are equipped with a variety of manufacturing systems. The general machinery division handles these systems (such as glass transport robots). Meanwhile, the electrical machinery division sells motors that are parts for these systems to the manufacturer of the glass transport robots. The electronics business subsequently sells compact LCD panels produced by the LCD plant to mobile phone manufacturers. In this business model, Sun-Wa Technos handles all distribution channels from upstream (production equipment parts/materials) to downstream (final products) for the category of LCD panels due to its coverage of the three fields.

General machinery and electronic machinery divisions both rely on capital investments by corporate customers as the demand driver. Trends affecting demand for electronics division products are corporate production activities and consumer spending.

Customers and demand drivers for the business divisions

	Products handled	Source of demand	Drivers of demand, macroeconomic indicators
Electrical machinery	Electrical components for customers' products	Plants of customer companies	Capital investment by manufacturers, machinery orders, and other measures of industrial expansion
General machinery	Production lines of customer companies		
Electronics	Components produced by customer companies	Manufacture of final products	Consumer spending, industrial production index, etc.

Source: Prepared by FISCO from Company materials

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Sun-Wa Technos is taking steps to strengthen engineering divisions. This reflects a sales method of proposing system solutions involving products from the three business divisions (electric machinery, electronics, and general machinery), rather than as standalone items. The Company's reinforcement and implementation of engineering business directly overlaps with the growth strategy. We provide a detailed review in the growth strategy section.

Results trends

Upbeat sales expansion in 2H of FY3/17, posting healthy results above initial guidance

1. FY3/17 results

For FY3/17, Sun-Wa Technos reported net sales at ¥116,611mn (+10.3% YoY), operating income at ¥3,014mn (+23.3%), ordinary income at ¥3,215mn (+21.6%), and net income attributable to owners of the parent at ¥1,584mn (-6.3%). Net sales reached an all-time high. While the Company lowered 1H and FY3/17 guidance at the Q1 results announcement, it ended up beating the reduced targets by 5.1% for net sales and 34.0% for operating income and also exceeded period-start guidance, resulting in an upbeat outcome.

Net income attributable to owners of the parent dropped YoY and missed existing guidance due to booking a ¥660mn extraordinary loss for an impairment loss on land and a building it owns in Ota Ward, Tokyo.

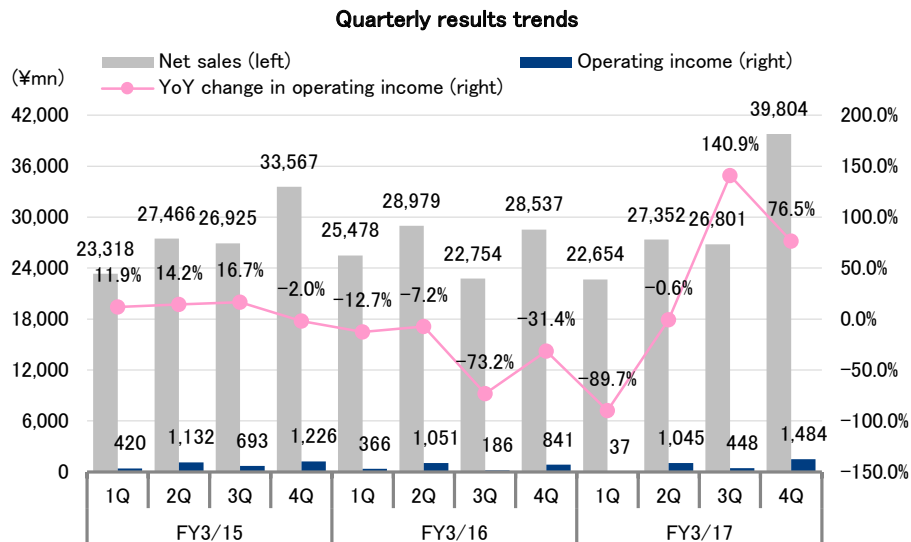
FY3/17 results

	FY3/16 Results		FY3/17 Results			
	Results	Initial forecasts	Revised forecasts	Results	Growth rate (YoY)	Growth rate versus revised forecasts
Net sales	105,748	114,500	111,000	116,611	10.3%	5.1%
Operating income	2,444	2,500	2,250	3,014	23.3%	34.0%
Operating income margin	2.3%	2.2%	2.0%	2.6%	-	-
Ordinary income	2,645	2,700	2,450	3,215	21.6%	31.2%
Net income attributable to owners of the parent	1,690	1,800	1,650	1,584	-6.3%	-4.0%

Source: Prepared by FISCO from Company materials

Sun-Wa Technos released revised forecasts on April 25, 2017, and its FY3/17 results were on track with these figures. The direct reason for healthier results than anticipated in FY3/17 was demand not dropping in Q3-Q4 thanks to improved demand from the smartphone industry in China and robust capital investment demand in semiconductor and display industries. Demand was also upbeat in India and other emerging markets. Sun-Wa Technos, a leading sales distributor, benefited from an environment that generally lifted Japanese FA-related manufacturers.

