COMPANY RESEARCH AND ANALYSIS REPORT

NIHON DENGI CO., LTD.

1723

Tokyo Stock Exchange Standard Market Index

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Summary

Steady progress toward goals of medium-term management plan

1. Developing air conditioning instrumentation and industrial systems based on instrumentation engineering technologies

Nihon Dengi Co., Ltd. <1723> (the "Company") specializes in instrumentation engineering. Instrumentation refers to the organic functioning of equipment and machinery in buildings and factories, including air conditioning and production lines by means of measurement, monitoring and control. Targeting non-residential buildings such as office buildings and hotels, the Company engages in the field of air conditioning instructions for automated control of air conditioning. The Company has extensive experience and technology as the largest distributor for Azbil Corporation <6845>, a major manufacturer of automated control equipment, and as a pioneer in the industry. In its industrial systems-related business, the Company is involved in everything from design to system development, construction, robot deployment and operation, and maintenance for production and conveyance lines in factories and provides services that support the creation of smart factories (automation and energy efficiency for factories and production lines overall using digital technologies).

2. Strength in instrumentation engineering, which combines instrumentation and engineering technologies

The Company's strength lies in possessing both instrumentation technology and engineering technology. In the air conditioning instrumentation-related business, the Company has a track record of new work site orders, including for redevelopment projects in the Tokyo metro area. This is because the handling of Azbil's new products requires engineering technology that the Company is unique in providing among Azbil's distributors. Demand for building renovations increase as buildings age, and this is also a positive factor for the Company. In the industrial systems-related business, its strength in instrumentation engineering is more fully demonstrated, because to convert factories to smart factories systems are needed to set up measurement equipment and robots, etc., for production processing and conveyance lines and organically connect them and provide automated control, and the Company's instrumentation engineering technology is optimal for this.

3. Expected to meet full-year forecasts as large projects scheduled to be completed in 2H FY3/23

The Company reported 1H FY3/23 results of ¥23,778mn in construction orders received (+25.7% YoY), ¥11,562mn in net sales (-5.2%), and ¥609mn in operating income (-34.2%). Construction orders received steadily increased on Tokyo metro redevelopment projects, etc., but net sales declined YoY in reaction to large projects being completed the same period of the previous fiscal year. Additionally, operating income declined due to there being more large projects with relatively low profitability. At the same time, in its outlook for FY3/23, the Company is initially projecting construction orders received of ¥32,500mn (-4.5%), net sales of ¥33,500mn (+5.8%) and operating income of ¥4,100mn (+0.6%). While its progress on full-year forecasts has been slow, there are seasonal factors that increase net sales in the fourth quarter, large-scale projects are expected to be completed in 2H, and the industrial systems-related business is steadily expanding, so its full-year forecasts are achievable.

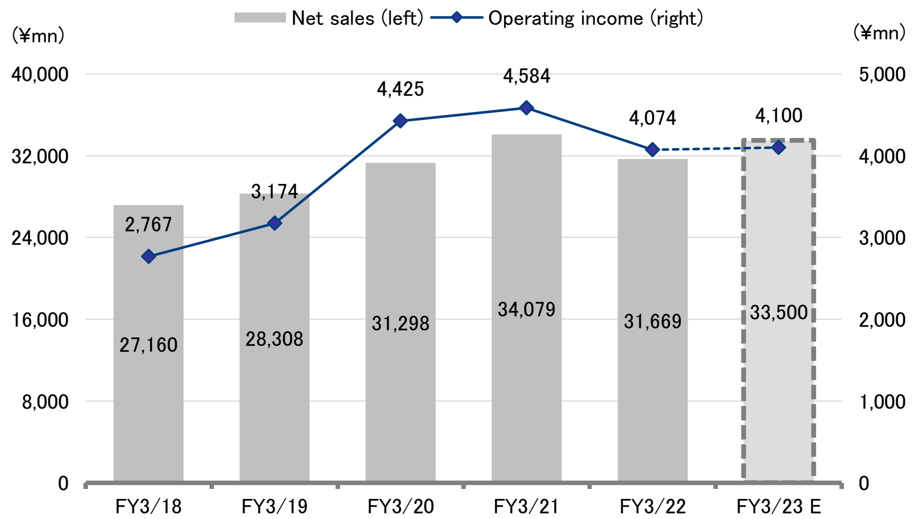
4. Phase 1 steadily progressing toward ¥4,500mn operating income in FY3/24

