COMPANY RESEARCH AND ANALYSIS REPORT

SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange Prime Market

4-Jul.-2022

FISCO Ltd. Analyst
Noboru Terashima

FISCO Ltd.
https://www.fisco.co.jp

Index

Summary

Demand continued to recover in both domestic and overseas markets, and operating profit increased greatly in FY3/22. Operating profit forecast to increase in FY3/23 as well by 8.4% YoY

Sakai Heavy Industries, Ltd. <6358> (herein after also referred to as "the Company") is a manufacturer specializing in road rollers for road paving and other road construction equipment. It has a long history in this field, and boasts the industry's highest market share in Japan at over 70%. In recent years, the Company has been focusing on developing overseas markets, especially in North America and Southeast Asia.

1. Outline of results for FY3/22

In the consolidated results for FY3/22*, net sales increased 23.0% year on year (YoY) to ¥26,599mn, operating profit increased 97.3% to ¥1,383mn, ordinary profit rose 113.6% to ¥1,407mn, and profit attributable to owners of parent was ¥1,427mn (versus ¥4mn in FY3/21). Profit attributable to owners of parent grew significantly YoY as a result of recording ¥381mn of deferred tax assets at a North American subsidiary. Net sales in Japan grew steadily against a backdrop of measures to accelerate the national resilience plan. Overseas, in China, domestic sales were sluggish and unchanged from the previous fiscal year amid stagnation of the Chinese market, but North America and other regions that had been impacted by the COVID-19 pandemic in the previous fiscal year recovered substantially. Although SG&A expenses increased YoY alongside the resumption of business activities following restrictions on movement, operating profit increased greatly through an increase in gross profit (up 18.5% YoY) in conjunction with increased sales.

* Since the start of FY3/22, the Company has been applying the Accounting Standard for Revenue Recognition (ASBJ Statement No. 29, March 31, 2020) and other relevant standards, but there was no impact on FY3/22. Furthermore, figures for the previous fiscal year do not reflect the application of the standard.

2. Outlook for FY3/23

For FY3/23 consolidated results, the Company is forecasting net sales of ¥29,300mn (up 10.2% YoY), operating profit of ¥1,500mn (up 8.4%) ordinary profit of ¥1,450mn (up 3.0%), and profit attributable to owners of parent of ¥950mn (down 33.4%). The decline of profit attributable to owners of parent is mainly due to the absence of temporary deferred tax assets recorded (¥381mn) that occurred in the previous fiscal year. The outlook for net sales and profit by region has not been disclosed, but the Company's policy is to pursue sales increases in all regions. In spite of the fact that construction equipment is on track toward stable recovery as infrastructure investments increase globally, there are many uncertain factors including further increases in supply and material prices and the heightening of pressure to reorganize supply chains, in addition to the impact of lockdowns in Shanghai (restrictions on going out were virtually lifted on June 1, 2022) and the situation in Russia and Ukraine. For those reasons, the operating profit margin is projected to decline by 0.1pp YoY.