This difference is obvious in a graph of the results trend on a quarterly basis. In Q1, results started at a sluggish level because business followed the trend from 2H FY3/16 where there had been the impact of the yen's appreciation and slowdown in emerging economies, including China. The Company reduced guidance due to these conditions. In Q2, meanwhile, capital investments in China by smartphone manufacturers and activity in the semiconductor industry suddenly picked up. Sustainability was a concern, but momentum did not falter even in Q3-4 and this resulted in upbeat FY3/17 results.



Source: Prepared by FISCO from Company materials

Sales increased by about the same amount in electrical machinery, electronics, and general machinery divisions; higher sales and profit gains in primary market Japan

2. Divisional and regional trends

Increased investment in flat panel display (FPD) lines and related upturn in electrical machinery sales fueled growth in the electrical machinery division. Additionally, the Company expanded sales to semiconductor and industrial machinery industries. Segment sales hence grew 8.7% YoY to ¥20,736mn, even with decline in sales of control equipment for solar power systems just as in the previous fiscal year.

Similar to electrical machinery, the Company's electronics division posted higher sales of electronic parts for FA equipment to industrial machinery and FPD industries. Stronger sales of electronics parts to the automotive industry was a notable trend in FY3/17 too. Sun-Wa Technos launched its automotive sales department, which caters to the automotive industry, in April 2015. Sales grew in line with expectations in the first fiscal year. Electronics segment sales were up 10.6% YoY to ¥85,819mn due to these trends.

In general machinery division, Sun-Wa Technos posted higher sales of production facilities to the industrial machinery industry and equipment to the FPD industry, but its sales to the home equipment industry weakened. Segment sales expanded 10.7% YoY to ¥10,055mn.

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Net sales trend by business division

(¥mn)

	FY3/16					FY3/17				
	1Q	2Q	3Q	4Q	Full year	1Q	2Q	3Q	4Q	Full year
Electrical machinery	4,664	5,443	3,880	5,080	19,069	3,857	5,258	4,575	7,046	20,736
YOY	8.6%	-9.9%	-25.3%	-28.8%	-15.8%	-17.3%	-3.4%	17.9%	38.7%	8.7%
Electronics	19,609	20,859	16,937	20,186	77,593	17,128	19,576	20,351	28,764	85,819
YOY	13.8%	8.6%	-16.7%	-14.8%	-3.6%	-12.7%	-6.2%	20.1%	42.5%	10.6%
General machinery	1,204	2,676	1,935	3,269	9,084	1,667	2,518	1,875	3,994	10,055
YOY	-32.6%	20.8%	38.8%	19.1%	11.6%	38.5%	-5.9%	-3.1%	22.2%	10.7%
Total net sales	25,478	28,979	22,754	28,537	105,748	22,654	27,352	26,801	39,804	116,611
YOY	9.3%	5.5%	-15.5%	-15.0%	-5.0%	-11.1%	-5.6%	17.8%	39.5%	10.3%

Source: Prepared by FISCO from Company materials

In Japan, the primary market, Sun-Wa Technos recorded a 15.3% YoY gain to ¥92,213mn in net sales, despite decline in control equipment for solar power systems, thanks to increased sales of electronic parts to the automotive industry, electrical machinery to the FPD industry, electronic components to the FA equipment industry, electrical machinery, electronic parts, and production facilities to the industrial machinery industry, and electrical machinery to the semiconductor industry. Operating income rose sharply by 37.1% to ¥2,165mn. We think it is worth noticing that Q4 sales climbed by a robust 32.6% YoY to ¥29,183mn.

In Asia, sales slipped 0.7% to ¥29,896mn and operating income was down 4.3% to ¥816mn, even though sales improved for electronic parts used in electric equipment and electrical machinery for the industrial machinery industry, because of diminished sales of electronic parts to the amusement industry. Looking at 2H, however, this region substantially advanced with sales rising 31.2% YoY to ¥18,053mn and operating income climbing 44.3% to ¥508mn.

In the US and Europe, sales expanded 71.6% YoY to ¥6,323mn owing to gains in electronic parts for the amusement industry, production equipment for the industrial machinery industry, and electrical machinery for the FPD industry. Operating income, though low, steadily increased to ¥14mn (+375.5%).

