COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

Tokyo Stock Exchange First Section

14-Jul.-2021

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Summary

Currently orders continue to be strong, mainly for semiconductors and EV-related, and profits are set to increase significantly in FY3/22

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 FY3/21, profits increased by double digits from the recoveries in the factory automation and industrial equipment fields and the effects of reducing SG&A expenses

In the FY3/21 consolidated results, sales decreased, with net sales declining 2.3% year-on-year (YoY) to ¥134,769mn, but profits increased for the first time in three fiscal years, with ordinary profit rising 19.7% to ¥2,567mn. Due to the impact of the novel coronavirus pandemic (hereafter, COVID-19), capital investment by companies in the manufacturing industries cooled down, and therefore net sales decreased. However, when examined by fiscal quarter, sales trends changed direction and increased from the 3Q onward. This was due to a recovery in demand for electrical machinery and electronic parts related to factory automation and industrial equipment that resulted from more active capital investment, particularly in China, as well as improved demand for automotive electronic parts. In particular, orders received in the 4Q grew greatly compared to the same fiscal year in the previous fiscal year, increasing 23.2% to ¥43,643mn, and the recovery, mainly for China, was remarkable. Although it appears that the Company's orders include those pushed forward due to the effects of the semiconductor shortage, even after subtracting these, the current ordering environment appears excellent. The main reasons why profits increased even though sales decreased were the improvement to the gross profit margin, and also decreases of ¥502mn YoY in SG&A expenses as a result of actively utilizing online tools under a teleworking system.

2. In FY3/22, profits are forecast to increase significantly due to the growth of capital investment in the semiconductor and automotive industries

The outlook for the FY3/22 consolidated results is for net sales to increase 0.8% YoY to ¥135,800mn and ordinary profit to rise 36.3% to ¥3,500mn. For net sales, paid-for supplied products, whose sales were previously indicated in automotive electronic equipment, will change from FY3/22 to being indicated in the net amount that does not include sales, which will have the effect of reducing sales by ¥15,500mn. However, if viewed in comparison to the previous standard, the sales-increase rate will be 12.3%, and capital investment in the semiconductor industry and the automotive industry, centered on electric vehicles (EV), will increase even further, mainly in Asia. Also, the forecast is that installation projects for local 5G at factories will increase in Japan. The gross profit margin will rise due to improved product mix, while the Company will continue to work to keep down SG&A expenses, and therefore the outlook is for ordinary profit margin to increase from 1.9% in FY3/21 to 2.6%.

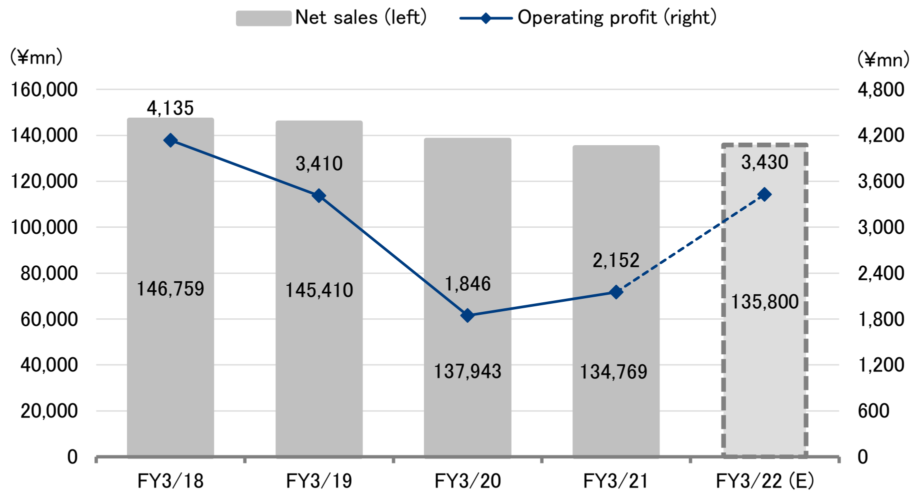
3. Is progressing the fundamental policies in NEXT 1800, the medium-term management plan, and taking on the challenge of achieving a great recovery

Looking at the progress made for NEXT 1800, which is the three-year medium-term management plan started in FY3/20, the numerical results are being impacted by COVID-19, so it is highly likely that the FY3/22 numerical targets (net sales of ¥180bn and ordinary profit of ¥5bn) will not be achieved. However, the Company is making steady progress in implementing the fundamental policies ("Contributing to customers' manufacturing by enhancing core businesses," "Expanding global business and supporting marketdemand," "Rising to the challenge of new business fields and accelerating sustainable growth," and "Initiatives to realize a sustainable society"). In particular, in FY3/22 as new attempts toward a great recovery, it is working on "Overcome COVID-19 and acquire share of the 'new normal' market," "Build a strategy that utilizes DX and complete its implementation system," and "Output reliable results through deepening existing businesses, developing new businesses, and reviewing the business portfolio," and its policy is to aim for a further leap forward.

Key Points

- In FY3/21, orders recovered from the 3Q and profits increased by double digits even while sales decreased, including due to the reduction of SG&A expenses
- Orders are strong, mainly for the semiconductor and automotive industries, and profits are forecast to increase significantly in FY3/22
- Toward realizing a decarbonized society, the policy is to strengthen businesses in the environment-related field

Results trends



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

Results trends

In FY3/21, orders recovered from the 3Q and profits increased by double digits even while sales decreased, due in part to the reduction of SG&A expenses

1. FY3/21 results overview

In the FY3/21 consolidated results, net sales decreased 2.3% YoY to ¥134,769mn, operating profit increased 16.5% to ¥2,152mn, ordinary profit rose 19.7% to ¥2,567mn, and profit attributable to owners of parent grew 33.2% to ¥1,786mn. Although sales decreased, each profit item increased for the first time in three fiscal years, while the results were also above the Company forecasts.