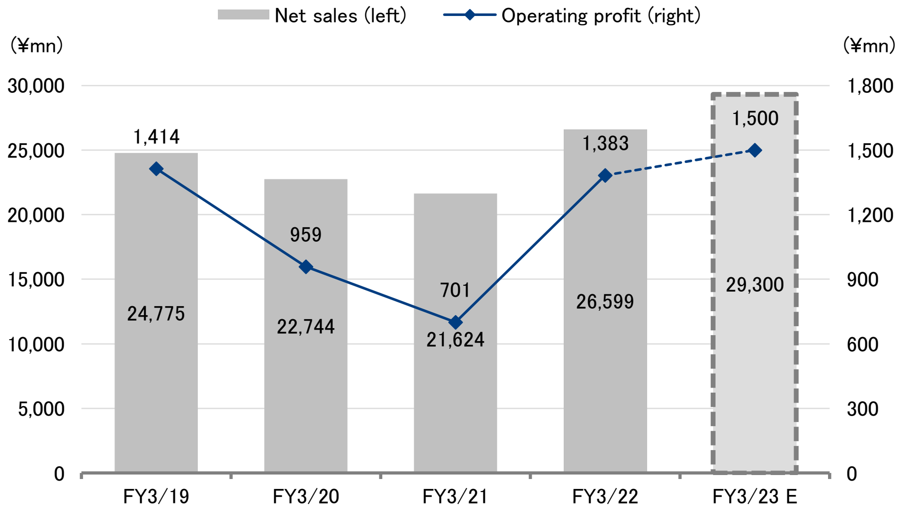
3. Medium- to long-term growth strategy

In June 2021, the Company released its "Medium-Term Management Policy" which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this, the Company will promote a "business growth strategy" and an "efficient capital strategy." In terms of numerical targets, in FY3/26, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, ROE (return on equity) of 8%, and will aim to maintain a stable dividend payout ratio of 50% (a DOE (dividend on equity ratio) of 4%). Net sales developed at a pace exceeding the plan in the first year, but the policy currently remains the same, and the Company has kept these numerical targets unchanged. With regard to dividends, a ¥165.0 annual dividend was paid in FY3/22 (a dividend payout ratio of 49.0%) and a ¥165.0 annual dividend (a dividend payout ratio of 73.6%) is also planned in FY3/23, which is currently underway. In this way, it is commendable that the Company has released a clear capital policy targeting an improvement in ROE, and is carrying out shareholder returns in line with this policy.

Key Points

- Japan's leading manufacturer of road rollers with a long history. Domestic market share is over 70%, and the Company aims to grow by expanding its overseas market share
- Demand continued to recover in both domestic and overseas markets, and operating profit increased greatly in FY3/22. Operating profit forecast to increase in FY3/23 as well by 8.4% YoY
- As medium-term numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26

Result trends



Note: Since FY3/22, the Company has been applying the Accounting Standard for Revenue Recognition
Source: Prepared by FISCO from the Company's financial results

Company profile

The top manufacturer of road rollers with a long history

The Company has a long history, dating back to 1918 when the Company was founded by Kinnosuke Sakai. At the time, the Company manufactured and repaired parts for automobiles, internal combustion engines, and steam locomotives. After starting to manufacture locomotives in 1927, in 1929 the Company started manufacturing road rollers for road rolling compaction. Since then, the Company has continued to develop as a specialized manufacturer of road rollers for paving roads and other road construction equipment. Currently, the Company is the top manufacturer in Japan, and boasts a market share of over 70%. In 1970, the Company established a joint venture in Indonesia, as part of the Company's effort to expand business overseas at an early stage. As of March 31, 2022, the Company has four domestic subsidiaries, and five overseas subsidiaries (U.S., China, three in Indonesia).

The Company listed its shares on the Second Section of the Tokyo Stock Exchange in 1964, and its shares were reclassified to the First Section of the Tokyo Stock Exchange in 1981. In conjunction with the Tokyo Stock Exchange's market recategorization in April 2022, it moved to the Prime Market.

History

Year	Description
1918	Founded by Kinnosuke Sakai with the aim of manufacturing and repairing parts for automobiles, internal combustion engines and steam locomotives
1927	Production of locomotives begins
1929	Starts producing road rollers for road rolling compaction
1949	Company is incorporated to establish SAKAI WORKS Co., Ltd.
1964	Listed on Second Section of Tokyo Stock Exchange
1967	Renamed SAKAI HEAVY INDUSTRIES, LTD.
1970	Joint venture, P.T. SAKAI SAKTI, established in Jakarta, Indonesia, to assemble and repair road rollers
1976	SAKAI AMERICA, INC. established in Delaware, U.S., for the purpose of importing/exporting and selling construction equipment
1981	Listed on First Section of Tokyo Stock Exchange
1996	Acquired ISO9001 certification, meeting international standards for quality assurance stipulated by the International Organization for Standardization
2004	Developed the world's first vibratory pneumatic tired roller (GW750)
2018	Celebrated its 100th anniversary
2019	Consolidated the three bases in Indonesia, including P.T. SAKAI INDONESIA, and established a new factory in order to bolster the local production system targeting an expansion of overseas business domains and to build a supply platform to achieve medium- to long-term growth
2022	In conjunction with the Tokyo Stock Exchange's market recategorization, moved to the Prime Market

Source: Prepared by FISCO from the Company's annual securities report and website

Business overview

The top manufacturer of road rollers with a domestic market share of over 70%. Will seek growth by offering high value-added and expanding overseas market share

1. Business description

The Company's main business is the manufacture and sale of road rollers used in road paving and other applications, and road roller-related net sales account for approximately 95% of all net sales. Also, the Company's corporate philosophy is to "Contribute to the social project of global land development through the road construction equipment business."