Results trends by geographical market

(¥mn)

	FY3/16					FY3/17					
	1Q	2Q	3Q	4Q	Full year	1Q	2Q	3Q	4Q	Full year	
Net sales	18,570	21,523	17,896	22,005	79,995	17,931	23,136	21,962	29,183	92,213	
YOY	1.7%	0.8%	-5.5%	-5.1%	-2.1%	-3.4%	7.5%	22.7%	32.6%	15.3%	
Japan	Operating income	93	832	34	620	1,580	-85	837	260	1,154	2,165
	YOY	-54.6%	8.2%	-91.0%	-19.9%	-25.8%	-	0.6%	664.7%	86.1%	37.1%
	Operating income margin	0.5%	3.9%	0.2%	2.8%	2.0%	-0.5%	3.6%	1.2%	4.0%	2.3%
Asia	Net sales	7,816	8,520	6,384	7,376	30,097	5,774	6,068	6,647	11,406	29,896
	YOY	32.7%	21.3%	-27.8%	-34.5%	-8.8%	-26.1%	-28.8%	4.1%	54.6%	-0.7%
	Operating income	257	242	142	210	853	141	167	202	306	816
	YOY	16.3%	-26.8%	-48.9%	-51.0%	-32.3%	-45.1%	-31.2%	42.3%	45.7%	-4.3%
	Operating income margin	3.3%	2.8%	2.2%	2.8%	2.8%	2.4%	2.8%	3.0%	2.7%	2.7%
US and Europe	Net sales	837	888	722	1,236	3,685	1,044	847	1,171	3,260	6,323
	YOY	8.7%	26.0%	-3.7%	2.6%	7.4%	24.7%	-4.6%	62.2%	163.8%	71.6%
	Operating income	22	-14	-7	2	2	-14	31	1	-3	14
	YOY	37.5%	-	-	-94.3%	-96.6%	-	-	-	-	375.5%
	Operating income margin	2.6%	-1.6%	-1.0%	0.2%	0.1%	-1.3%	3.7%	0.1%	-0.1%	0.2%

Source: Prepared by FISCO from Company materials

■ Medium-term growth strategy

Steady implementation of the Challenge 1500 medium-term plan is the growth strategy; promoting three business strategies

1. Overview of the medium-term management plan

Sun-Wa Technos is currently implementing the Challenge 1500 three-year medium-term management plan that covers FY3/17-19. The plan's content continues and builds upon the previous JUMP 1200 medium-term plan that ended in FY3/16. The Company views the medium-term plan as a stage for healthy income expansion aimed at ¥150bn in net sales utilizing the organization and operations created during the previous plan. Steady implementation of the medium-term plan and realization of its goals is the growth strategy.

Looking at first-year FY3/17 results in the context of Challenge 1500 goals, the first half of the year had a slow start as explained above, but demand expanded sharply in the second half. While net sales missed the plan target, earnings surpassed their goal to create an upbeat start for the first fiscal year. Sun-Wa Technos sets business goals of ¥137,000mn in net sales, ¥4,300mn in operating income, and 3.1% operating margin for FY3/19, the final year. These are not easy levels given the rapid pace of changes in the external environment.

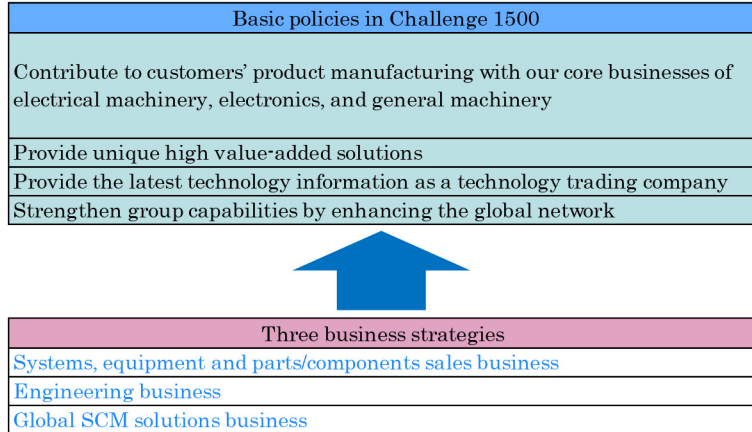
Business goals of Challenge 1500

	Challenge 1500 medium-term management plan				
	FY3/17		FY3/18		FY3/19
	Business goals	Results	Business goals	Forecasts	Business goals
Net sales	117,000	116,611	126,000	126,000	137,000
Operating income	2,800	3,014	3,500	3,200	4,300
Operating income margin	2.4%	2.6%	2.8%	2.5%	3.1%
Ordinary income	3,000	3,215	3,700	3,450	4,500
Ordinary income margin	2.6%	2.8%	2.9%	2.7%	3.3%
Forex assumption (JPY/USD)	117	116.5	117	110	117