In response to a changing management environment caused by shifting social structures and accelerating digitalization, the Company has established "ND for the Next 2030," a set of long-term management guidelines. Along with its comprehensive strength in instrumentation engineering, the Company will solve issues related to sustainability to work for further growth, aiming to achieve net sales of ¥45,000mn and operating income of ¥6,000mn in FY3/31. The Company is currently in Phase 1 (FY2021-2023), which is aimed at building a growth foundation ahead of FY3/31, and it is working to build and strengthen this foundation by strengthening existing businesses, executing growth strategies, and growing the ND corporate culture. The Company is making steady progress in this regard. In FY3/24, it is targeting orders received of ¥35,000mn, net sales of ¥34,000mn, operating income of ¥4,500mn and ROE of 10% or higher. In addition, to fulfill its long-term management guidelines, the Company has determined that it will be important to raise capital efficiency and strengthen its policy on shareholder returns, and so it has changed its dividend policy.

Key Points

- Though slow progress in 1H FY3/23, expected to meet full-year forecasts as large projects scheduled to be completed in 2H
- Moving off a plateau for renewed growth in the air conditioning instrumentation-related business, and active business development in industrial systems, where growth is expected
- In Phase 1 of its long-term management guidelines, targeting operating income of ¥4,500mn in FY3/24 and making steady progress

Results trends



Note: Changed from FY3/21 to disclose based on non-consolidated to consolidated results, but they have been compared side-by-side for convenience
Source: Prepared by FISCO from the Company's results briefing materials

Company profile

An "instrumentation engineering" company handling building air conditioning and plant automation and contributing to the realization of a sustainable society

1. Company profile

The Company's business areas include the field of air conditioning instrumentation for automated control of air conditioning equipment in large non-residential buildings such as offices, hotels, hospitals and factories, and the field of industrial systems to automate production and conveyance lines in factories. In its mainstay field of air conditioning instrumentation, the Company has extensive experience and know-how as the largest distributor for Azbil, a major manufacturer of automated control equipment, and as a pioneer in the industry. In addition, in the air conditioning instrumentation market, a majority of which is controlled by the Azbil Group, which includes the Company, the Company has strength as an engineering company that handles everything from design to construction and maintenance. At the same time, in the field of industrial systems, where there is major room for growth, the Company is increasing the efficiency of factories and production lines through high added-value automation and energy-saving technologies based on its know-how in air conditioning instrumentation and engineering as well as the production control systems of subsidiary Jupiter Advanced Systems Co., Ltd. Instrumentation engineering not only improves building comfort and production efficiency, it can also be said to contribute to the realization of a sustainable society—one that is energy efficient and carbon-free—by reducing the carbon dioxide emitted by buildings and factories.

Air conditioning instrumentation is a stable revenue source, with industrial systems a growth driver

2. Business description

The Company's business includes the air conditioning instrumentation-related business and the industrial systems-related business, which accounted for 85.2% and 14.8% of net sales in 1H FY3/23, respectively. The air conditioning instrumentation-related business can be divided into new site work that handles air conditioning instrumentation work during building construction, and existing site work for maintenance and renovation at existing buildings. While new site installation business largely receives orders from subcontractors, existing site work involves a direct contract with the building owner or others in which the Company itself is the main contractor (as existing site work is contracted directly it is more profitable). The industrial systems-related business conducts automation and energy efficiency for factories overall from controlling production and conveyance lines to setting up robots. The Company is also boosting its system development capabilities in the industrial systems-related business, and by actively incorporating the latest AI, IoT and cloud computing technologies, it aims to provide new, high added-value services as an "Instrumentation engineering" company.