FY3/21 results (consolidated)

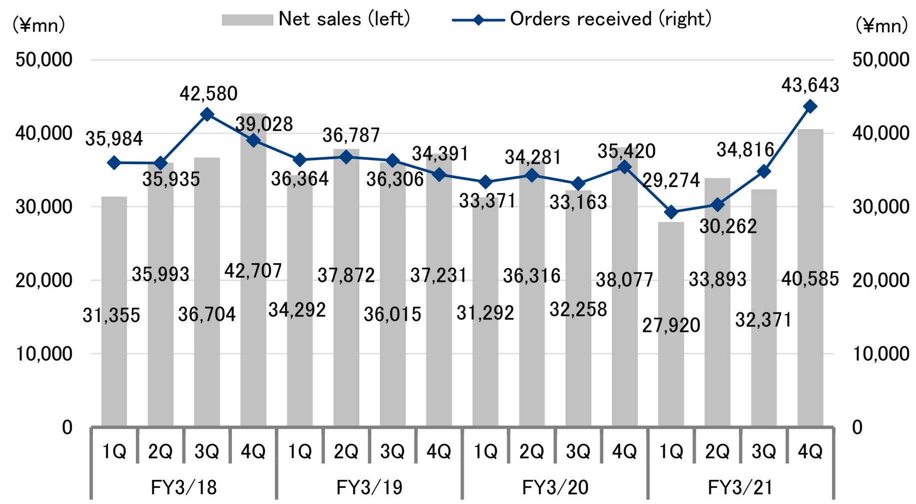
(¥mn)

	FY3/20		FY3/21				
	Results	% of sales	Company forecast	Results	% of sales	YoY	vs. forecast
Net sales	137,943	-	130,000	134,769	-	-2.3%	3.7%
Gross profit	14,421	10.5%	-	14,224	10.6%	-1.4%	-
Selling, general and administrative expenses	12,574	9.1%	-	12,071	9.0%	-4.0%	-
Operating profit	1,846	1.3%	1,800	2,152	1.6%	16.5%	19.6%
Ordinary profit	2,144	1.6%	2,100	2,567	1.9%	19.7%	22.2%
Profit attributable to owners of parent	1,341	1.0%	1,400	1,786	1.3%	33.2%	27.6%

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

Due to the impact of COVID-19, operations declined at the factories of manufacturing-industry companies and there was a movement toward postponing capital investment. Therefore, in factory automation and industrial equipment-related business, sales slumped of electrical machinery and electronic parts up to the 2Q. In addition, sales fell greatly of automotive electronic equipment and electronic parts for the amusement industry, and these were the main factors behind the decline in sales. However, since the 3Q, sales have recovered for factory automation and industrial equipment-related business, mainly in China, and sales increased on a fiscal quarterly basis. Looking at how orders trended by fiscal quarter, in the 4Q they increased 23.2% compared to the same fiscal year in the previous fiscal year to ¥43,643mn, recovering to exceed the ¥40bn level for the first time in three years. It appears that the Company's orders include those pushed forward due to the effects of the shortage of semiconductors, but even after subtracting these, currently the ordering environment appears excellent.

Orders and net sales by fiscal quarter



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

The main reasons why profits increased even though sales decreased were that the gross profit margin improved 0.1 of a percentage point YoY, and also that SG&A expenses decreased ¥502mn YoY as a result of actively utilizing online tools under the teleworking system since April 2020. Transportation expenses, including overseas business trip expenses, declined. Advertising and publicity expenses also declined due to the cancellations of various exhibitions. Gross profit decreased ¥197mn YoY. Breaking this down, the decrease in gross profit due to the decline in net sales was ¥333mn and the increase from the improvement to the gross profit margin was ¥134mn. Also, non-operating profit rose ¥120mn YoY, mainly due to the improvement to foreign exchange losses because the yen weakened over the end of the period.

By region, the recovery has been the fastest in China, while by industry, there were recoveries in the 2H for factory automation and industrial equipment, automotive electronic equipment, and information / communications

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 profit 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

The main products in the electrical machinery segment include servo motors, motion controllers, programmable controllers, inverters, and power conditioners. Net sales increased for the first time in three fiscal years, rising 9.6% YoY to ¥23,157mn. This was due to the increases in sales for the industrial machinery industry and semiconductor industry in Japan, and for the industrial machinery industry in China.

The main products in the electronics segment are wide ranging, including general electronic parts such as capacitors, connectors, relays and switches, as well as fan motors, stepping motors, LEDs, power supplies, and heat sinks. Net sales decreased 3.5% YoY to ¥102,657mn. The main factors were the significant decrease in sales to the amusement industry due to a major decline in capital investment in the casino industry because of the COVID-19 pandemic, which outweighed the increases in sales for industrial machinery in Japan and China. Sales for automotive (on-board products) had slumped up to the 2Q due to production adjustments, but they recovered from the 2H of FY3/21 and for the full fiscal year, they had returned to around the same level as in the previous fiscal year.