Source: Prepared by FISCO from Company materials

The Company is pursuing three business strategies aimed at achievement of medium-term plan goals - "systems, equipment, and parts/components sales business," "engineering business," and "global SCM solutions business." As explained in our previous report, we are primarily interested in the engineering business and the global SCM solutions business. Reinforcement of "systems, equipment, and parts/components sales business" overlaps with bolstering sales in the three existing business divisions, and we think efforts to strengthen the engineering business should naturally results in bolstering and attaining this strategy.

Four basic policies and three business strategies in Challenge 1500



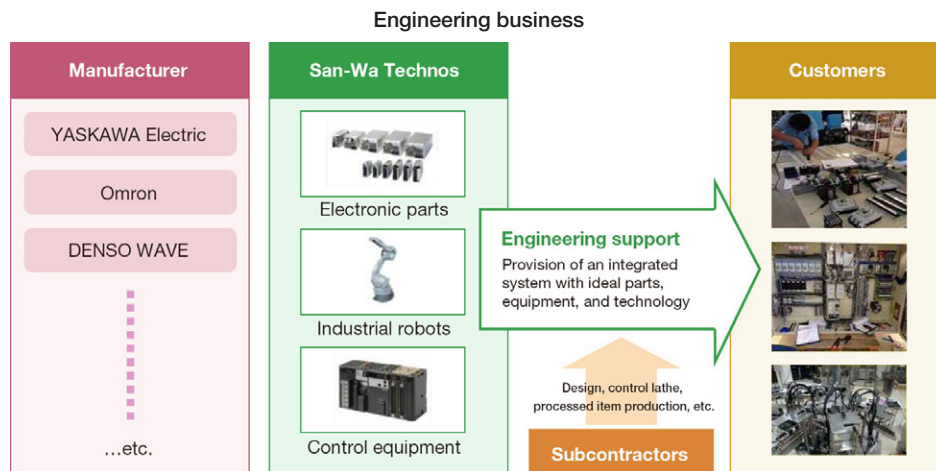
Source: Prepared by FISCO from Company materials

Engineering business growing at a healthy pace; opportunities from new distribution channels of direct transactions with end users

2. Engineering business overview and progress

(1) Business overview

Engineering business at Sun-Wa Technos is a sales approach for “proposing products from the three business divisions of electrical machinery, electronics, and general machinery as system solutions, rather than standalone items.” We can use the example of a food supermarket to help explain the positioning of engineering business. Up to now, the company had been selling ingredients, such as meat, fish, and vegetables, to customers. Engineering business, meanwhile, involves preparing these individual ingredients for delivery to customers. The extent of processing can vary from selling a prepared item to a meal box. The Company does not book sales as the engineering business and related income is allocated to the electrical machinery, electronics, and general machinery divisions.



Source: From the website

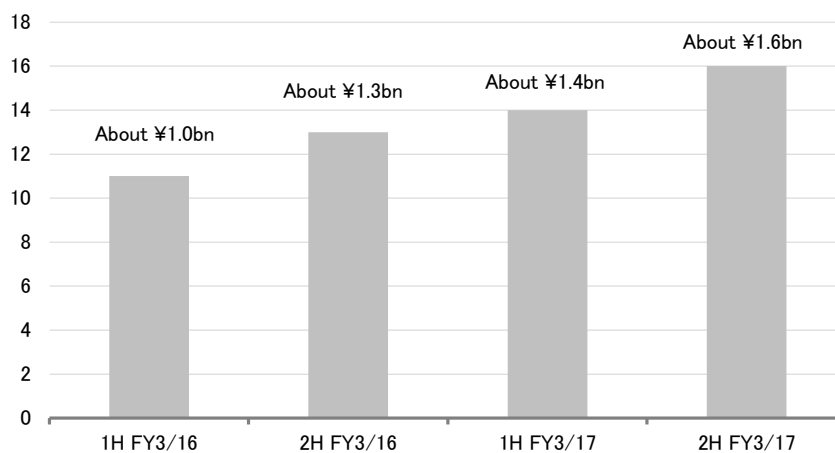
Sun-Wa Technos has consistently sought to strengthen engineering business since the previous medium-term plan (JUMP 1200) period. This is because it corresponds to activities that procurement sources and sales counterparts want to “unload to realize smooth operations.” Engineering absorbs these outsourcing needs. Sun-Wa Technos seeks to expand sales of various items as part of the engineering activities. From an earnings perspective, it can pursue higher profitability than is possible in sales agent business as a trading company with margin from the added value of supplying “solutions.” Sun-Wa Technos hence has steadily grown the engineering business given its excellent match with its determination to meet customer needs and raise profitability.