The term "road roller" actually covers quite a wide range of machines in terms of capabilities and size, among other features. The Company has roughly 20 platforms alone for road rollers, and when different variations are added the total number of products is in the 70-80 range. There is also a wide range in sizes, from one ton to 20 tons (for large civil engineering projects). The core price range is from ¥5mn (medium-size rollers) to ¥10mn (large rollers), but the Company also has road cutters and other machines that cost tens of millions in yen. Production is carried out on an expected production basis, and the Company does not manufacture machines based on individual orders. The useful lives of the Company's products are in the 20-30 year range, but very few customers use a machine until the end of its useful life. In most cases, they replace it after statutory depreciation (7-10 years) with a new one. Most of the depreciated equipment are resold as used machines to overseas customers (especially in developing countries).

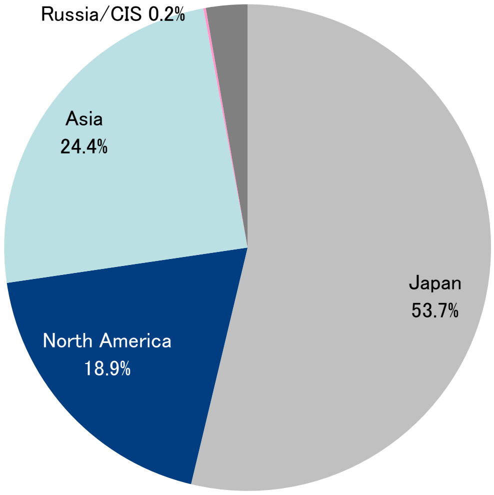
The Company's road equipment

Source: From the Company's Medium-Term Management Policy

In terms of net sales by region in FY3/22*, net sales in Japan were ¥14,292mn (53.7% of total net sales), net sales in North America were ¥5,039mn (18.9%), net sales in Asia were ¥6,492mn (24.4%), net sales in the ME and Russia/CIS were ¥44mn (0.2%) and net sales to Other regions totaled ¥731mn (2.8%).

* Net sales by region is the amount of products actually sold to customers, and differs from the reportable segment "Net Sales by Location" in the financial results.

Ratio of net sales by region in FY3/22



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

In Japan, approximately 70% of the Company's sales are to construction equipment rental companies (Kanamoto Co., Ltd. <9678>, NISHIO RENT ALL CO., LTD. <9699>, etc.), while the remaining 30% of sales are to end users (large and small- and medium-sized general contractors, roadwork companies, etc.). Sales to end users include sales via finance companies due to credit management issues. Overseas, sales are mainly to end users via distributors, but in North America some sales are through rental companies.

2. Characteristics and strengths

As mentioned above, the Company is a specialized manufacturer of road rollers and other road construction equipment, and the Company has the following special characteristics and strengths.

(1) Long history as a specialized manufacturer

The Company's greatest strength is its long history as a specialized manufacturer of road rollers and other road construction equipment. In other words, by deploying a global niche strategy through selection and concentration, the Company has increased its level of expertise and accumulated its own unique technologies. Based on this long history and its experience, the Company has boosted its technological capabilities and credibility as follows.

(2) Technological capabilities

When it comes to hardening and paving roads, the necessary pressure, torque, and other variables (compaction technology) differ depending on the specific land, land quality, soil, and other conditions. Therefore, roadwork companies often require different types of road rollers to match individual worksites (ground, etc.). According to the Company, the work function of a road roller itself determines the final quality of the road or embankment (density, flatness, lifespan). Generally speaking, a 1% rise in rolling compaction density extends the life of a road by 10%. For this reason, for companies that order roadwork as well as for roadwork companies, not only the price of the road roller, but the product quality (performance) is extremely important. Because the Company has been a specialized manufacturer of road rollers and other road construction equipment for many years, it boasts a high level of technological capabilities with respect to compaction technology, and it is not easy for its competitors to catch up to it.

The Company's technological capabilities can be summed up by the phrase "Expertise in products and services." In other words, it is the Company's engineering capabilities covering the entire roadwork process and the ability to handle a variety of materials. Specifically, combining the various technologies makes it possible to increase the quality and efficiency of roadwork. Such technologies include kneading by tires, increased rolling compaction power by vertical vibration, rubbing by horizontal vibration, thick layer compaction by vertical vibration, further high-density compaction by tire vibration, and eliminating difficult compaction issues with high-frequency vibration.

One example of the Company's strong technological capabilities is its ability to control the relationship between mechanical vibration technology and the technology to prevent this vibration. For road rollers, one important means of increasing functionality is various mechanical vibrations, but on the other hand, vibration itself can cause machine failure, and it also greatly influences operator comfort. Therefore, the ability (technology) to control the opposing relationship between enhancing vibration compaction power and machine quality is important, and this is not something that can be amassed quickly.