The main products in the general machinery segment include robots for Yaskawa Electric Corporation <6506>, as well as conveyors and reduction gears. Net sales decreased 13.9% YoY to ¥8,955mn following the end of a large-scale project in Japan for the industrial machinery industry, which had contributed to sales domestically in FY3/20.

Net sales by business segments

(¥mn)

	FY3/20			FY3/21		
	1H	2H	Full year	1H	2H	Full year
Electrical machinery	10,565	10,572	21,137	10,793	12,364	23,157
YoY	-20.8%	-5.9%	-14.0%	2.2%	17.0%	9.6%
Electronics	52,470	53,930	106,400	46,249	56,408	102,657
YoY	-2.0%	-3.4%	-2.7%	-11.9%	4.6%	-3.5%
General machinery	4,571	5,833	10,404	4,770	4,185	8,955
YoY	-13.4%	-5.8%	-9.3%	4.3%	-28.3%	-13.9%
Total net sales	67,608	70,335	137,943	61,813	72,956	134,769
YoY	-6.3%	-4.0%	-5.1%	-8.6%	3.7%	-2.3%

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

(2) Sales trends by industry

Looking at how sales trended by industry on a half-year basis, in 1H FY3/21, sales decreased compared to the same fiscal year in the previous fiscal year in practically all industries. But in the 2H, sales increased mainly for the factory automation and industrial equipment industry, and for automotive (on-board products), information / communications, and medical equipment. The main factors were active investment in China in areas including EV, semiconductors, and base stations for the "5G" high-speed communication standard, and also a recovery in orders for factory automation and industrial equipment. In Japan as well, where capital investment had slumped, a movement began to restart capital investment, mainly in the automotive and semiconductor industries. Looking at the full fiscal year, sales for information / communications increased by approximately 20%, but it seems that sales for the mainstay factory automation and industrial equipment and automotive (on-board products) industries were basically unchanged, and that sales for semiconductors and LCD-related declined by a single digit.

Conversely, the industries that continued to slump even in 2H FY3/21 were the amusement, food, and security-related industries. In the amusement industry, the slump of the casino market has become prolonged due to COVID-19, and it seems sales declined by slightly more than 50% YoY for the full fiscal year. For the food industry as well, there was a decline as a reaction to the completion of large-scale project that contributed in the previous fiscal year.

Increase-decrease trends in net sales by industry

Customers (industry)	Increase-decrease trend (arrow) and share (%)							
	1H FY3/19		2H FY3/19		1H FY3/20		2H FY3/20	
Factory automation /industrial equipment	↘	36.6%	→	35.3%	↘	38.2%	↗	35.2%
Automotive (on-board products)	↗	22.8%	→	22.1%	↘	20.4%	↗	24.7%
Semiconductors /LCDs	↗	9.3%	↗	10.8%	↘	10.7%	→	8.8%
Social infrastructure	↗	3.6%	↗	3.9%	↘	3.6%	→	3.1%
Amusement	↘	3.7%	↘	2.9%	↘	1.7%	↘	1.2%
Information /communications	↘	2.4%	↗	2.5%	↘	2.2%	↗	3.7%
Medical equipment	↗	1.7%	↘	1.4%	↘	1.6%	↗	1.4%
Environment /energy	↘	1.5%	→	1.4%	↘	1.2%	→	1.0%
Food	↘	0.1%	↗	1.3%	↘	0.4%	↘	0.0%
Security	↘	0.2%	↘	0.1%	→	0.1%	↘	0.1%
Other	↘	18.4%	→	18.3%	→	19.9%	↗	20.7%
Total		100.0%		100.0%		100.0%		100.0%

* The aggregation method was changed from FY3/20.

Source: The Company's results briefing materials

(3) Trends in sales and profits by segment

In Japan, net sales declined 1.9% YoY to ¥108,252mn and operating profit decreased 6.9% to ¥1,197mn, so the declines in sales and profits continued. Sales of electronic machinery increased for the industrial machinery industry and the semiconductor industry, while sales of electronic parts rose for the industrial machinery industry. However, net sales declined mainly because of the decreases in sales of electronic parts for the amusement industry and equipment for the industrial machinery industry.

In Asia, net sales increased 3.0% YoY to ¥35,492mn and operating profit rose 54.9% to ¥917mn, and sales and profits both grew for the first time in three fiscal years. This was because although sales of electronic parts to the amusement industry decreased, sales of electrical machinery and electronic parts for the industrial machinery industry increased. In particular, sales for China, which provides more than 70% of total sales, benefitted from the growth of capital investment for the automotive, semiconductor, and solar cell industries, resulting in an increase of sales and profit.

In Europe and the US, net sales decreased 26.4% YoY to ¥4,711mn and the operating loss was ¥1mn (a loss of ¥84mn in the previous fiscal year). Due to the cooling-down of the casino market, sales of electronic parts to the amusement industry fell significantly. However, the extent of the operating loss was reduced through efforts to keep down costs.