(2) Update on progress

Sun-Wa Technos has been making necessary investments to accelerate the engineering business. Using the example cited above, it has been expanding capabilities, including external hires of human resources to handle the role of processing ingredients into prepared items and meals. It restructured in April 2015, establishing the factory automation sales headquarters (now, the FA system sales department), the industrial solutions headquarters (industrial solutions department), and engineering department and accelerating proposals and sales that cut through the three product types.

Engineering business is expanding at a healthy pace thanks to success with these measures. It is difficult to numerically express these results because engineering business is a sales approach and its revenue is allocated to the three business divisions. We have utilized a curry-dish analogy to explain the relationship. Products from the three business divisions represent the meat and vegetables, and the engineering business prepares and sells the curry. System integration (SI) corresponds to the sauce. Sun-Wa Technos handles some SI activities internally, but outsources a substantial portion that shows up in SI procurement value. This amount expanded from about ¥1.4bn in 1H FY3/17 to roughly ¥1.6bn in 2H.

SI procurement results



Source: Prepared by FISCO from Company materials

Engineering business sales (curry sales using the example explained above) are not disclosed, but we estimate the value at ¥5-7bn. Sun-Wa Technos is currently targeting ¥10bn in engineering business as a near-term goal, and our estimate takes into account the Company’s stance that it has established an outlook for realizing the goal during the current medium-term plan period.

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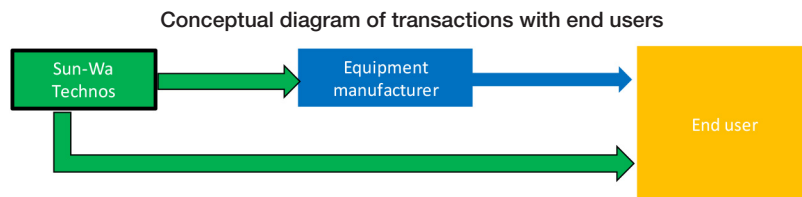
(3) New distribution channels in the engineering business: End user transactions

An important trend emerged in FY3/17. The Company’s engineering business had previously catered to equipment manufacturers as the direct counterpart. Equipment manufacturers delivered the output to end-user corporate plants as production equipment.

In FY3/17, however, Sun-Wa Technos successfully delivered automated systems to an end user as the direct counterpart. This was obviously possible because of the Company’s technology and solution capabilities, but also enabled by the presence of an expert on plant production lines at the end user. Sun-Wa Technos needs a contact point for discussions with its sales team. The end user in this case had a contact.

It appears that companies in the end-user position are moving forward with enhancement of production line engineers more than generally thought. We attribute this trend to efforts to curtail capital investments in production lines and growing needs to prevent outflow of production knowhow. Also helping is the growing mobility of human resources in Japan’s industrial community as a whole, which makes it easier to recruit personnel with advanced knowhow related to building production lines.

As seen in this case, recent end-user activity corresponds to expansion of contact points at customers and offers a clear tailwind. We think working directly with end users creates potential for repeat orders as well. While potential varies by industry and customer size, success in the first project raises expectations for repeat orders by delivering similar equipment to the subject customer’s other production lines and plants. We will be closely monitoring progress in this area.



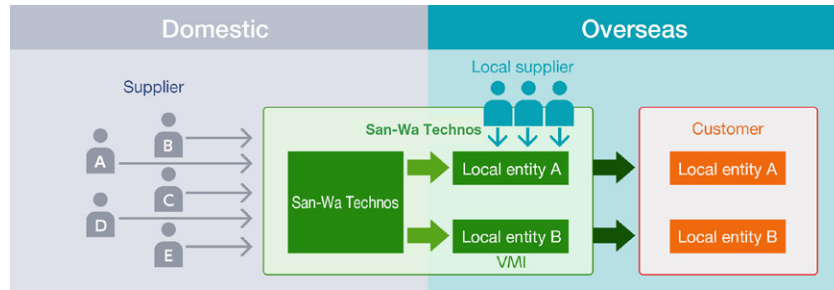
Source: Prepared by FISCO from Company materials

Contributing to reduction of customer global procurement costs, transaction value is steadily growing

3. Global SCM solutions business overview and progress

Sun-Wa Technos officially started the global SCM solutions business from the current medium-term management plan after preparation during the JUMP 1200 plan period. This business aims to utilize logistics warehouses held by the Company’s 13 overseas local entities (with 25 sites) and their respective knowhow regarding warehousing and logistics to generate income by providing paid services to customers and also expand business opportunities. We think the global SCM solutions business can be implemented in a variety of ways. One example is described here. The Company delivers other items required by the customer at the same time, regardless of whether they are the Company’s catalog products or not, in addition to the ordered product when delivering products based on an order from the customer. It intends to operate this service as an income-earning business, obtaining margin on each of the products.

