COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

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Summary

Is aiming to speed-up the major strategies set out in the medium-term management plan and to grow earnings from FY3/22 onwards

SUN-WA TECHNOS CORPORATION <8137> (hereinafter, "the Company") is an independent trading company that specializes in technology products. Approximately 40% of its sales are to the factory automation and industrial equipment industries, which are its mainstay fields. The Company has steadily expanded its businesses by leveraging coverage of three major areas (electrical machinery, electronics, and general machinery) and two-way trade in which it sells equipment and materials for manufacturers' production lines and then procures the products made by these manufacturers. In recent years, it has been focusing on the engineering business and global SCM solutions.

1. In the 1H FY3/21 results, secured profits on the same level as in the same period in the previous fiscal year through a recovery for the Chinese market and the effects of cost reductions

In the 1H FY3/21 (April to September 2020) consolidated results, net sales decreased 8.6% year-on-year (YoY) to ¥61,813mn and ordinary income declined 1.5% to ¥1,020mn. Due to the impact of the novel coronavirus pandemic, the severe market environment continued, including the freezing of capital investment by companies in the manufacturing industry. In this situation, the Company's sales fell in the automotive industry, mainly for on-board electronic equipment and electronic parts for the amusement industry, so net sales declined for the second consecutive year. However, orders recovered for the semiconductor and FPD industries and for the Chinese market, while in addition, the Company as a whole worked to keep down costs. As a result, it was able to secure results on the same level as in the same period in the previous fiscal year, on a profits basis. In particular, the recovery for China included a recovery of orders for the solar cell industry, and by region, its sales are quickly recovering.

2. The forecasts for FY3/21 are for single-digit declines in sales and profits

For the FY3/21 consolidated results, the Company is forecasting that net sales will decrease 5.8% YoY to ¥130,000mn and ordinary income will decline 2.1% to ¥2,100mn, and it has upwardly revised the ordinary income forecast from that previously announced in July 2020 (net sales of ¥130,000mn and ordinary income of ¥1,400mn). Current ordering conditions are improving, as in addition to the recovery for the semiconductor industry, orders in China are active for the automotive industry as well. In Japan as well, orders for electronic equipment have returned to the same level as in the same period in the previous fiscal year. In addition, sales of novel coronavirus-related products (including a spatial sterilizing and deodorizing device) are strong, and are expected to contribute tens of millions of yen over the full fiscal year. On the other hand, for costs, the Company intends to work to keep down costs in the 2H also and does not expect any particular increases. Therefore, as long as corporate activities do not once again cool down due to the novel coronavirus pandemic, we at FISCO think that it is possible that ordinary income will exceed its forecast.

3. Status of progress on NEXT1800, the medium-term management plan

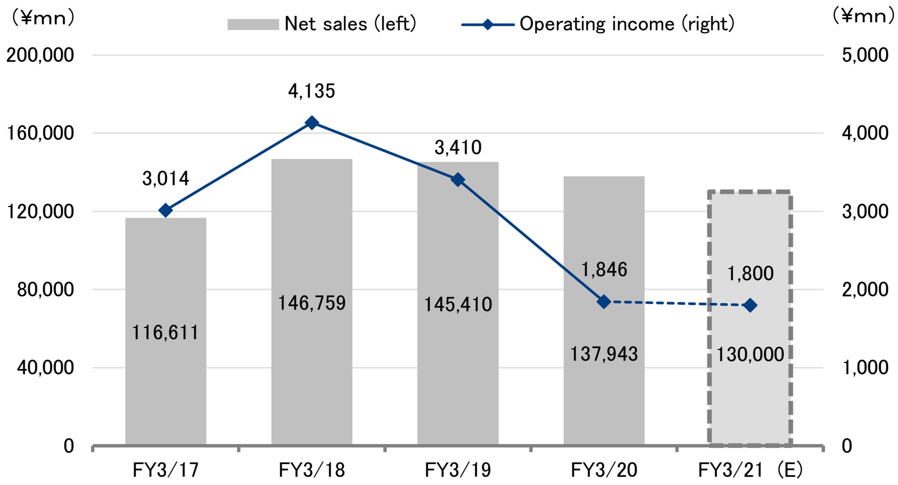
Looking at the status of progress of NEXT 1800, which is the three-year medium-term management plan started in FY3/20, we see that the numerical results are lagging behind the initial forecasts, mainly due to the deterioration of the market environment. Therefore, it seems that the FY3/22 numerical targets (net sales of ¥180bn and ordinary income of ¥5bn) will be revised in the future. However, there is a sense that progress is being made for the priority measures set out as the fundamental policies, and going forward, it is thought that growth will acquire momentum from FY3/22 onwards as the Company aims to further speed-up these measures. Among the priority measures, to strengthen the engineering business in order to improve profitability, it is aiming to further improve the profit margin by acquiring orders for large-scale projects, while to strengthen the global SCM solutions business in order to increase scale, it intends to acquire and to deepen transactions with new customers. Also, the micro sales office,* which was started on a trial basis in Japan from 2019 as a new measure, has been highly evaluated by customers and it has been confirmed that there are no problems with it in terms of profitability. Therefore, the Company plans to actively open these offices in the future. In FY3/21, two new offices will be newly established in Nagaoka and Kofu, and one in Kanazawa (currently under consideration). Going forward as well, it intends to establish offices in areas where it has few sales staff, such as the Tohoku area. The Company has many excellent customers in small- and medium-sized regional cities, and will build strong relations with these customers by establishing sales offices nearby. Online sales consultations are becoming widespread due to the novel coronavirus pandemic, but in the B-to-B market to which the Company belongs, face-to-face sales remain important. Its strategy is to grow sales by training human resources while increasing the number of micro sales offices.

* A micro sales office refers to a sales office with a few sales staff supported by clerical-work staff in remote locations. In July 2019, the Company opened the Shikoku Sales Office (Ehime) on a trial basis.