Net sales by segment

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	YoY
Japan	115,002	115,993	110,335	108,252	-1.9%
Asia	39,491	37,188	34,454	35,492	3.0%
Europe/US	8,865	8,084	6,398	4,711	-26.4%
Other	1,506	1,733	1,396	931	-33.3%
Adjustment amount	-18,106	-17,589	-14,641	-14,617	-
Total	146,759	145,410	137,943	134,769	-2.3%

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

Operating profit by segment

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	YoY
Japan	2,333	1,939	1,285	1,197	-6.9%
Asia	1,489	1,208	592	917	54.9%
Europe/US	310	254	-84	-1	-
Other	-20	3	7	16	118.7%
Adjustment amount	22	4	46	23	-
Total	4,135	3,410	1,846	2,152	16.5%

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

Profits forecast to increase significantly in FY3/22 through strong orders, particularly for the semiconductor and automotive industries

3. Outlook for FY3/22 results

The outlook for the FY3/22 results is for sales and profits to increase, with net sales to rise 0.8% YoY to ¥135,800mn, operating profit to grow 59.4% to ¥3,430mn, ordinary profit to increase 36.3% to ¥3,500mn, and profit attributable to owners of parent to rise 26.0% to ¥2,250mn. The end of the COVID-19 pandemic is not yet in sight, so there remains a strong sense of uncertainty about future economic conditions. But results will benefit from the growth in capital investment in EV and in the semiconductor industry in China, where the steady economic recovery is continuing. In the domestic market as well, the desire to conduct capital investment is recovering in the automotive and semiconductor industries, while demand is also expected to increase given factors such as the movement to work on creating smart factories in factories utilizing "local 5G," and automated transportation robots as an investment in saving labor power.

FY3/22 consolidated results forecast

(¥mn)

	FY3/21		FY3/22		
	Results	% of sales	Company forecast	% of sales	YoY
Net sales	134,769	-	135,800	-	0.8%
(Net sales based on former standards)	-	-	151,300	-	12.3%
Operating profit	2,152	1.6%	3,430	2.5%	59.4%
Ordinary profit	2,567	1.9%	3,500	2.6%	36.3%
Profit attributable to owners of parent	1,786	1.3%	2,250	1.7%	26.0%

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

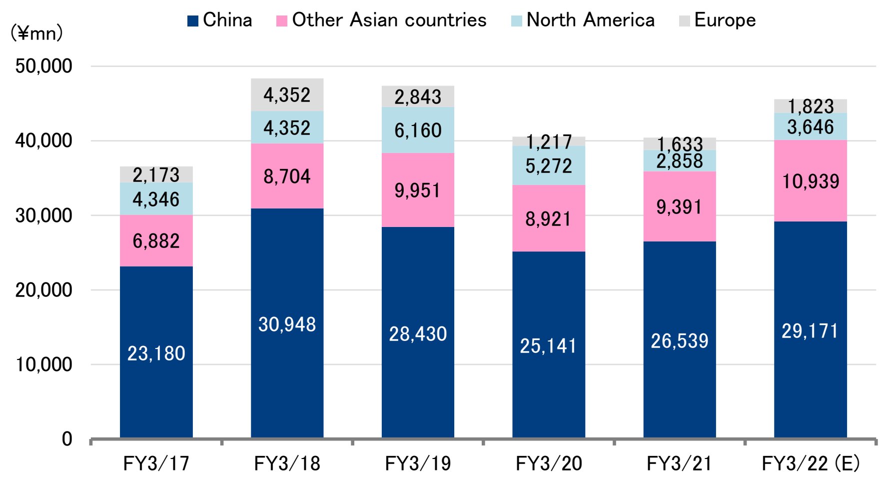
The reason for the low growth rate of net sales is that following a change of accounting standards relating to recognizing earnings from FY3/22, automotive (on-board products) paid-for supplied products, which were previously recorded in net sales, have been removed, which is considered by the Company to have a negative impact of ¥15,500mn on net sales. When compared to the previous standard, the outlook is for net sales to increase 12.3% YoY to ¥151,300mn.

The main factors behind the increase in the operating profit include a rise in gross profit margin resulting from improved product mix and curtailment of SG&A expenses, which the Company has been working on since the previous fiscal year. Although there will be increases in personnel costs due to the rise in the number of personnel and in advertising costs, including to exhibit in exhibitions, costs will continue to be kept down under the teleworking system.

Assuming an exchange rate of ¥104 to US$1 (¥110 to US$1 in the previous period), overseas net sales (on a local-corporation basis) will increase 11.6% YoY to ¥45,580mn, and their sales composition ratio will be 33.6% (30.3% in the previous period). Sales are forecast to increase not only in China but in all regions, including other parts of Asia and Europe and the US. In China, demand continues to grow for factory automation and industrial equipment for the automotive and semiconductor industries, while in other parts of Asia, sales of global SCM solutions are increasing. In, Europe and the US, the forecast is that demand for capital investment-related will recover as the COVID-19 pandemic approaches its end. Sales for overseas are mainly denominated in US$, and it seems that the amounts that results will be positively affected by the weakening of the yen to the US$ are approximately ¥400mn for net sales and in a range of tens of millions of yen for gross profit. Also, the fiscal year for all of the 13 overseas subsidiaries ends in December, so these subsidiaries' January-to-March 2021 results will be reflected in the 1Q FY3/22 consolidated results.

The anticipated risk factors are that the COVID-19 pandemic will further worsen and that global economic conditions will once again cool down. However, progress is being made with distributing the various vaccines, particularly in Europe, the US, and China, and therefore at FISCO we think that this risk is only small at the present time. Other than this, should there be a situation of a shortage of the supply of semiconductors installed in factory automation and industrial equipment due to the impact of the fire at the Renesas Electronics factory, this may temporarily have a negative impact.