Over the medium to long term, new construction projects involving air conditioning instrumentation are not expected to grow significantly beyond existing levels because the era of new buildings being put up one after the other is over, and competition is also intensifying. At the same time, industrial systems are expected to see substantial market growth on a tailwind of factory digitalization (conversion to smart factories). For this reason, over the long term, the Company sees the air conditioning instrumentation-related business as a stable revenue source supporting the Company and the industrial systems-related business as a growth driver, and it plans to actively commit management resources to the field of industrial systems, which has major potential for further development, to boost the growth of the industrial systems-related business.

Comprehensive production of automated control system of air conditioning facilities

3. Air conditioning instrumentation-related business

The air conditioning instrumentation-related business involves the comprehensive management of automated air conditioning control systems for non-residential buildings through heat source control, air conditioning control, power control, central monitoring equipment, and other functions. By creating comfortable spaces through optimal automated control systems, and also by proposing equipment/machine upgrades, assisting with building energy management, proposing ways to save energy, and providing other related services, the Company helps customers preserve their building assets and reduce lifecycle costs. The Company's air conditioning instrumentation-related business is divided into the building systems business and the solutions business. The building systems business is the Company's mainstay business and provides one-stop services for the air conditioning systems installed in buildings when they are built, from system design to installation, pre-handover test operations and adjustments, and usage guidance at the time of handover. In addition, in the area of heat supply equipment (district heating and cooling), the Company builds systems for the automated control of equipment and devices used to supply energy. In the solutions business, the Company is involved in maintenance and upkeep of air conditioning systems and system upgrades after buildings are completed. It also assists in energy savings and reducing costs through improving energy efficiency and system operations.

Supporting conversion to smart factories

4. Industrial systems-related business

Backed by instrumentation engineering technologies, the industrial systems-related business provides services such as building automated control systems by setting up measurement devices, robots and other equipment for production processing and conveyance lines from small- to large-scale factories. Specifically, this involves automation and energy savings through electrical instrumentation work and the installation of utility equipment (cold/hot water, steam, compressed air, etc.) that meets special specifications; reduction of environmental impact, energy savings and lower operating costs through the effective use of waste hot water and waste heat discharged from factories, etc.; support for ensuring safety, improving the precision and efficiency of sorting work; use of robots in labor-intensive processes such as box filling, inspection, assembly and cargo handling to improve productivity; and ensuring safety and security (food defense) through the absence of human intervention. In short, by addressing the various issues faced by food and drug production sites, the Company supports the optimization of customer value chains. This business supports the conversion of factories to smart factories, and the market is expanding significantly. Market growth is accelerating, so the Company introduced a divisional system for the industrial systems-related business and initiated strategies specific to the business division, including establishing a service site, exhibiting at trade shows, and collaborating with plant manufacturers.

Results trends

Addressing risks in advance, including higher raw material costs and fuel price, and supply shortages

1. Industry environment

In the current business environment, new projects are accumulating, including Tokyo metro redevelopment projects, after having marked time since the 2020 Tokyo Olympics and Paralympics. However, risks have grown as well, including higher raw material costs and fuel price and supply shortages, for semiconductors in particular, caused by the global spread of COVID-19, as well as continued yen depreciation. As of the present, this is not having an impact of the Company's business results, but higher raw material costs, specifically steel prices and transportation costs, are affecting major construction companies, so there are signs of increasing price competition in the air conditioning instrumentation industry as well. However, the Company is not likely to be largely impacted as of the time being. At the same time, shortages of semiconductors and other supplies continue to have an impact. The possibility of delays in deliveries and construction schedules has been raised in the industry, but in the Company's case, it is making advance preparations from the design stage, drawing on the advantages of being a distributor that makes all purchases from Azbil, so as of the present there have been no major delivery delays.