Key Points

- In the 1H FY3/21 results, profits were secured at the same level as in the same period in the previous fiscal year, due to the recovery for the Chinese market and the effects of cost reductions
- Results for China were strong, while results recovered for the automotive (on-board products) industry in Japan as well, and there is room for the FY3/21 results to slightly exceed the forecasts on a profits basis
- Intends to deepen sales by establishing micro sales offices in small- and medium-sized regional cities and building “a new closeness” with excellent customers

Results trends



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

Results trends

In the 1H FY3/21 results, profits were secured at the same level as in the same period in the previous fiscal year, due to the recovery for the Chinese market and the effects of cost reductions

1. 1H FY3/21 results overview

In the 1H FY3/21 consolidated results, net sales decreased 8.6% YoY to ¥61,813mn, operating income declined 1.0% to ¥900mn, ordinary income fell 1.5% to ¥1,020mn, and net income attributable to owners of the parent increased 2.4% to ¥705mn. Economic activities were stagnant due to the impact of the novel coronavirus pandemic, and movements could be seen in the factory automation and industrial equipment market environments, which are the Company's mainstay markets, including movements in companies in the manufacturing industry to reduce operations at factories and to postpone capital investment. The Company's result can be highly evaluated because it exceeded its forecasts on a profits basis despite the severe environment.

1H FY3/21 results (consolidated)

(¥mn)

	1H FY3/20		1H FY3/21					
	Results	% of sales	Initial forecast	Revised forecast (July 2020)	Results	% of sales	YoY	vs. initial forecast
Net sales	67,608	-	70,000	62,000	61,813	-	-8.6%	-11.7%
Gross profit	6,984	10.3%	-	-	6,719	10.9%	-3.8%	-
SG&A expenses	6,075	9.0%	-	-	5,819	9.4%	-4.2%	-
Operating income	909	1.3%	750	500	900	1.5%	-1.0%	20.0%
Ordinary income	1,036	1.5%	800	650	1,020	1.7%	-1.5%	27.5%
Net income attributable to owners of the parent	689	1.0%	500	400	705	1.1%	2.4%	41.0%

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

Although orders recovered for the semiconductor and FPD industries and for the solar cell industry in China, and orders also increased for investment in plant automation using robots and for novel coronavirus-related products, sales fell for on-board electronic equipment and for electronic parts for the amusement industry in Japan and overseas, leading to a decrease in net sales. However, due to factors such as the changes to the sales composition ratio, including the decline in sales of on-board electronic equipment that have a relatively low profit margin, and the improved profitability of the engineering business, which is a field in which the Company is strengthening, the gross margin rose 0.6 of a percentage point (pp) YoY to 10.9%, while gross profit decreased by only 3.8%.

SG&A expenses decreased 4.2% YoY. Due to the impact of the novel coronavirus pandemic, the teleworking rate rose to around 80% in April and May, so transportation expenses, including overseas business trip expenses, declined. Advertising and publicity expenses also declined due to the cancellations of various exhibitions. In addition, the efforts in the Company as a whole to reduce costs were a main factor behind the decrease. In particular, for teleworking, as parts of its series of workstyles reforms that it has worked on for the last two years, the Company has completed investment in establishing a structure by, for instance, introducing online tools, so it was able to smoothly transition to teleworking, which lead to an improvement in work efficiency. Because the effects of these reductions in SG&A expenses absorbed the part that gross profit decreased, operating income was secured at the same level as in the same period in the previous fiscal year.

Looking at the factors that caused deviations from the initial Company forecasts, net sales were 11.7% below forecast, mainly because sales of on-board electronic equipment and sales for the amusement industry fell more than expected. However, operating income was 20% higher than forecast, due in part to the effects of the reductions in SG&A expenses and the improvements to work efficiency.

Looking at each region, China is recovering quickly, while by industry, sales to the semiconductor and FPD industries are increasing

2. Segment, industry and regional trends

The Company discloses net sales after breaking them down into the three business segments of electrical machinery, electronics, and general machinery, according to the products handled. In addition, the Company discloses net sales and operating income as segment information by region, and discloses the sales composition ratio by industry and trend fluctuations as reference information.

(1) Trends in net sales by business segments

Net sales by business segments

(¥mn)

	FY3/19				FY3/20				FY3/21	
	1H	YoY	2H	YoY	1H	YoY	2H	YoY	1H	YoY
Electrical machinery	13,332	7.6%	11,237	-24.0%	10,565	-20.8%	10,572	-5.9%	10,793	2.2%
Electronics	53,553	6.4%	55,817	-7.1%	52,470	-2.0%	53,930	-3.4%	46,249	-11.9%
General machinery	5,278	14.3%	6,192	36.5%	4,571	-13.4%	5,833	-5.8%	4,770	4.3%
Total	72,164	7.2%	73,246	-7.8%	67,608	-6.3%	70,335	-4.0%	61,813	-8.6%

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

The main products in the electrical machinery segment include servo motors, motion controllers, programmable controllers, inverters, and power conditioners. Although sales decreased for the environment / energy industry, sales of electrical machinery parts for the industrial machinery industry increased in Japan and in China, and for the information / communications industry in Japan. As a result, net sales increased for the first time in two fiscal periods, up 2.2% YoY to ¥10,793mn.

The main products in the electronics segment are wide ranging, including general electronics parts such as capacitors, connectors, relays and switches, as well as fan motors, stepping motors, LEDs, power supplies, and heat sinks. Due to the impact of the novel coronavirus pandemic, sales for the automotive (on-board products) industry in Japan fell greatly, while sales declined similarly significantly for the amusement industry in Japan and the United States. Therefore, net sales decreased 11.9% YoY to ¥46,249mn.

The main products in the general machinery segment include robots for Yaskawa Electric <6506>, as well as conveyors and reduction gears. Sales declined of equipment for the industrial machinery industry in Japan, but increased of equipment for the FPD industry in Japan and Taiwan. Therefore, net sales increased for the first time in two fiscal periods, rising 4.3% YoY to ¥4,770mn.