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

Progressing new measures toward a great recovery

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 with FY3/22 as its final fiscal year. It has positioned this three-year fiscal year as the fiscal year to build a structure toward realizing "Sun-Wa Vision 2025" *, which is the Company's long-term management vision. The plan has four fundamental policies, including "Contributing to customers' manufacturing by enhancing core businesses," and it is working on priority measures based on each of these basic policies.

* In "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."

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. It is also working on workstyle reforms to increase productivity through utilizing ITC in the form of responding to societal changes, on realizing a corporate culture that provides work satisfaction, and on contributing to SDGs (Sustainable Development Goals). Particularly in relation to the utilization of ICT, the Company is being required to respond to the new normal social style during the COVID-19 pandemic. But in this situation, even by 2019 it had already introduced and completed a working environment ahead of its peers, including introducing online communication tools, and it rapidly transitioned to a teleworking system without any decline in work productivity. This has also been a factor behind it achieving an early earnings recovery.

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

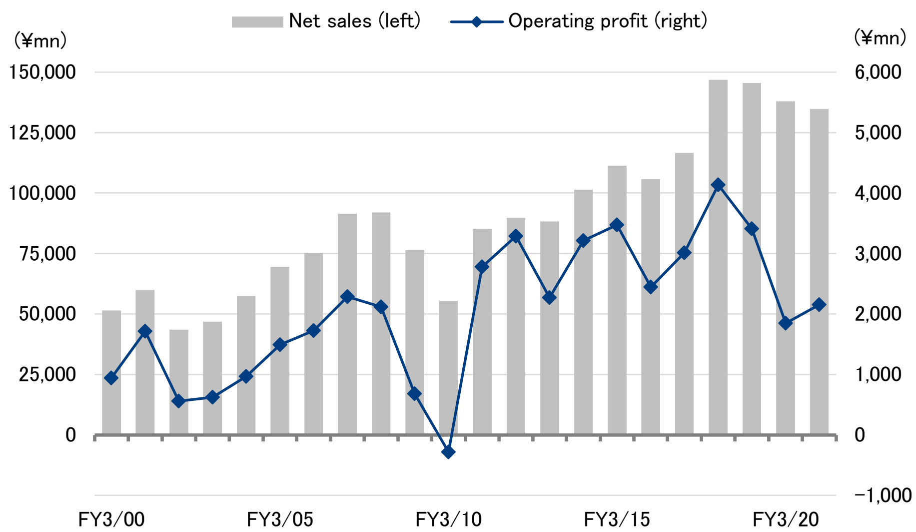
(2) The NEXT 1800 numerical management targets and taking on new challenges toward a great recovery

The NEXT 1800 numerical management targets for FY3/22, the plan's final fiscal year, are net sales of ¥180,000mn, operating profit of ¥4,800mn, and ordinary profit of ¥5,000mn. In terms of the market environment, a severe environment continued after the plan was formulated, including the impact of the prolonging of trade friction between the US and China and the deterioration of the global economy due to COVID-19. Therefore, results up to FY3/21 were below the initial numerical targets, while it is also highly possible that the FY3/22 results will not achieve the initial targets. However, the sense is that the Company is responding to this situation through its fundamental-policy measures, and it intends to steadily implement them in FY3/22 as well. Moreover, as new challenges toward a great recovery in FY3/22, it intends to focus on the following three points.

a) Overcome COVID-19 and acquire share of the 'new normal' market
b) Build a strategy that utilizes DX and complete its implementation system
c) Output reliable results through deepening existing businesses, developing new businesses, and reviewing the business portfolio

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 21 years from FY3/00 to FY3/21, net sales have grown at an average annual rate of 4.7%, while operating profit has grown at an average annual rate of 4.0%. In the 18-year fiscal year 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 profit grew at an average of 8.6% per year. In order to achieve the target in the long-term vision of net sales of ¥250bn in FY3/26, it will be necessary to accelerate the speed of growth more than up to the present time. But if the Company can deepen its existing businesses and develop new businesses through implementing the priority measures it is working on in NEXT 1800, at FISCO we think it is fully capable of accelerating growth.

Medium- to long-term results



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

Policy is to strengthen businesses in the environment-related field toward realizing a decarbonized society

2. State of progress of the fundamental policies in the medium-term management plan

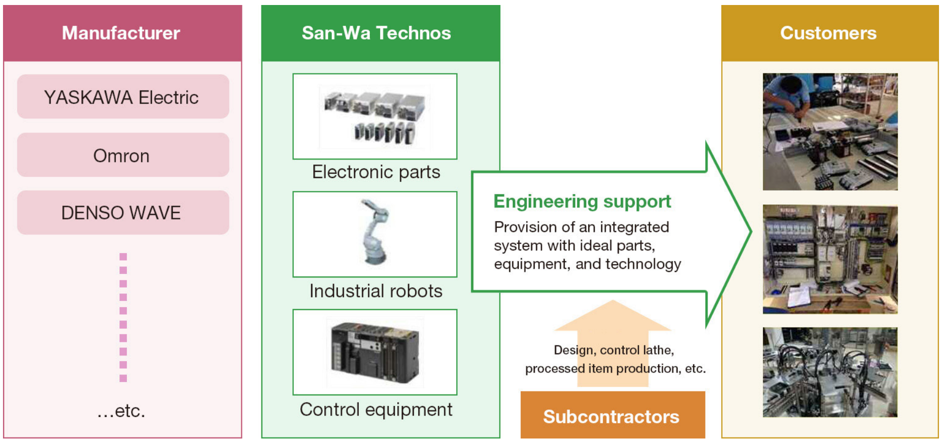
(1) Progress for “contribute to customer production activities by strengthening core businesses”