In the industrial systems-related business, device manufacturers are highly varied, so depending on the systems manufacturer, construction periods could be extended due to delivery delays, but the situation is explained to the client, etc. at the stage the project is initiated and product arrangements have always been made in advance, so the Company expects to have this risk covered to a certain extent. At the same time, over the medium term, domestic labor shortages are expected to grow more severe, so internally and at construction sites, the Company plans to promote digitalization company-wide in order to raise work efficiency and labor productivity. In addition, in new site work, the Company will take on more high-profit properties that will lead to existing site work, and this will improve the earnings mix. In existing site work, it plans to increase use of remote maintenance using IoT and make proposals suited to a decarbonized society in order to raise added value.

Comparatively fewer large-scale project completions in 1H FY3/23

2. 1H FY3/23 results trends

The Company reported 1H FY3/23 results of ¥23,778mn in construction orders received (+25.7% YoY), ¥11,562mn in net sales (-5.2%), ¥609mn in operating income (-34.2%), ¥674mn in ordinary income (-31.1%) and ¥450mn in Net profit attributable to owners of the parent (-47.6%).

1H FY3/23 results

(¥mn)

	1H FY3/22			1H FY3/23			Change rate
	Results	% of sales	Rate of progress	Results	% of sales	Rate of progress	
Orders received	18,913	-	-	23,778	-	-	25.7%
Net sales	12,195	100.0%	38.5%	11,562	100.0%	34.5%	-5.2%
Gross profit	3,906	32.0%	36.4%	3,616	31.3%	-	-7.4%
SG&A expenses	2,979	24.4%	44.8%	3,006	26.0%	-	0.9%
Operating income	926	7.6%	22.7%	609	5.3%	14.9%	-34.2%
Ordinary income	978	8.0%	23.6%	674	5.8%	16.2%	-31.1%
Net profit attributable to owners of the parent	860	7.1%	28.4%	450	3.9%	15.7%	-47.6%

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

Construction orders received steadily accumulated for Tokyo metro redevelopment projects, factories, and research facilities, but net sales declined as a reaction to large-scale properties completed in the same period of the previous fiscal year in both new site work and existing site work. The gross profit margin declined due to more large-scale projects with relatively low profitability, and SG&A expenses increased slightly. These factors led to a decline in operating income. The Company's net sales are affected by seasonal factors. Project completion and delivery are concentrated in the fourth quarter, and operating rates increase accordingly, so 4Q sales are higher compared to the first to third quarters. For this reason, the rate of progress in 1H normally tends to decrease. Regarding progress against full-year forecasts, there were large-scale properties recorded during the same period of the previous fiscal year, so results are lower than usual; however, they are in line with plans.

Expanding business scope in the industrial systems-related business

3. Status by business

In the air conditioning instrumentation-related business, construction orders received totaled ¥21,626mn (+27.5% YoY). The breakdown includes ¥8,022mn (+68.9%) in new site work and ¥13,603mn (+11.4) in existing site work. Meanwhile, the value of completed work was ¥9,721mn (-8.6%). Of this, new site work was ¥4,251mn (+10.0%) and existing site work was ¥5,470mn (-19.2%). Net sales and orders received for control equipment were ¥129mn (+6.2%). As a result, orders received in the air conditioning instrumentation-related business totaled ¥21,755mn (+27.4%), and net sales was ¥9,851mn (-8.4%).

In the industrial systems-related business, construction orders received were ¥1,891mn (+11.4% YoY) and completed projects totaled ¥1,580mn (+20.5%). Net sales and orders received of control equipment were ¥131mn (-0.5%). As a result, orders received in the industrial systems-related business came to ¥2,022mn (+10.5%), and net sales were ¥1,711mn (+18.6%).