(2) Trends in sales composition ratio by industry and sales increase/decrease

Table of sales composition ratio and increase/decrease by industry (non-consolidated)

Customers (industry)	1H FY3/19		1H FY3/20		1H FY3/21	
	% of sales	YoY	% of sales	YoY	% of sales	YoY
Factory automation/industrial equipment	41.5%	○	36.6%	×	38.2%	-
Automotive (on-board products)	16.7%	○	22.8%	○	20.4%	×
Semiconductors/LCDs	10.3%	○	9.3%	×	10.7%	○
Social infrastructure	3.6%	○	3.6%	×	3.6%	×
Information/communications	3.0%	×	2.4%	×	2.2%	×
Amusement	3.8%	○	3.7%	×	1.7%	×
Medical equipment	1.3%	○	1.7%	○	1.6%	×
Environment/energy	1.1%	×	1.5%	○	1.2%	×
Food	0.5%	○	0.1%	×	0.4%	○
Security	0.3%	○	0.2%	×	0.1%	×
Other	17.9%	○	18.1%	-	19.9%	-
Total	100.0%		100.0%		100.0%	

Note: ○ indicates an increase, × a decrease, and - unchanged.
Source: Prepared by FISCO from the Company’s results briefing materials

Looking at the top ranking of sales distribution by industry, the ratio for the mainstay factory automation and industrial equipment industry rose from 36.6% in the same period in the previous fiscal year to 38.2%, while net sales were basically unchanged YoY. The main factors were that in China, capital investment-related demand recovered quickly, and also in Japan, orders for robotization investment continued to be strong. Orders also continue to be strong for the semiconductor and FPD industries in Japan and China, increasing by a single-digit YoY. In addition, sales grew for the food industry.

Conversely, the sales composition ratio of the automotive (on-board products) industry decreased from 22.8% in the same period in the previous fiscal year to 20.4%, and net sales declined by nearly 20%, mainly because of production adjustments implemented by customers. However, the operating rate has been slowly rising since the 2Q, and as of October, it had recovered to the same level as in the same period in the previous fiscal year. While the amusement industry's sales composition ratio is low, it seems that its net sales declined by more than 50% YoY. Estimating from the sales composition ratios, it can be provisionally calculated that around half of the decrease in sales was for the automotive (on-board products) industry and approximately 20% for the amusement industry.

(3) Trends in net sales and profits by region

Net sales and operating income by region

(¥mn)

	FY3/19		FY3/20		FY3/21	
	1H	2H	1H	2H	1H	YoY
Net sales by segment						
Japan	57,653	58,340	53,889	56,446	49,445	-8.2%
Asia	18,646	18,542	16,243	18,211	16,788	3.4%
Europe/US	4,204	3,880	3,746	2,652	2,435	-35.0%
Other	791	942	899	497	480	-46.6%
Adjustment amount	-9,131	-8,458	-7,170	-7,471	-7,336	-
Total	72,164	73,246	67,608	70,335	61,813	-8.6%
Operating income by segment						
Japan	1,065	874	529	756	474	-10.5%
Asia	778	430	289	303	377	30.7%
Europe/US	275	-21	35	-119	17	-51.5%
Other	9	-6	21	-14	24	13.8%
Adjustment amount	0	4	33	13	6	-
Total	2,129	1,281	909	937	900	-1.0%

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

In Japan, net sales declined 8.2% YoY to ¥49,445mn and operating income decreased 10.5% to ¥474mn, so the declines in sales and profits continued. Sales increased of electrical machinery parts for the industrial machinery industry and the information / communications industry, and of equipment for the FPD industry and the industrial machinery industry. However, the main reasons for the declines in sales and profits were decreases in sales for electronic parts for the automotive (on-board products) industry and the amusement industry, and for production equipment for the industrial machinery industry.

In Asia, net sales increased 3.4% YoY to ¥16,788mn and operating income rose 30.7% to ¥377mn, making it the only region in which both sales and profits increased. Sales electronic parts for the industrial machinery industry and the amusement industry both decreased. However, sales increased of electrical machinery parts for the industrial machinery industry, of electronic parts for the industrial machinery industry and semiconductor industry, and of equipment for the FPD industry. Looking at each country, sales and profits increased for China, which provides 70% of the region's sales, due in part to an increase in orders for solar cell manufacturing equipment.

In Europe and the US, net sales decreased 35.0% YoY to ¥2,435mn and operating income declined 51.5% to ¥17mn. The US casino market was hit hard by the novel coronavirus pandemic, and sales of electronic parts for the amusement industry fell significantly.

Sales are strong for China, and are also recovering for the automotive (on-board products) industry in Japan, so there is room for the FY3/21 results to slightly exceed the forecasts on a profits basis

3. Outlook for FY3/21 results

For the FY3/21 results, the Company is forecasting that net sales will decrease 5.8% YoY to ¥130,000mn, operating income will decline 2.5% to ¥1,800mn, ordinary income will fall 2.1% to ¥2,100mn, and net income attributable to owners of the parent will increase 4.4% to ¥1,400mn, and it has upwardly revised the forecasts for each profit item from those announced in July 2020. As previously stated, the main factor behind this is the effect of SG&A expenses being reduced more than expected. There has been no change to a situation in which the future of the economy is unclear due to the impact of the novel coronavirus pandemic. But including because a medical system is now in place, it seems unlikely that we will return to the same situation as in April and May, when corporate activities were severely restricted.

FY3/21 consolidated results forecast

(¥mn)

	FY3/20		FY3/21					
	Results	% of sales	Previous forecasts (July 2020)	Revised forecasts (October 2020)	% of sales	YoY	Revision amount	2Q rate of progress
Net sales	137,943	100.0%	130,000	130,000	100.0%	-5.8%	-	47.5%
Operating income	1,846	1.3%	1,100	1,800	1.4%	-2.5%	700	50.0%
Ordinary income	2,144	1.6%	1,400	2,100	1.6%	-2.1%	700	48.6%
Net income attributable to owners of the parent	1,341	1.0%	900	1,400	1.1%	4.4%	500	50.4%

Source: prepared by FISCO from the Company's financial results and press releases