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.

a) Engineering business

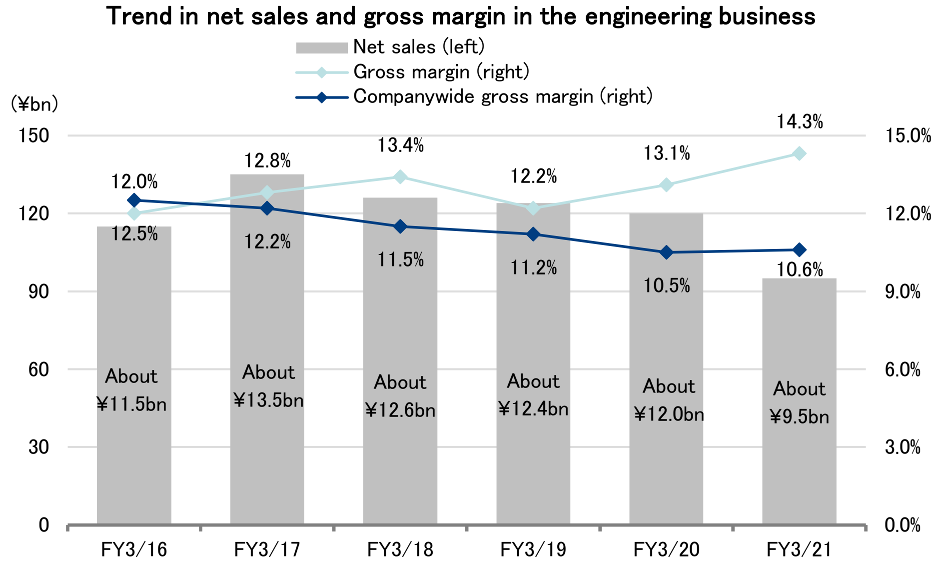
The engineering business sells to customers what the Company itself combines and systemizes from the products previously sold individually that are handled in each of the three respective business segments of electrical machinery, electronics, and general machinery. In other words, the engineering business is not some sort of separate, new business, but it is a sales method in the trading company function. The underlying reasons for focusing on this business include the advancing functions of factory-automation equipment such as industrial robots, and diversification in response to customer demands, which cannot be met by stand-alone sales of individual products. The Company’s view is that it will be possible to increase profitability through the added value of engineering while expanding the scale of orders per project.

Overview of engineering business



Source: The Company’s website

In the engineering business in FY3/21, net sales were approximately ¥9.5bn, down from around ¥12bn in the previous period, including due to the impact of COVID-19. However, the gross profit margin steadily rose from 13.1% in the previous fiscal year 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. As measures to save labor in the future, demand is expected to increase including for introductions of automated transportation robots and of equipment to respond to smart factories that utilize IoT / local 5G technology. In particular, the latter will require advanced engineering technologies through systemization, which at FISCO we think is an excellent opportunity to increase orders.



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

The Company's FY3/21 gross profit margin was 10.6% on a company-wide basis, but it was approximately 12% if excluding the effects of paid-for supplied products for the automotive (on-board products) industry. Therefore, the added-value of the engineering business is still no more than around 2%. The initial target for this business was a gross profit margin of 25% to 30%, but at the current time, the gap to this target remains large. This is considered to be because there are still few projects proposed to customers that utilize the knowledge and experience that the Company has acquired in the past, and instead that the majority of projects are in the form of orders from customers, so it is unable to acquire sufficient compensation for the inherent value-added portion.

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.

In order to break-out of this situation, in FY3/20 the Company began revising the business model of the engineering business and has changed to a sales policy of not accepting orders for projects in which past findings cannot be utilized and of prioritizing profitability. It can be said that this is the reason for increase in the profit margin despite lower net sales, and the Company thinks there still is plenty of room for improvement.

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 previous stated, in the future alongside the further progress made in shifting to smart factories, it is expected that needs will further increase for overall optimization from systemization and that opportunities to acquire customers will widen. 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.

b) Global SCM solutions business

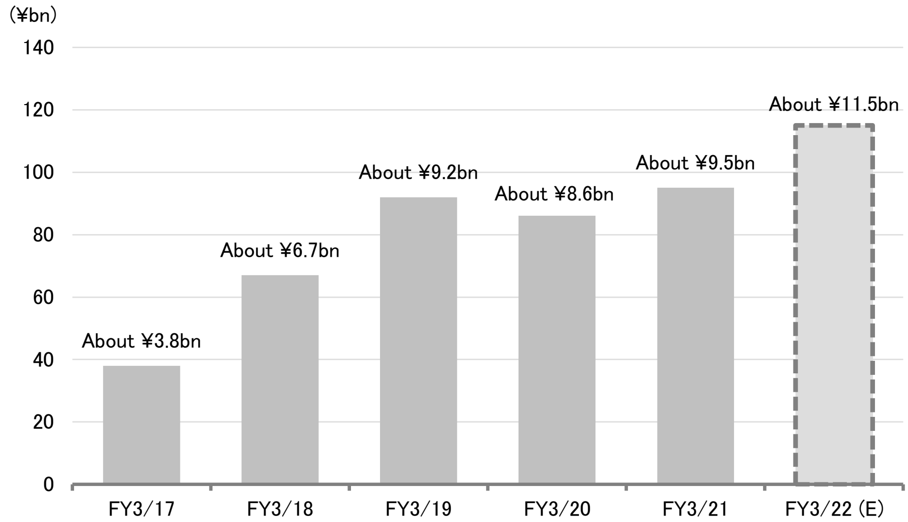
The global SCM solutions business is rooted in the services that the Company has provided since the distant past of services such as procurement agent, logistics agent, and delivery management services. The various manufacturing companies that are the Company's main customers are pursing efficiency improvements to the same level as major companies, and they are conducting streamlining under the name of business structural reforms. 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 functions that customer companies have so far procured independently from various suppliers, such as electronic parts and equipment, into the Company, these customers can enjoy benefits including 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 strengths include the expertise it has accumulated over its long history as a technologies trading company and its expansive overseas network (28 bases around the world). It is aiming to utilize these strengths to respond to customers' outsourcing needs and to grow the scale of the global SCM solutions business.