(3) Credibility

Credibility backed by experience engineering and track record is also a strength of the Company. The technology to ensure underground compaction quality is a black box, and is not something that is easy for late-arriving manufacturers and non-specialized manufacturers to copy. For example, asphalt mixture brought in at high temperatures must be worked on within a limited time, and if the work is of poor quality, it must be redone which involves a large price. Also, work quality issues for roads and embankments are slow to emerge, and the compaction quality at the time that work is completed tends to be a black box. For this type of experience engineering, the Company's brand which customers have used for many years and the long-term insight due to variety of worksite experiences are strengths, and these are points that have earned the trust of many customers.

3. Market share and competitors

According to data from the Japan Construction Equipment Manufacturers Association, in FY2021 domestic construction equipment shipment value was ¥2.9tn, and road roller and other road construction equipment (the Company's main products) account for 2.6% of this amount. The Company has a share of over 70% in this road equipment market, making it the top manufacturer in Japan. Competitors include companies such as Hitachi Construction Machinery Co., Ltd. <6305>, but none of these companies are specialized manufacturers. Some overseas manufacturers have entered the market in Japan, but none have much of a presence. In Japan, the Company's earnings rise and fall along with the ups and downs of the market.

In the global market, although there are no accurate statistics, the Company's market share (on a units produced basis) is estimated to be in the 5-6% range. However, this is on a global basis, and if we limit the scope to the main markets that the Company operates in (Japan, ASEAN, North America), the Company's market share is around 20%. The Company's main competitors in the global market include Caterpillar <CAT>, FAYAT SAS, Deere & Company <DE>, and Volvo Personvagnar AB, but none of these companies are manufacturers that specialize in road rollers.

Results trends

Demand continued to recover in both domestic and overseas markets, and operating profit increased greatly in FY3/22

1. Outline of results for FY3/22

In the consolidated results for FY3/22, net sales increased 23.0% YoY to ¥26,599mn, operating profit increased 97.3% YoY to ¥1,383mn, ordinary profit increased 113.6% to ¥1,407mn, and profit attributable to owners of parent was ¥1,427mn (versus a ¥4mn in FY3/21).

Net sales decreased slightly in China, but all other regions, including Japan, saw increased sales. There was substantial recovery particularly in North America and Asia, which saw decreased sales in the previous fiscal year due to the impact of the COVID-19 pandemic. The gross margin was 24.1%, down 0.9pp YoY, but this was the result of factors such as increases in raw material costs and logistics costs. However, the increase in the cost of goods sold ratio was less than initial projections. Although SG&A expenses increased by 6.7% YoY alongside the resumption of business activities following restrictions on movement, operating profit ultimately increased greatly through an increase in gross profit (up 18.5% YoY) in conjunction with increased sales. Additionally, profit attributable to owners of parent grew significantly YoY as a result of recording ¥381mn of deferred tax assets at its North American subsidiary.

Analyzing the change factors for operating profit, the increase in sales had a positive ¥1,244mn impact, the increase in the cost of goods sold ratio had an impact of minus ¥245mn, and the increase in SG&A expenses had an in impact of minus ¥316mn. Breaking down the increase in SG&A expenses, personnel expenses had a positive ¥83mn impact, shipping expenses had a positive ¥85mn impact, technology and research expenses had a positive ¥76mn impact, and other expenses had a positive ¥73mn impact.

Overview of FY3/22 consolidated results

(¥mn)

	FY3/21		FY3/22		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	21,624	100.0%	26,599	100.0%	4,974	23.0%
Gross profit	5,408	25.0%	6,407	24.1%	998	18.5%
Selling, general and administrative expense	4,707	21.8%	5,023	18.9%	316	6.7%
Operating profit	701	3.2%	1,383	5.2%	682	97.3%
Ordinary profit	659	3.0%	1,407	5.3%	748	113.6%
Profit attributable to owners of parent	4	0.0%	1,427	5.4%	1,423	-

Note: Since FY3/22, the Company has been applying the Accounting Standard for Revenue Recognition
Source: Prepared by FISCO from the Company's financial results

2. Trends by region

Domestically, sales related to public investments such as road and civil engineering projects were relatively strong against a backdrop of measures to accelerate the national resilience plan. Net sales were ¥14,292mn (up 9.6% YoY). Overseas, net sales totaled ¥12,306mn (up 43.4% YoY) because of continued recovery of demand for construction equipment in the main markets. Within this amount, in North America, net sales increased significantly to ¥5,039mn (up 55.3% YoY) as a result of infrastructure construction increasing through recovery from the COVID-19 pandemic, as well as the result of sales activities aimed at increasing market shares. In Asia, net sales were ¥6,492mn (up 33.7%) as demand recovered in the buoyant markets of Indochina, such as Vietnam and Thailand, as well as in the stagnant market of Indonesia. In other regions, net sales totaled ¥731mn (up 62.7%) as Latin America, Oceania, and Africa all trended toward recovery.