Conceptual image of global SCM solutions business



Source: From the website

This business is steadily growing with sales reaching the ¥4bn level in FY3/17. Transaction value has grown thanks to making its presence known primarily to major customers, such as YASKAWA Electric and Omron Corporation <6645>. Sun-Wa Technos hopes to expand global SCM solutions business sales to ¥6.5bn in FY3/18, ¥7.7bn in FY3/19, and over ¥10bn in FY3/20.

We think global SCM solutions business fundamentally accommodates customer outsourcing needs, similar to the engineering business, and expect healthy expansion to continue. The main issue is securing profits. This business is primarily a procurement agent service and unlikely to generate profits if it just remains as a “service.” It can only become a genuine income earner when Sun-Wa Technos can provide a “solution” with unique added value. We will be closely monitoring this trend.

Organizational enhancements and work style reforms are also important parts of the growth strategy

4. Organizational enhancements and work style reforms

Sun-Wa Technos is also bolstering organizational capabilities with the aim of broader business scope and enhanced customer support and continuing its efforts to effectively utilize employees and conduct work style reforms. It believes that these modest efforts are also important parts of the growth strategy in terms that drive stronger results through improved employee motivation.

Recent initiatives were upgrades of the Nagoya Branch to the Nagoya Office and the Yokohama sales site to the Yokohama Branch in April 2017. The Nagoya upgrade takes into account substantial growth in recent transaction value and expectations for further growth in automotive industry business. The Yokohama upgrade, meanwhile, reflects broadened business scope from a sales site under the electronics sales division to a branch that handles the three core divisions. This move aims to enhance regional contacts. Both of these changes suggest that Sun-Wa Technos is expanding business at a healthy pace.

In work style reforms, replacement of the former New Life Promotion Office with the Eco New Life Support Department deserves notice. Sun-Wa Technos started the New Life initiative in April 2015 to contribute to realization of a “society in which women shine.” It aims to create opportunities for women to flourish at the company and also achieve work-life balance. This led to format of a team of women selling LED lights, AEDs (automated external defibrillators), and other products and formation of the New Life Promotion Office, as sales team led by women, in April 2016. The Eco New Life Support Department seeks expand to this initiative to the entire company. We will be monitoring its activity from a long-term perspective, just as before.

Business outlook

Sales and profits likely to expand during FY3/18 in line with the initial medium-term plan; upside opportunity too barring unforeseen situations

The Company forecasts ¥126,000mn in net sales (up 8.1% YoY), ¥3,200mn in operating income (up 6.2%), ¥3,450mn in ordinary income (up 7.3%), and ¥2,150mn in net income attributable to owners of the parent (up 35.7%) in FY3/18, projecting higher sales and profits.

Net sales forecast are on par with initial targets from the Challenge 1500 medium-term management plan. While operating income and following values are modestly lower than initial levels, we think they are roughly in line with the initial plan on a real basis considering forex rate differences (the medium-term plan uses ¥117/\$ versus the FY3/18 outlook's ¥110).

Overview of FY3/18 forecasts

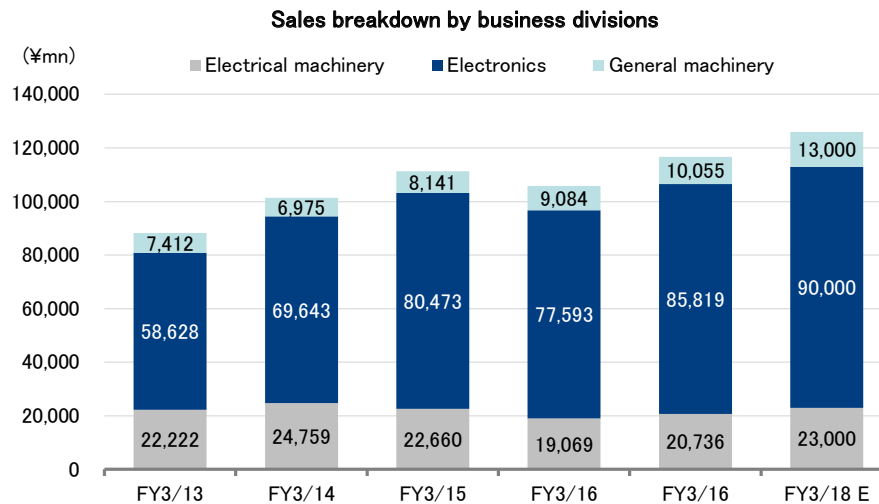
	FY3/17		FY3/18				
	Full year		1H		Full year		Initial medium-term plan
	Results	Forecasts	Forecasts	Growth rate (YoY)	Forecasts	Growth rate (YoY)	
Net sales	116,611	61,500	23.0%		126,000	8.1%	126,000
Operating income	3,014	1,550	43.2%		3,200	6.2%	3,500
Operating income margin	2.6%	2.5%	-		2.5%	-	2.8
Ordinary income	3,215	1,700	54.1%		3,450	7.3%	3,700
Net income attributable to owners of the parent	1,584	1,050	37.4%		2,150	35.7%	-