In FY3/21, net sales increased 10% YoY to approximately ¥9.5bn, while in FY3/22, they are forecast to rise 21% to around ¥11.5bn. This will be mainly due to the steady progress made in acquiring customers at the local Japanese companies advancing into Southeast Asia. Examples of sales discussions leading to orders include acquisitions of an order for overseas export agency work from a harness processing manufacturer, and also orders for an SCM project for the Chinese factory of a FPD manufacturing-equipment manufacturer and a project to transfer the production of security cameras (transfer from China to Vietnam). In terms of sales strategy, the previous sales style was passive, and consisted of simply waiting for requests from customers. When the global SCM solutions business was launched in April 2019, it prioritized increasing sales and it actively worked to acquire orders, and profitability declined as a result. Therefore, it is currently conducting sales activities that prioritize profitability.

Even so, at FISCO we think that global SCM outsourcing will grow in the future. This is because, due to the intensification of the trade friction between the US and China, a movement has started to transfer some factories from China to South East Asia, Latin America, or Japan. Also, due to the risk relating to parts procurement once again appearing because of COVID-19 and a fire at a semiconductor factory, the importance of SCM functions is being reviewed once again. Rather than building a stand-alone supply chain, customer companies can aim to reduce business risk by outsourcing SCM functions to specialist businesses, which also has an advantage in terms of costs. 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

(2) Progress made in "Expanding global business and supporting market demand"

For this theme, the Company established a business base in Ho Chi Minh City, Vietnam, in August 2019, while in Japan, it has worked to strengthen the sales system through a two-base structure. However, no significant progress was made in 2020, mainly due to the impact of COVID-19. Conversely, since 2019 it has been operating smart sales offices as a new measure in Japan.

The smart sales office refers to a small-sized sales office comprised of only sales staff (around two people) that is opened to cover regional medium- and small-sized cities. For in-office work without clerical staff, the costs incurred by the sales office in order to support branch offices in remote locations and the personnel costs for the staff working in the office can be kept down. Among the Company's customers, there are many excellent customers in regional medium- and small-sized cities, and the aim is to have closer contact with these customers and deepen transactions with them, while also aiming to acquire new customers. During the COVID-19 pandemic, cases of online sales discussions are increasing, and in the B-to-B market, such as factory automation and industrial equipment, customers' requests are diverse and, in many cases, listening to what they have to say in direct discussions leads to building relations of trust with them and new sales discussions. In fact, at the Shikoku Sales Office (Niihama, Ehime), which was the first smart sales office opened in 2019, and the Nagaoka Sales Office (Nagaoka, Niigata) and the Kofu Sales Office (Kofu, Yamanashi), which were newly opened in FY3/21, the numbers of sales discussions with customers are increasing, which is expected to lead to the growth of transactions in the future.

The Company has three conditions to open a smart 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, it opens the smart sales office. Overseas also, it newly opened sales offices with local staff in Penang, Malaysia, in January 2021, and in Xiamen, China, in May 2021, with the aim of deepening transactions with the local companies of Japanese customer companies. In Japan as well, it is considering new openings at locations including Kanazawa City and the Tohoku region. The Company has 26 bases in Japan. In Tohoku, it has only 1 sales office in Sendai (Sendai, Miyagi), resulting in a situation where 4 or 5 sales staff cover the entire Tohoku area. There are many manufacturing-industry factories in Tohoku, and the fact is that it cannot fully cover them all under its current structure. However, it is expected that opening smart sales offices will advance acquisitions of excellent customers in regions that it cannot fully cover. Similarly, the Company currently has no sales bases in Hokkaido, so it may open smart sales offices there in the future, and as one strategy for sales growth, we shall be paying attention to developments in the future.

(3) 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 28 bases in 13 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. In particular, in the Chinese market the government's policy going forward is to develop industries, including the semiconductor and EV industries, and capital investment is expected to grow in the medium- to long-term. Therefore, if the Company can capture many excellent local customers in these industries, this would contribute to its growth.

(4) Progress for "Conduct initiatives to realize a sustainable society"

For workstyle reforms that utilize ICT, as previously stated, during the COVID-19 pandemic, the Company is responding flexibly with new normal workstyle reforms, including transitioning quickly to a teleworking system. For SDGs as well, it is working on awareness-raising activities, including appointing SDGs ambassadors within the Company to raise the awareness of employees. For the business aspect, it is once again extracting businesses on the theme of the environment, including renewable energy such as solar panels, as a measure toward realizing a decarbonized society, and on EV-related, and its policy is to further strengthen sales activities in the future.