Results by segment in 1H FY3/23

(¥mn)

Construction orders received	1H FY3/22		1H FY3/23		
	Results	% of sales	Results	% of sales	Change rate
Air conditioning instrumentation-related business	16,960	-	21,626	-	27.5%
New site work	4,749	-	8,022	-	68.9%
Existing site work	12,211	-	13,603	-	11.4%
Industrial systems-related business	1,698	-	1,891	-	11.4%

Net sales	1H FY3/22		1H FY3/23		
	Results	% of sales	Results	% of sales	Change rate
Air conditioning instrumentation-related business	10,752	88.2%	9,851	85.2%	-8.4%
Air conditioning instrumentation work	10,631	87.2%	9,721	84.1%	-8.6%
New site work	3,864	31.7%	4,251	36.8%	10.0%
Existing site work	6,766	55.5%	5,470	47.3%	-19.2%
Control equipment sales	121	1.0%	129	1.1%	6.2%
Industrial systems-related business	1,443	11.8%	1,711	14.8%	18.6%
Industrial instrumentation work	1,310	10.7%	1,580	13.7%	20.5%
Control equipment sales	132	1.1%	131	1.1%	-0.5%

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

Initiatives in 1H FY3/23 included the following. In new site work in the air conditioning instrumentation-related business, the Company is building an optimal sales and installation system by collecting project information nationwide and working to take orders selectively that will lead to maintenance orders by strengthening coordination with existing site work sales. In existing site work, the Company is increasing the quality of maintenance services, expanding the value it provides, making proposals for a decarbonized society, and building a system of partner companies with a view to the future. In particular, to provide value, the Company is enhancing service offerings for energy savings and operations support, deepening relationships with customers through grasping and controlling equipment operating conditions, and in this way is working to create long-lasting relationships with its customers. With regard to building a partner company system, the Company intends to secure long-term capacity by eliminating personnel bottlenecks. Injecting capital into a partner company because of a lack of successor and to secure human capital, it made ND Tech Services a subsidiary. Going forward, the Company seems likely to continue investing in partners companies.

In the industrial systems-related business, the Company will make investments for organizational restructuring, establishment as a Group company, and foundation building. Regarding organizational restructuring, against the backdrop of its divisional system, it is working to flexibly and efficiently deploy onsite personnel, share sales information with the business division as whole, and strengthen human resources development by enhancing engineering education. Regarding establishment as a Group company, the Company is strengthening coordination with subsidiary Jupiter Advanced Systems Co., Ltd. and plans to offer customers its industrial systems (instrumentation) and the production control systems of Jupiter Advanced Systems on a one-stop basis in order to meet customers' needs related to conversion to smart factories and other areas. As for foundation building, the Company will continue exhibiting at trade shows and making growth investments while considering business alliances for business expansion and M&A.

As a result, construction orders received in the air conditioning instrumentation-related business increased in new site work for offices and factory properties, etc. and in existing site work for educational facilities and offices. The value of completed work increased in new site work for office and warehouse properties, etc., but in existing site work, it declined for offices, broadcast facilities and other properties. Business conditions may appear soft, but the Nittele Tower, a large hospital and other large-scale projects recorded in the same period of the previous fiscal year in both new site and existing site work were not recorded this year, and there are large-scale properties currently underway that are scheduled to be recorded in FY3/24, including Tokyo metro redevelopment projects, so it was only a numerical plateau in results. In the industrial systems-related business, construction orders received increased for electrical work, etc., and in completed projects, electrical work, industrial robot-related work and other areas increased. Properties ordered the previous fiscal year are being completed, and it can be seen that the Company's business scope is steadily expanding. In addition, the Company is strengthening partnerships with plant manufacturers and has very recently seen an increase in orders via these companies.

Project performance in 1H FY3/23

Business / Project name	Project content	Location	Date
Air conditioning instrumentation-related business / Building systems business			
Nagoya International Exhibition Hall (Port Messe Nagoya), First Exhibition Hall	Air conditioning automated control	Aichi Prefecture	June 2022
Itami City's new city hall building	Air conditioning automated control	Hyogo Prefecture	September 2022
Hilton Hiroshima	Air conditioning automated control	Hiroshima Prefecture	May 2022
Air conditioning instrumentation-related business / Solutions business			
LaLaport Tokyo-Bay, South Building	Replacement project for central monitoring facilities	Chiba Prefecture	August 2022
Nittele Tower	Heat supply system upgrade	Tokyo	September 2022
National Printing Bureau, Oji Plant	Automated control work	Tokyo	September 2022
Kotobuki Social Medical Corporation, Tominaga Hospital	Replacement project for central monitoring facilities	Osaka	August 2022
Industrial systems-related business			
TOWER BAKERY Co., Ltd.	Electrical instrumentation work	Saitama Prefecture	June 2022
Showa Sangyo Co., Ltd. Funabashi Plant	Robot installation work	Chiba Prefecture	July 2022
Ozaku Purification Plant	Electrical instrumentation work	Tokyo	September 2022
Nippon Shinyaku Co., Ltd., Odawara Central Factory	Equipment installation work	Kanagawa Prefecture	August 2022
Suntory Whisky Yamazaki Distillery	Electrical instrumentation work	Osaka	August 2022