Source: Prepared by FISCO from Company materials

Business conditions in FY3/18 are likely to continue trends from 2H FY3/17 with ongoing strong smartphone output and vibrant FPD and semiconductor investments in China and robust activity at domestic FA-related manufacturers. Sun-Wa Technos should be delivering electrical machinery, electronic parts, and production equipment to these industries.

We expect continued healthy trends in electrical machinery for industrial machinery, FPD, and semiconductor industries and electronic parts for FA equipment given the environment described above. Furthermore, demand is rising for products handled by Sun-Wa Technos related to ADAS (advanced driver assistance system), as a separate trend from automobile output, in the auto industry. This business is likely to grow in FY3/18 as well.

Sun-Wa Technos guides for higher sales in all three business divisions in FY3/18 due to these favorable conditions. Specifically, it expects electrical machinery at ¥23,000mn (+10.9%), electronics at ¥90,000mn (+4.9%), and general machinery at ¥13,000mn (+29.3%). By region, the plan projects Japan at ¥100,000mn (+8.4%), Asia at ¥32,800mn (+9.7%), and the US and Europe at ¥7,600mn (+20.2%). (Regional sales values include internal sales.)



Source: Prepared by FISCO from Company materials

The 1H FY3/18 outlook calls for very strong YoY growth rates, but this can be explained by weak levels from the previous year. Sun-Wa Technos does not see much risk of missing 1H targets based on current orders and inquiries. For 2H, however, it is cautious because sudden forex rate changes, high geopolitical risks, and other risk factors cannot be ruled out. Yet it explained that real business is not facing conditions or signs of steep decline in demand. We think FY3/18 earnings might overshoot unless unexpected risks materialize.

Attention should remain on progress in engineering business and global SMC solutions business, which are core components of the medium-term plan, again in FY3/18. The engineering business, as explained in the growth strategy section, has been receiving direct engineering requests from end users since FY3/17. We will be closely monitoring this situation because of large potential for Sun-Wa Technos if it becomes a major distribution channels.

Summary income statement

	FY3/15	FY3/16	FY3/17	FY3/18	
				1H E	Full year E
Net sales	111,276	105,748	116,611	61,500	126,000
YoY	9.8%	-5.0%	10.3%	23.0%	8.1%
Gross profit	13,988	13,256	14,255	-	-
Gross profit margin	12.6%	12.5%	12.2%	-	-
SG&A expenses	10,516	10,812	11,240	-	-
YoY	11.1%	2.8%	4.0%	-	-
Ratio of SG&A expenses to sales	9.5%	10.2%	9.6%	-	-
Operating income	3,471	2,444	3,014	1,550	3,200
YoY	8.1%	-29.6%	23.3%	43.2%	6.2%
Operating income margin	3.1%	2.3%	2.6%	2.5%	2.5%
Ordinary income	3,761	2,645	3,215	1,700	3,450
YoY	9.4%	-29.7%	21.6%	54.1%	7.3%
Net income attributable to owners of the parent	2,466	1,690	1,584	1,050	2,150
YoY	13.7%	-31.5%	-6.3%	37.4%	35.7%
EPS (¥)	171.83	117.76	113.64	75.77	155.14
Dividend (¥)	26.00	28.00	28.00	14.00	28.00