As one initiative to strengthen the corporate governance system, in June 2021 the Company plans to transition from being "a company with audit and supervisory board" to being "a company with audit and supervisory committee and other committees."

Simplified income statement and main indicators

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22 (E)
Net sales	146,759	145,410	137,943	134,769	135,800
YoY	25.9%	-0.9%	-5.1%	-2.3%	0.8%
Gross profit	16,883	16,318	14,421	14,224	-
Gross profit margin	11.5%	11.2%	10.5%	10.6%	-
Selling, general and administrative expenses	12,747	12,908	12,574	12,071	-
Selling, general and administrative expenses ratio	8.7%	8.9%	9.1%	9.0%	-
Operating profit	4,135	3,410	1,846	2,152	3,430
YoY	37.2%	-17.5%	-45.8%	16.5%	59.4%
Operating profit margin	2.8%	2.3%	1.3%	1.6%	2.5%
Ordinary profit	4,349	3,627	2,144	2,567	3,500
YoY	35.3%	-16.6%	-40.9%	19.7%	36.3%
Profit attributable to owners of parent	3,085	2,628	1,341	1,786	2,250
YoY	94.8%	-14.8%	-49.0%	33.2%	26.0%
EPS (¥)	222.65	164.08	84.11	113.23	142.62
Dividend (¥)	30.00	34.00	34.00	34.00	34.00

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

Simplified balance sheet

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	Change amount
Current assets	66,231	64,209	62,713	64,430	1,717
Cash and deposits	8,596	10,005	12,052	13,113	1,061
Trade receivables	46,077	42,256	39,838	42,453	2,615
Non-current assets	11,381	9,905	9,024	11,951	2,927
Total property, plant and equipment	3,005	2,861	2,759	2,590	-169
Intangible assets	168	143	193	170	-23
Total investments and other assets	8,207	6,900	6,072	9,190	3,118
Total assets	77,613	74,114	71,738	76,381	4,643
Current liabilities	43,077	37,199	35,402	36,372	970
Payment obligations	34,298	31,427	29,108	29,455	347
Non-current liabilities	6,542	4,970	4,608	4,978	370
Total liabilities	49,619	42,169	40,011	41,350	1,339
Interest-bearing debt	9,222	6,705	6,709	7,048	339
Shareholders' equity	23,731	29,056	29,552	30,802	1,250
Accumulated other comprehensive income	4,262	2,888	2,174	4,228	2,054
Total net assets	27,993	31,944	31,726	35,030	3,304

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

Statements of Cash Flows

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21
Cash flows from operating activities	-2,221	1,636	3,238	1,589
Cash flows from investing activities	29	-153	-200	-141
Cash flows from financing activities	3,962	28	-945	-309
Cash and cash equivalents at end of period	8,112	9,521	11,568	12,629

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

Management indicators

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21
Equity ratio	36.2%	43.1%	44.2%	45.9%
Interest-bearing debt ratio	32.9%	21.0%	21.1%	20.1%
ROE	12.0%	8.8%	4.2%	5.4%
Net cash	-626	3,300	5,343	6,065

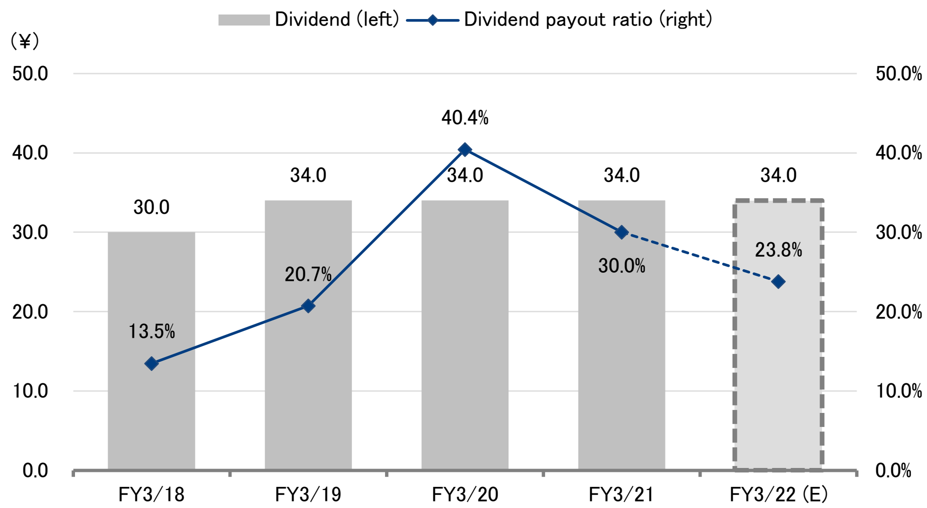
Source: Prepared by FISCO from the Company's financial results

Shareholder return policy

Plans for FY3/22 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 it did not increase the dividend significantly due to temporary, rapid results growth, it did steadily increase the dividend in response to profit growth. Conversely, from FY3/19 it maintained dividend payments even during a phase of two consecutive fiscal years of declining profits. Therefore, in FY3/22, it plans to pay a dividend per share of ¥34.0 (dividend payout ratio of 23.8%), which is unchanged YoY. However, it seems that the Company's policy is to consider increasing the dividend if it appears that results will steadily grow and the dividend payout ratio will fall to a low level.

Dividend per share and dividend payout ratio



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

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