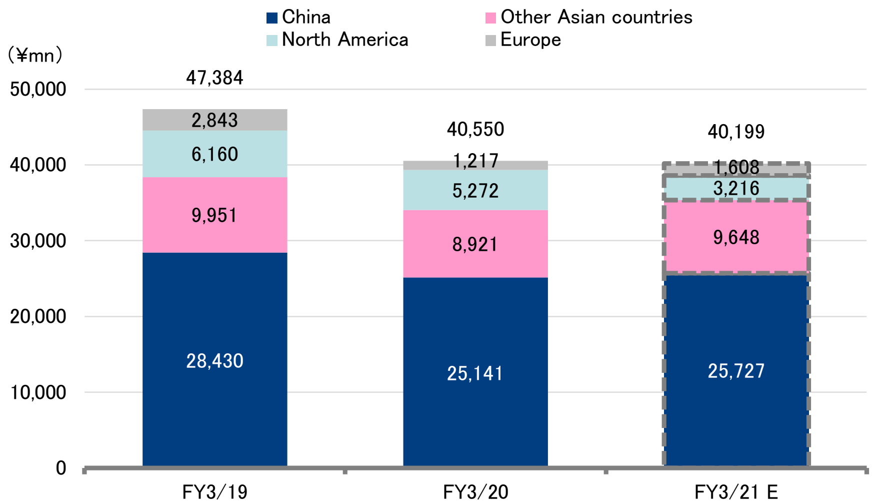
The expectations for the Company include that orders from the semiconductor industry will continue to recover, that capital investment will increase alongside the automation of factories in the factory automation and industrial equipment industry, that sales of on-board electronic equipment in Japan will recover in conjunction with the recovery of automotive production, and that orders of novel coronavirus-related products will increase. Therefore, the outlook is that sales in the 2H will increase by around 10% compared to in the 1H. By region, orders for China are continuing to trend upward. In addition, the measures in response to the novel coronavirus pandemic that were thoroughly implemented at the initial-outbreak stage seem to have been successful, and the economy has quickly returned to a recovery trend. Even within this situation, production has been recovering in the automotive industry since April and is trending favorably, increasing 14.1% YoY in September, so it would seem that capital-investment movement has also become more active.

Capital investment in the semiconductor industry is expected to increase by around 10% YoY in fiscal 2020, against the backdrop of the growth in demand for data centers and 5G, and the Company's orders are trending at about the same level. Orders for automotive (on-board products) recovered in September to the same level as in the same month in the previous year, and the outlook is that they will also be strong in the 2H. In novel coronavirus-related products, orders for Aeropure, which is a spatial sterilizing and deodorizing device, are strong to the extent that there are back orders for it, and it is expected to be a profit-increase factor worth tens of millions of yen over the full fiscal year.

While net sales in the 2H are expected to increase by around 10% compared to the 1H, the forecast is for operating income to be the same level as in the 1H. Normally, an increase in sales would result in an increase in operating income, but due to the uncertainty about the impact of the novel coronavirus pandemic, it seems that the Company has set conservative forecasts, on a profits basis. However, if net sales trend as forecast, at FISCO we think that it is highly likely that the results will exceed the forecasts on a profits basis, the same as for the 1H results. In terms of the outlook for SG&A expense in the 2H, the teleworking rate will be in the vicinity of around 20%, and sales visits to customers by the other parties are resuming. Therefore, transportation expenses are expected to increase slightly compared to in the 1H. But the Company has no plans for overseas business trips or to exhibit at exhibitions in the 2H (it will hold online seminars), and its policy is to continue with measures to reduce costs. Therefore, the forecast is that SG&A expenses will increase only slightly compared to in the 1H.

Assuming an exchange rate of ¥110 to US$1, overseas net sales will decrease 0.9% YoY to ¥40,199mn, and their sales composition ratio will be 30.9% (29.4% in the previous period). While sales will decrease for North America, they are expected to increase for China and other Asian countries. In other Asian countries, there are orders for large-scale projects in global SCM solutions, so sales are forecast to increase in the 2H. The impact of a strong yen on the full fiscal year results will be approximately ¥400mn for net sales and around ¥30mn for ordinary income, although the Company enters into exchange contracts to partially hedge the risk of this.

Overseas net sales (on a local-corporation basis)



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

Progress of the medium-term management plan

Is working to speed-up the fundamental policies in the NEXT 1800 medium-term management plan, aiming for growth from FY3/22 onwards

1. Medium-term management plan NEXT 1800

(1) Overview of the medium-term management plan

In May 2019, the Company announced NEXT 1800, its three-year medium-term management plan. The Company's medium- to long-term growth strategy is to use this three-year medium-term management plan as a signpost, and to position this as a period to build a management foundation that will allow the company to achieve sustainable growth over the medium- to long-term by steadily implementing the plan's priority measures.

In its long-term management vision "Sun-Wa Vision 2025," the Company calls for "strengthening core businesses to build operations that contribute to advances in industrial activity in local societies as a total coordinator of production sites and distribution and help in attaining the goal of ¥250bn in consolidated net sales in FY3/26." Similar to the Company's previous medium-term management plans, NEXT 1800 is positioned as a three-year action plan toward the realization of the corporate mission and Sun-Wa Vision 2025.

In NEXT 1800, the Company presents four items as fundamental policies, including "contribute to customer production activities by strengthening core businesses" and works on priority measures for each of the policies. We review the details of plan measures later in this report. In the core portion of income growth, the Company hopes to make improvements and achieve further advances versus Challenge 1500, the previous medium-term management plan, and realize a growth strategy with even higher certainty, while also carrying out initiatives for new business creation that lay the groundwork for growth over a longer term as a new initiative. Additionally, it places more emphasis on themes with strong social content, such as work style reforms that enhance productivity by utilizing ICT in a way that addresses changes in society, achievement of a corporate culture that stimulates interest in work, and working on contributions to SDGs (sustainable development goals), than previously.

Fundamental policies in NEXT 1800

Contribute to customer production activities by strengthening core businesses
★ Strengthen core businesses ★ Promote collaboration with business partners to bolster solution proposals
Expand global business capabilities to support market demand
★ Strengthen hiring of overseas local employees and organizational capabilities ★ Consider establishment of new locations
Pursue new business fields to accelerate sustainable growth
★ Strengthen investments in new business creation ★ Cultivate managerial personnel by adopting an intrapreneurship program ★ Create new value through SCM improvements
Initiatives to realize a sustainable society
★ Foster a corporate culture that stimulates interest in work by boosting employee engagement ★ Implement work style reforms that "enhance productivity" utilizing ICT ★ Conduct initiatives that contribute to SDGs ★ Fulfill corporate social responsibility (promote CSR and compliance)

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

(2) Numerical management targets in the NEXT 1800 plan

As the numerical management targets in the NEXT 1800 medium-term management plan, as suggested by the title of this plan, in FY3/22 the Company is aiming to achieve net sales of ¥180,000mn, operating income of ¥4,800mn, and ordinary income of ¥5,000mn. However, after setting the targets, the market environment has continued to be severe, due in part to the prolonging of the trade friction between the US and China and the deterioration of the global economy because of the novel coronavirus pandemic, so the FY3/21 results forecasts have been set lower than the initial target values (net sales of ¥165,000mn and operating income of ¥3,800mn). Therefore, it is anticipated that the Company will re-evaluate and review the FY3/22 numerical management targets in the future.