Note: Property names are the names used internally by the Company, and may differ from official building names
Source: Prepared by FISCO from the Company's materials

Outlook

Various risks exist, but profit forecasts are conservative as usual

1. FY3/23 outlook

In its outlook for FY3/23, the Company is initially projecting construction orders received of ¥32,500mn (-4.5% YoY), net sales of ¥33,500mn (+5.8%), operating income of ¥4,100mn (+0.6%), ordinary income of ¥4,150mn (+0.3%), and net profit attributable to owners of the parent of ¥2,870mn (-5.3%). The outlook assumes that the economic environment will return to its pre-COVID-19 state, but a certain amount of risk is being anticipated as well; specifically, the persistence of COVID-19, higher raw material costs and fuel price, tight semiconductor supply-and-demand globally, and continuing yen depreciation. The Company is projecting a decline in net profit attributable to owners of the parent, but this is in reaction to Gain on sales of non-current assets recorded as extraordinary income in the previous fiscal year.

FY3/23 outlook

(¥mn)

	FY3/22		FY3/23		
	Results	% of sales	Forecast	% of sales	Change rate
Construction orders received	34,016	-	32,500	-	-4.5%
Net sales	31,669	100.0%	33,500	100.0%	5.8%
Gross profit	10,724	33.9%	-	-	-
SG&A expenses	6,649	21.0%	-	-	-
Operating income	4,074	12.9%	4,100	12.2%	0.6%
Ordinary income	4,139	13.1%	4,150	12.4%	0.3%
Net profit attributable to owners of the parent	3,029	9.6%	2,870	8.6%	-5.3%

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

For the full year, the Company is projecting construction orders received to decline on the assumption of a decline in existing site work projects. New site work is stable thanks to redevelopment projects in the Tokyo metro area and large regional projects, and even in existing site work, which faces difficulty securing personnel, the decline will likely not be large. The forecast for construction orders received is conservative as is normally the case. In the air conditioning instrumentation-related business, the Company expects large-scale projects to be completed, including Tokyo metro redevelopment projects and pharmaceutical company research facilities and plants, and is projecting an increase in net sales centering on new site work. In the industrial systems-related business, capital investment trends are expected to recover, and the Company is projecting continued increases in both construction orders received and net sales. There are many projects from pharmaceutical companies and precision equipment makers in particular that involve major electrical work, building and renovating factories, and upgrading production lines (digitalization). On the profit front, the Company is forecasting a decline in the operating income margin because it is assuming that steel prices will go up and costs like transportation expenses will rise as corporate activities are normalized. However, these forecasts are somewhat conservative as is normally the case.

Making steady progress for operating income of ¥4,500mn in FY3/24

2. Medium-term management plan

The speed of technological innovation is accelerating against a backdrop of changes in the social structure and digitalization. In order to accommodate such changes in the management environment, the Company formulated long-term management guidelines, "ND for the Next 2030." Along with its comprehensive capabilities in instrumentation engineering, a technology asset it has cultivated to date, the Company will work for further sustainable growth by solving issues related to sustainability and is targeting net assets of ¥45,000mn and operating income of ¥6,000mn in FY3/31. The Company has divided the 10 years to FY3/31 into Phase 1 (FY2021-2023) for building a growth foundation, Phase 2 (FY2024-2027) for achieving growth and further increasing business quality, and Phase 3 (FY2028-2030) for endeavoring to take another major leap forward. Medium-term management plans are being created for each phase in order to achieve steady growth. Currently, in Phase 1, the Company is working to build and strengthen a foundation for growth by promoting three growth strategies: strengthening existing businesses for stable growth of the air conditioning instrumentation-related business, executing growth strategies aimed at building a system and growth foundation for the industrial systems-related business, and growing the ND corporate culture for engaging in sustainability management. It can be said to be making steady progress on this. In FY3/24, the Company is targeting orders received of ¥35,000mn, net sales of ¥34,000mn, operating income of ¥4,500mn, and ROE of 10% or higher.