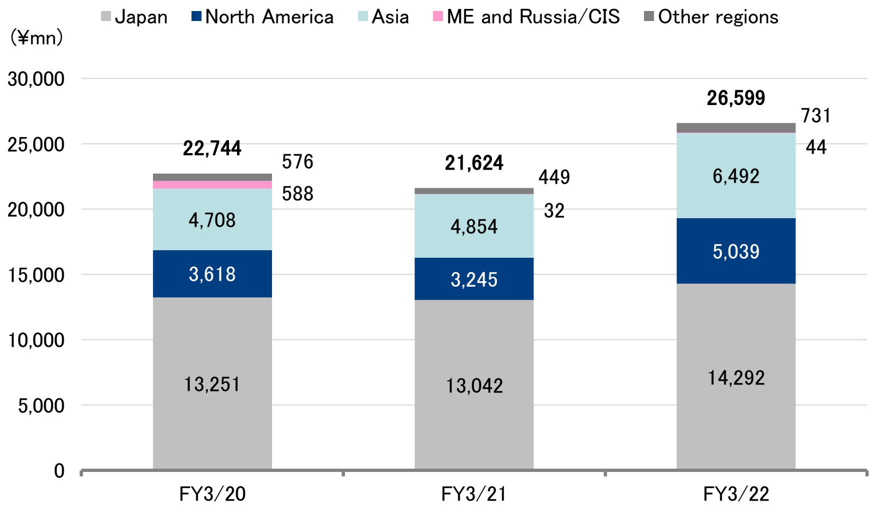
Net sales by region

(¥mn)

	FY3/20		FY3/21		FY3/22		Change	
	Results	% of total	Results	% of total	Results	% of total	Amount	%
Japan	13,251	58.3%	13,042	60.3%	14,292	53.7%	1,249	9.6%
Overseas	9,492	41.7%	8,582	39.7%	12,306	46.3%	3,724	43.4%
North America	3,618	15.9%	3,245	15.0%	5,039	18.9%	1,793	55.3%
Asia	4,708	20.7%	4,854	22.5%	6,492	24.4%	1,637	33.7%
ME and Russia/CIS	588	2.6%	32	0.2%	44	0.2%	11	35.3%
Other regions	576	2.5%	449	2.0%	731	2.8%	281	62.7%
Total	22,744	100.0%	21,624	100.0%	26,599	100.0%	4,974	23.0%

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

Trends in net sales by region



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

Stable financial condition, ample cash and deposits of ¥7,993mn

3. Financial condition

In terms of the Company's financial condition as of the end of FY3/22, current assets were ¥25,075mn (up ¥2,148mn from the end of the previous fiscal year). The main factors included a ¥1,009mn increase in cash and deposits, a ¥578mn increase in notes and accounts receivable – trade (including electronically recorded monetary claims -- operating), and a ¥157mn increase in inventories. Non-current assets were ¥12,782mn (up ¥609mn). The main factors include a ¥259mn increase in property, plant and equipment mainly through capital investment and a ¥427mn increase in investments and other assets. As a result, total assets were ¥37,858mn (up ¥2,757mn YoY).

Meanwhile, total liabilities were ¥14,697mn (up ¥1,634 from the end of the previous fiscal year). The main factors among current liabilities included a ¥1,278mn increase in payables (notes and accounts payable – trade and electronically recorded obligations – operating), a ¥582mn increase in short-term borrowings, a ¥410mn decline in long-term borrowings among non-current liabilities, and a ¥80mn decrease in deferred tax liabilities. Total net assets stood at ¥23,161mn (up ¥1,123mn), with the main factors including a ¥959mn increase in retained earnings due to the booking of profit attributable to owners of parent and a ¥168mn decrease in valuation difference on available-for-sale securities. As a result, the equity ratio as of the end of FY3/22 was 61.1% (62.7% at the end of the previous fiscal year).