Medium-term management plan numerical targets

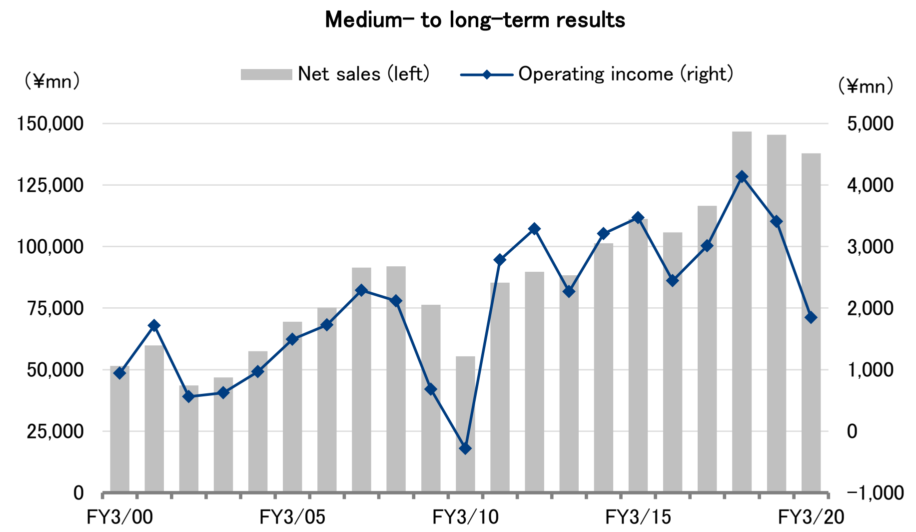
(¥mn)

	FY3/19 Results	FY3/20		FY3/21		FY3/22 Target
		Target	Results	Target	Forecast	
Net sales	145,410	150,000	137,943	165,000	130,000	180,000
Operating income	3,410	3,100	1,846	3,800	1,800	4,800
Ordinary income	3,627	3,300	2,144	4,000	2,100	5,000
Ordinary margin	2.5%	2.2%	1.6%	2.4%	1.6%	2.8%

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

However, the Company's awareness is that the direction of the four points set out as the fundamental policies is not incorrect, and it is thought that speeding-up efforts for these priority measures will lead to growth from FY3/22 onwards. In the post-coronavirus era, there is likely to be a recognition that investing in labor saving as a measure to prevent the infection spreading is an important management issue, while it is also possible that introductions of industrial robots in the manufacturing industry will accelerate more than in the past. In addition, in the case of a company introducing industrial robots, it will need to build systems suitable for each respective manufacturing line, which can be understood to be an opportunity for growth for the engineering business, as described below.

Although the market environment has temporarily deteriorated due to the novel coronavirus pandemic, it can be said that the possibility of seeing the changes as an opportunity and taking advantage of the opportunity to realize growth has increased. From a medium- to long-term perspective, capital investment is expanding alongside economic growth while tracking the positive and negative economic cycles. It seems that the Company's results over the years since FY3/22 have also trended similarly. In terms of the average annual growth rate over the 20 years from FY3/00 to FY3/20, net sales have grown at an average annual rate of 5.1%, while operating income has grown at an average annual rate of 3.4%. In the 18-year period up to FY3/18, which represents the most recent peak in results, net sales grew by an average of 6.0% per year, and operating income grew at an average of 8.6% per year. In order to achieve sales of ¥250bn, as targeted in the long-term vision for FY3/26, the pace of growth will have to become faster than before, but at FISCO we believe that if the priority measures in the medium-term management plan proceed smoothly, there is a good possibility that we may even surpass the average growth rate for the past twenty years.



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

Is aiming to increase the profitability of the engineering business and to expand the scale of the global SCM solutions business

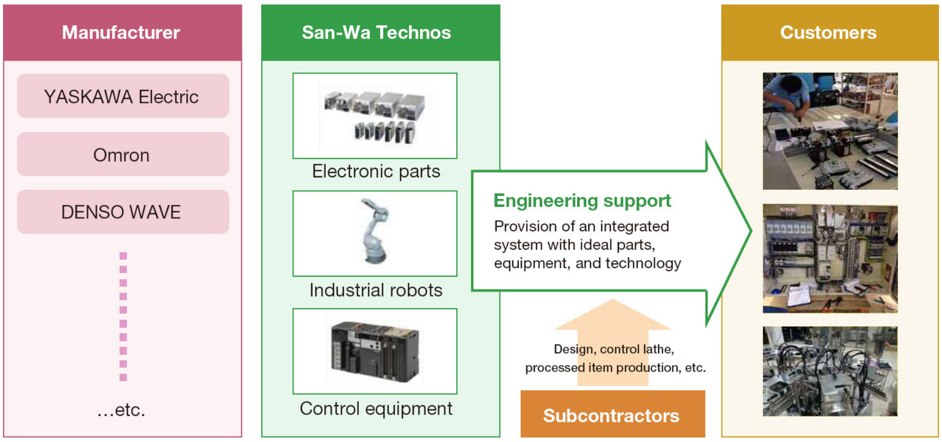
2. Progress for "contribute to customer production activities by strengthening core businesses"

Among the four fundamental policies set out in the medium-term management plan, the theme of "contribute to customer production activities by strengthening core businesses" is the most important within the Company's growth strategy. Within this fundamental policy, the Company is focusing especially on the engineering business and the global SCM solutions business. Both of these businesses still only have annual sales of roughly ¥10bn, but these are seen as important businesses for realizing sales growth and improved profitability going forward. The progress made on each business is described below.