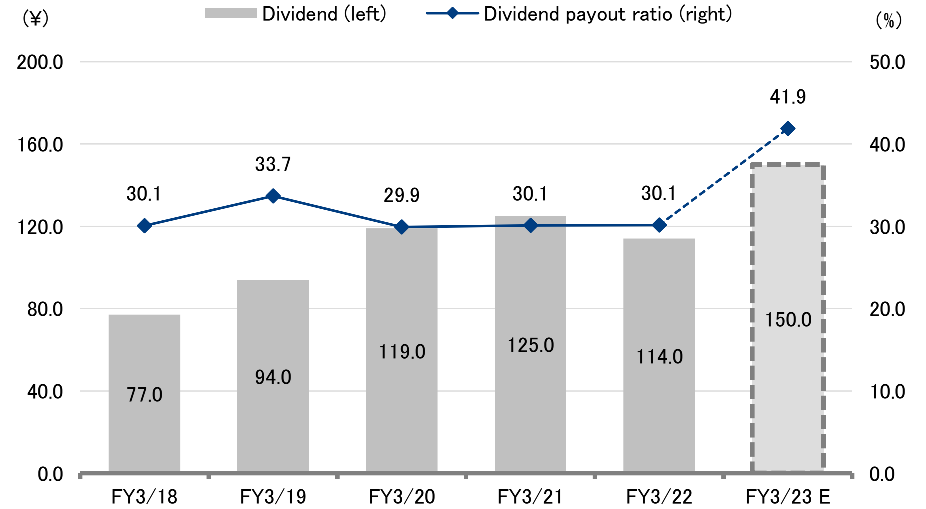
Shareholder return policy

Change in dividend policy while strengthening shareholder returns

The Company has a basic policy paying a dividend on retained earnings twice a year, an interim dividend and a year-end dividend. The body that determines these dividends is the Board of Directors for the interim dividend and the General Meeting of Shareholders for the year-end dividend. The Company's policy on internal reserves is to utilize the funds as is necessary for investing in human capital to recruit and development human resources and for expanding its business domain. Regarding shareholder returns, the Company previously had a policy of working to enhance shareholders' equity and maintain a sturdy financial base while considering growth investment and risk tolerance. It also emphasized capital efficiency, based on consolidated ROE of 10% or higher as its continuing management indicator, and returning profits to shareholders through dividends commensurate with profit growth, generally maintaining a payout ratio of around 30% unless there were events that had a major impact on results or plans for new capital investment.

Recently, the Company changed its dividend policy having determined that it will be important to work toward greater capital efficiency and enhance its shareholder return policy in order to fulfill its long-term management guidelines. As a result, the Company has set a target management indicator of consolidated ROE of 10% or higher and will work to make active investments based on capital costs and provide returns to shareholders. Regarding shareholder returns in particular, the Company's new policy is to provide a progressive dividend based on a standard DOE of 4%, unless there are events that have a major impact on results, and it will also flexibly buy back shares (if ROE is 10% and DOE is 4%, the payout ratio is 40%). Based on this, the annual dividend per share for FY3/23 has been revised and increased from the previous forecast of ¥108 (interim dividend of ¥10 and year-end dividend of ¥98) to ¥150 (interim dividend of ¥10 and year-end dividend of ¥140).

Trends in dividend and dividend payout ratio



Note: FY3/19 includes a ¥10.0 per share dividend commemorating the Company's 60th anniversary.
Source: Prepared by FISCO from the Company's financial results

FISCO

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