Source: Prepared by FISCO from Company materials

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Summary balance sheet

	(¥mn)				
	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Current assets	39,758	45,329	49,239	46,857	55,507
Cash and deposits	7,433	6,937	7,584	6,359	6,759
Notes and accounts receivable	27,866	33,075	34,419	33,006	34,141
Non-current assets	7,497	8,369	9,509	8,581	9,309
Tangible fixed assets	4,074	4,038	3,879	3,788	3,056
Intangible fixed assets	42	76	243	240	222
Investments and other assets	3,381	4,254	5,386	4,553	6,030
Total assets	47,256	53,698	58,748	55,439	64,816
Current liabilities	28,648	30,735	32,370	28,691	36,596
Notes and accounts payable - trade	24,784	25,917	27,496	24,732	31,182
Short-term loans payable, etc.	2,250	2,528	2,782	2,317	2,489
Non-current liabilities	4,258	4,309	4,426	4,484	4,581
Long-term loans payable	2,486	2,205	2,100	2,400	2,300
Shareholders' equity	13,660	16,807	18,929	20,217	21,034
Capital stock	1,935	2,553	2,553	2,553	2,553
Capital surplus	1,341	1,958	1,958	1,958	1,958
Retained earnings	10,437	12,350	14,472	15,761	16,950
Treasury shares	-53	-53	-54	-54	-427
Accumulated other comprehensive income	646	1,847	3,022	2,045	2,603
Non-controlling interests	41	-	-	-	-
Total net assets	14,349	18,654	21,951	22,263	23,637
Total liabilities and net assets	47,256	53,698	58,748	55,439	64,816

Source: Prepared by FISCO from Company materials

Cash flow statement

	(¥mn)				
	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Cash flow from operating activities	3,652	-1,374	1,353	-60	1,679
Cash flow from investing activities	-110	-127	-444	-384	-235
Cash flow from financial activities	-415	769	-470	-654	-818
Cash and cash equivalent conversion difference	135	236	209	-125	-224
Cash and cash equivalent change	3,262	-496	647	-1,225	400
Cash and cash equivalent period-start balance -	3,687	6,949	6,453	7,100	5,875
Cash and cash equivalent period-end balance -	6,949	6,453	7,100	5,875	6,275

Source: Prepared by FISCO from Company materials

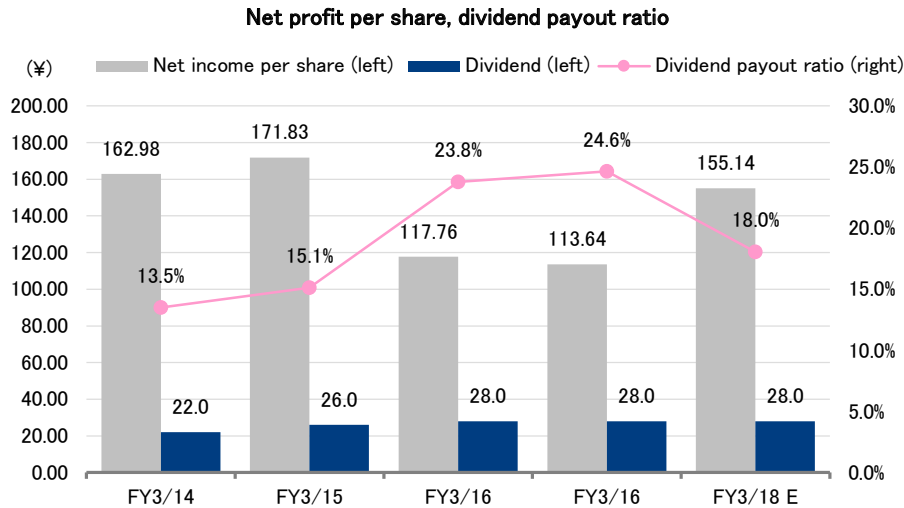
Shareholder return policy

Emphasizes a stable dividend with a track record of dividend hikes linked to profit growth

The Company’s basic policy is to provide returns to shareholders in the form of dividends. Management prioritizes providing stable, continuous dividends, as demonstrated in its track record to date. While remaining very aware of the need for stable dividends, the Company has also increased them in keeping with earnings growth.

Sun-Wa Technos paid a ¥28 dividend (¥14 at the interim, ¥14 at year-end), which was unchanged YoY, as expected. This put the dividend payout ratio at 24.6%. While FY3/17 results beat not only lowered targets, but also initial guidance, net income attributable to owners of the parent declined YoY due to booking an extraordinary loss. We think the ¥28 dividend, which was flat YoY, makes sense within this context.

The FY3/18 guidance calls for the dividend at ¥28 again (¥14 in the interim, ¥14 at period-end). At this level, dividend payout ratio works out to 18.0% of the projected ¥155.14 in net profit per share. Sun-Wa Technos is taking a cautious stance because of lingering uncertainty about 2H, as explained above. This is evident in the dividend target as well. We believe the Company might change its stance on the dividend too if its confidence in reaching guidance improves.



Source: Prepared by FISCO from Company materials



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