(1) Engineering business

The engineering business sells to customers what the Company itself combines and systemizes from the products previously sold individually that are handled in each of the three respective business segments of electrical machinery, electronics, and general machinery. In other words, the engineering business is not some sort of separate, new business, but it is a sales method in the trading company function. The factors in the background to the Company focusing on this business are the progress made in improving the functions of automation equipment, such as industrial robots, and also in response to this, the diversifying needs of customers, and that in this situation, the Company cannot meet these needs simply by selling individual products as single items, and that it may be able to increase profitability by providing the added-value of engineering, as well as increasing the scale of individual orders. Therefore, it is possible that the scale of this business will grow at the same time as its profitability improves.

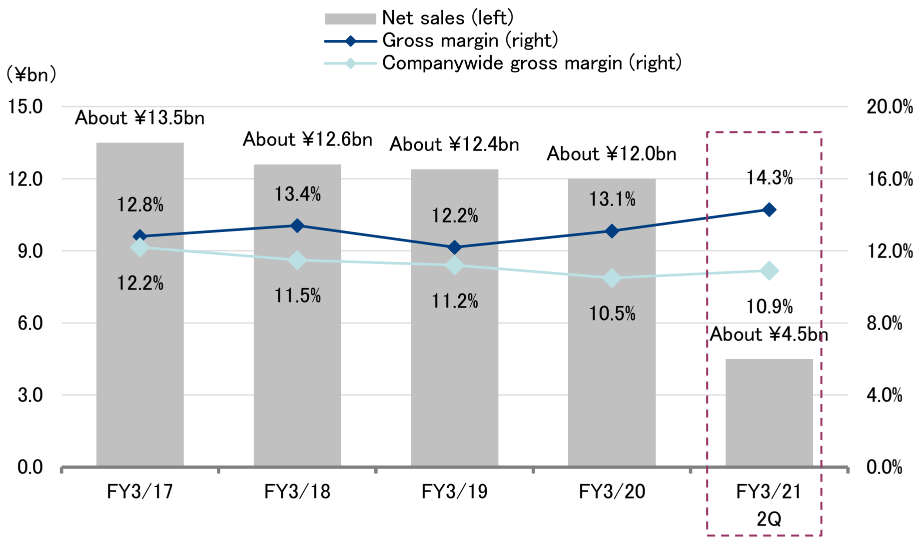
Overview of engineering business



Source: The Company's website

In the engineering business in 1H FY3/21, although net sales were ¥4.5bn, declining slightly YoY, the gross margin rose from 13.1% in the previous fiscal period to 14.3%. In order-related results, there were orders for conveyors for the FPD industry and for assembly robots for the industrial machinery industry, while going forward, the outlook is that orders will increase for projects to introduce industrial robots and to construct labor-saving lines that utilize IoT. Due to the novel coronavirus pandemic, it is said that while initially the plans were for introductions in the next three years, there are now some people calling for these plans to be pushed forward. As the situation in the external environment is unclear, the stage of making a final decision on implementing investment has not yet been reached. But if the future becomes clearer, it is thought that similar capital investment projects will increase, which we at FISCO think will be an excellent opportunity for the engineering business to grow.

Trend in net sales and gross margin in the engineering business



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

The Company's gross margin on a company-wide basis is around 10%, but it would likely be above 11% if excluding electronic parts for the automotive (on-board products) industry. Therefore, the added-value of the engineering business is still no more than around 3%. The Company is targeting a gross margin of 25% to 30%. It is thought that the main reason that it is below this level is it has few projects that it proposes to customers that utilize its past knowledge and experience, and instead the majority of projects are simply orders received from customers. As a result, costs per project, such as the personnel costs for the engineers, are high, and it it does not sufficiently obtain compensation for the inherent added-value it provides.

The Company's engineering business has been described by comparing it to curry. That is to say, previously it sold the meat, vegetables, and rice individually as the ingredients (an agency business). In contrast, the engineering business tries to use each of these ingredients to make and to sell curry rice, and the work to produce the curry roux and flavor the curry rice is the Company's expertise and is what provides the value added. However, in the current situation, the Company is not making and providing the curry using its own recipe, but rather it is making curry each time based on the customers' preferences, making it difficult to receive compensation for the costs involved and suppressing the profit margin.

Based on this situation, from FY3/20 the Company began to revise the business model for the engineering business, and it switched to a strategy that focuses on receiving orders with an emphasis on profitability, by turning down orders for projects that do not utilize its past knowledge. We can see that this type of measure is leading to an improvement in the gross margin. However, to improve the profit margin even further, the key will be whether it can build a structure to provide customers with services in which, in some way, the expertise that the Company has accumulated up to the present time has been standardized. As already stated, in the future, investment in labor saving will advance in various industries, including the electronic parts assembly and the food industries, and it is anticipated that opportunities to acquire customers will increase. If the Company can satisfy customer needs and also provide services in which they can sense cost benefits, then it will become possible to increase sales for the engineering business while simultaneously improving profitability. In particular, if orders increase for large-scale projects that can be expected to be highly profitable, it is likely that it will have in sight achieving a gross margin of 25% to 30%. The Company has approximately 50 engineers working in this business, and for the time being the Company's plan is to expand the business with this team of engineers.

(2) Global SCM solutions business

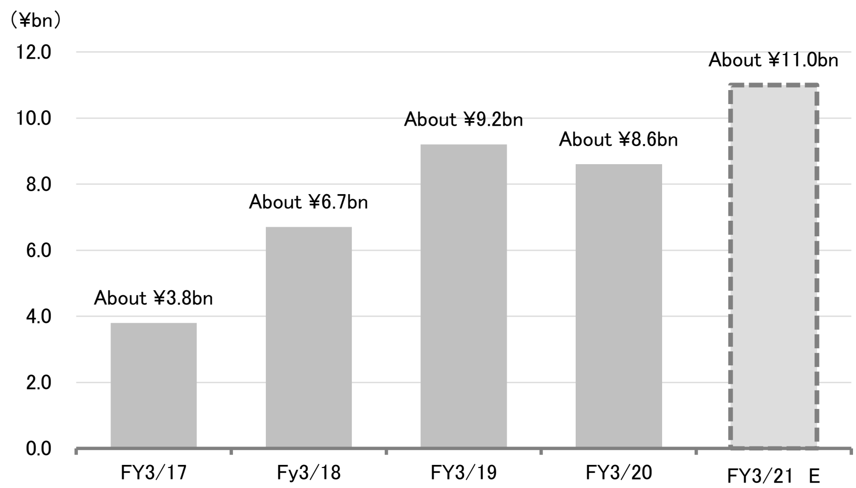
The global SCM solutions business is rooted in the services that the Company has provided since the distant past of services such as procurement agent, logistics agent, and delivery management services. The various manufacturers that are its main customers have been pursuing efficiency as major companies and progressing business structural reforms and restructuring. In this process, they have targeted reducing personnel and bases in areas such as global logistics, inventory management, and materials procurement, so the reality is that they currently have shortages of personnel. The Company's global SCM solutions business captures the outsourcing needs that arise due to these shortages. By consolidating the electronic parts and equipment, etc., which the client manufacturers had been procuring from various suppliers on their own up until this point, in the Company, customers can enjoy such benefits as reduced procurement costs and shortened lead times.

Using the moving business as an example, conventional procurement agent and logistics agent services just moving a person's items from the former home to the new home. In global SCM solutions business, meanwhile, the service also extends to setting up televisions and PCs for immediate use after the move and procuring and installing antennas and Wi-Fi equipment. Engineering business corresponds to selection and procurement of antennas and Wi-Fi equipment suited to the new area and wiring installation. The move might lead to more business too if an order is received for landscaping and softscaping work. The Company is aiming to grow the global SCM solutions business by utilizing the expertise it has accumulated over its long history as a technology trading company and its strength of having a wide overseas network (26 bases worldwide).

The outlook for FY3/21 is that net sales will grow, increasing 28% YoY to approximately ¥11bn. The main reasons for the higher sales will be the progress made in acquiring new customers and the orders for large-scale projects from among them. In terms of new projects, the company is receiving orders for overseas export agency work from a harness processing manufacturer. In terms of sales strategy, the previous sales style was passive, and consisted of simply waiting for requests from customers. Yet following the establishment of the global SCM solutions business division in April 2019, it prioritized increasing sales and actively worked to acquire orders. However, profitability declined as a result, so it is returning to a sales strategy that prioritizes profits.

Even so, at FISCO we think that global SCM outsourcing will grow in the future. The trade friction between the United States and China has intensified, and a partial movement has begun of relocating factories from China to South East Asia, Latin America, or Japan. But when relocating a factory, building a system from scratch by oneself, such as for local parts procurement, is inefficient, so in fact inquiries to the Company for this are increasing. In this business, this trend is leading not only to the growth in the scale of transactions with existing customers, but also to opportunities to acquire new customers. In order to strengthen the competitiveness of SCM services, the Company is reviewing the global logistics infrastructure at the same time as establishing a business division, and is starting improvement activities. As one part of this, it has begun fully fledged operations of Warehouse Management System (WMS), and it is aiming to improve profitability by making visible the logistics costs of each project.

Trends in net sales in the global SCM solutions business



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

Is aiming to deepen sales by establishing micro sales offices in small- and medium-sized regional cities and building a "new closeness" with excellent customers

3. Progress for "expand global business capabilities to support market demand"

For this theme, in August 2019 the Company established a business base in Ho Chi Minh City, Vietnam, and it intends to strengthen its sales structure in this country through a two-base structure. However, recently this plan has been impacted by the novel coronavirus pandemic and no noticeable changes can be seen. Conversely, as a new measure within Japan, in 2019 it launched a micro sales office on a trial basis that has produced a certain level of results, so it is working toward the fully fledged deployment of these offices.

The Company's sales offices consist of several sales staff and several clerical-work staff, but a micro sales office consists of only two or three sales staff, while the clerical-work staff provide support from remote locations. Therefore, it can keep down sales-office related expenses and personnel expenses for the clerical-work staff. Among the Company's customers, there are many excellent customers located in small- and medium-sized regional cities, so the Company is aiming to build closer relations with these customers and to deepen transactions with them by establishing nearby micro sales offices that will be in contact with them. It also intends for these offices to lead to acquisitions of new customers. During the coronavirus pandemic, cases of online sales discussions are increasing, but in the B-to-B market, there are significant differences between customers' requests, while relations of trust are built by directly meeting with and listening to the customer, which in many cases leads to new sales discussions. In fact, the micro sales office has been highly evaluated by customers of the Shikoku Sales Office, and the positive effects of establishing such offices have been confirmed.

The Company has three conditions for opening a micro sales office: that it opens it at a site exclusively for offices, not also for housing; that it has two or more sales staff; and that when opening the sales office, the person who wants to open the office prepares the planning document. At the stage when these three conditions are satisfied, the micro sales office can be opened. It has already decided to open offices in Nagaoka (Niigata) and in Kofu (Yamanashi), while it is currently considering an opening in Kanazawa (Ishikawa, which presently has one staff member and will open when it has two). The Company has 24 bases in Japan, and of these, 23 are located west of Kanto. In Tohoku, it has only 1 sales office in Sendai, resulting in a situation where 4 or 5 sales staff cover the entire Tohoku area. There are many manufacturing-industry factories in Tohoku, and it cannot fully cover them under the current structure. However, it is expected that opening micro sales offices will advance customer acquisition in regions that it cannot fully cover. Similarly, the Company currently has no sales base in Hokkaido, so it may open micro sales offices there in the future. Therefore, sales growth can be expected for the Japanese market in the future through openings of micro sales offices, and we shall be paying attention to developments going forward.

Is strengthening the training of management human resources to accelerate sustainable growth

4. Progress for "pursue new business fields to accelerate sustainable growth"

In order to "pursue new business fields to accelerate sustainable growth," the Company is aware that training human resources is an important issue, and it is strengthening measures for this. In particular, to train management human resources, it holds training events including the Global Next Leader Training, Discussion Panel Depicting 100 Years in the Future, and the Vision and Medium-term Management Plan Formulation Committee. Additionally, in order to grow the global business, the overseas bases are advancing measures to train and appoint local staff to be management human resources and to strengthen organizational capabilities.

Currently, because the majority of the customers of the overseas local corporations, which operate 26 bases in 12 countries, are Japanese companies, Japanese employees are involved in their management. However, to realize further growth, it is considered important to strengthen organizational capabilities even more by appointing local staff as managers. The number of consolidated employees has grown to approximately 1,000 people, of who, around 400 are foreign (non-Japanese) nationals (of who, around half are Chinese). As it is very costly to recruit human resources with management skills from outside the Group, the policy is to conduct training within the Group, and the training of management candidates starts in Japan. If the globalization of management human resources continues, we at FISCO anticipate that the Company will progress customer acquisition of foreign companies, which currently provide only around 10% of total sales (around 35% in the Chinese market), and that this will lead to the further growth of overseas sales.

Is working to realize a sustainable society through workstyle reforms that utilize ICT

5. Progress for "initiatives to realize a sustainable society"

For this theme, the Company is working on workstyle reforms through utilizing ICT, and the results of its ICT investment in 2018 are starting to appear, such as allowing the smooth transition to a teleworking structure. Going forward also, its policy is to respond flexibly to the post-corona era through workstyle reforms that reflect the new normal social environment. For SDGs as well, it has started Company-wide measures, including holding study sessions internally to raise employee awareness.

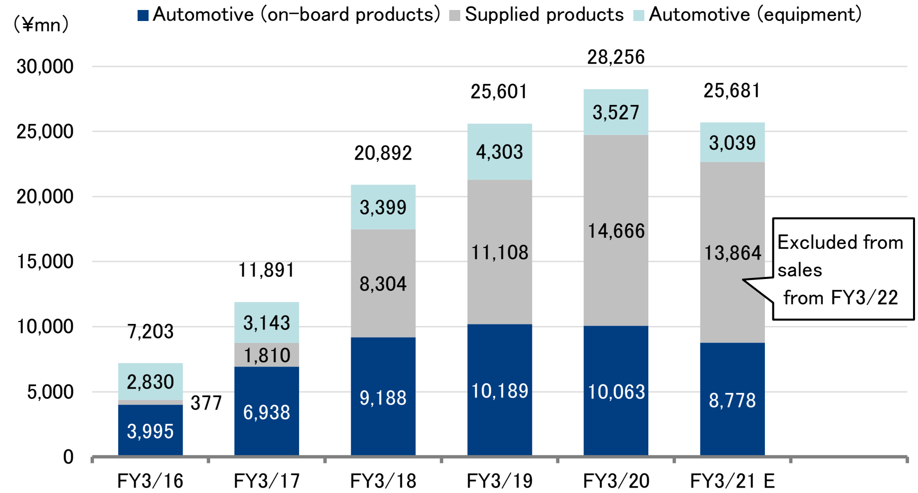
In the automotive (on-board products) business in FY3/22, net sales will decline by slightly less than ¥14bn due to an accounting change, but this will have no effect on profits

6. Outlook for the automotive business

The business for the automotive industry can be divided into two businesses: the electronic parts business for on-board electronic equipment, and the production equipment business for factories, such as for automotive manufacturers. Of these, the outlook for the electronic parts business for on-board electronic equipment, which has grown dramatically in the last few years, is that net sales will decrease by slightly less than ¥14bn in FY3/22. This is because for electronic parts, the supplied products from customers were previously recorded in net sales and the same amount was included in the purchased products account, but due to changes to accounting methods from FY3/22, supplied products will no longer be recorded in sales. However, this will have no effect on operating income and overall, it will seemingly lead to an improvement in profitability. On provisionally calculating the FY3/21 results forecasts based on the new standard, compared to the current accounting standard, the gross margin will rise 1.2pp and the operating margin 0.1pp. Previously, the growth in sales of on-board products was a factor that lowered the profit margin, but this effect will end from FY3/22.

Excluding supplied products, in FY3/21 net sales of electronic parts for on-board products are forecast to decline for the second consecutive period, falling 12.8% YoY to ¥8,778mn. However as previously stated, recently orders have recovered to the same level as in the same period in the previous fiscal year. It seems that the main mover will be the ADAS-related business, but going forward, in relation to automotives, it is expected that further progress will be made in the transition to electric devices, including the spread of the use of environmentally friendly vehicles like EV/HEV, and the introduction of automated driving technologies. Therefore, at FISCO we think that the growth trend will continue in the medium- to long-term. After excluding supplied products, this field has a sales composition ratio of 8%, ranking it behind only the factory automation and industrial equipment industry and the semiconductor and LCD industry in the sales composition ratios. So in the future, it can be expected to be one of the main fields supporting the Company's growth.

Trend in net sales for the automotive industry



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

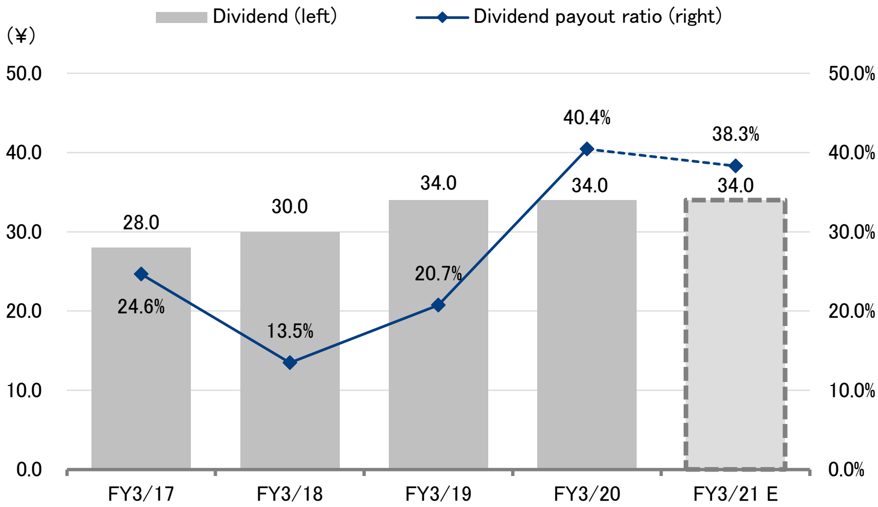
Shareholder return policy

Plans for FY3/21 dividend to be ¥34 per share, the same as the previous year

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 the Company does not sharply raise dividends in response to temporary rapid profit expansion, it has steadily increased them in keeping with earnings growth.

Profits continued to decline for two consecutive fiscal periods, in FY3/19 and FY3/20, but the Company still maintained the dividend per share at ¥34.0. For FY3/21 also, it plans to pay a dividend of ¥34.0 (dividend payout ratio, 38.3%), which is unchanged YoY. This indicates the importance it places on continuously paying a stable dividend.

Dividend per share and dividend payout ratio



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

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