Consolidated balance sheet

(¥mn)

	End of FY3/21	End of FY3/22	Change amount
Cash and deposits	6,983	7,993	1,009
Notes and accounts receivable – trade (including electronically recorded monetary claims – operating)	7,959	8,538	578
Inventories	7,050	7,207	157
Total current assets	22,927	25,075	2,148
Property, plant and equipment	6,725	6,985	259
Intangible assets	557	480	-77
Investments and other assets	4,889	5,316	427
Total non-current assets	12,173	12,782	609
Total assets	35,101	37,858	2,757
Notes and accounts payable – trade (including electronically recorded obligations – operating)	4,688	5,966	1,278
Short-term borrowings	5,105	5,688	582
Total current liabilities	11,488	13,530	2,042
Long-term borrowings	428	17	-410
Deferred tax liabilities	483	402	-80
Total non-current liabilities	1,574	1,166	-407
Total liabilities	13,062	14,697	1,634
Retained earnings	10,769	11,728	959
Valuation difference on available for-sale securities	1,732	1,564	-168
Total net assets	22,038	23,161	1,123

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

The Company has been focusing on slimming down its balance sheet, and as a result of this effort, net working capital (trade receivables + inventories – trade payables) at the end of FY3/22 declined 5.3% (down ¥542mn) YoY to ¥9,779mn. Mainly due to increasing the efficiency of inventory management, inventories increased ¥157mn to ¥7,207mn, a 23.0% increase. As a result, the net sales/inventory turnover ratio improved 0.62 times to a 3.69 times per year.

Net working capital

(¥mn)

	FY3/21 Results	FY3/22 Results	Change	
			Amount	%
Consolidated net sales (annualized consolidated net sales)	21,624	26,599	4,974	23.0%
Trade receivables	7,959	8,538	579	7.3%
Inventories	7,050	7,207	157	2.2%
Trade payables	-4,688	-5,966	-1,278	27.3%
Net working capital	10,321	9,779	-542	-5.3%

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

4. Cash flows

In FY3/22, net cash provided by operating activities was ¥2,359mn. The main revenue factors included ¥1,470mn in profit before income taxes, ¥680mn in depreciation, ¥237mn from decrease in inventories, and ¥1,103mn in increase in trade payables. The main expenditure factors included ¥369mn in increase in trade receivables.

Net cash used in investing activities was ¥263mn. This was mainly due to ¥258mn in expenditure from the purchase of property, plant and equipment. Net cash used in financing activities was ¥1,227mn. The main expenditures were ¥267mn from the decrease (net) in long- and short-term borrowings, ¥341mn in acquisition of treasury shares, and ¥468mn in dividends paid. As a result, cash and cash equivalents increased ¥1,079mn from the end of the previous fiscal year, and the balance of cash and cash equivalents at the end of FY3/22 was ¥7,926mn.

Consolidated statements of cash flows

(¥mn)

	FY3/21	FY3/22
Net cash provided by (used in) operating activities	1,525	2,359
Profit before income taxes	703	1,470
Depreciation	637	680
Change in trade receivables (- denotes increase)	-1,717	-369
Change in inventories (- denotes increase)	2,456	237
Change in trade payables (- denotes decrease)	-143	1,103
Net cash provided by (used in) investing activities	-508	-263
Net cash provided by (used in) financing activities	-812	-1,227
Change in long- and short-term borrowings (net)	-340	-267
Acquisition of treasury shares	-0	-341
Dividends paid	-343	-468
Change in cash and cash equivalents	164	1,079
Cash and cash equivalents at end of FY3/22	6,847	7,926

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

Outlook

Forecasts a 10.2% sales increase and 8.4% operating profit increase YoY since global demand for construction equipment is trending toward recovery

● Outlook for FY3/23

For FY3/23 consolidated results, the Company is forecasting net sales of ¥29,300mn (up 10.2% YoY), operating profit of ¥1,500mn (up 8.4%) ordinary profit of ¥1,450mn (up 3.0%), and profit attributable to owners of parent of ¥950mn (down 33.4%). The decline of profit attributable to owners of parent is mainly due to the absence of temporary deferred tax assets recorded (¥381mn) that occurred in the previous fiscal year.

The outlook for net sales and profit by region has not been disclosed, but the Company's policy is to pursue sales increases in all regions. In spite of the fact that construction equipment is on track toward stable recovery as infrastructure investments increase globally, there are many uncertain factors including further increases in the prices of energy and supplies and materials and the heightening of pressure to reorganize supply chains, in addition to the impact of lockdowns in Shanghai (restrictions on going out were virtually lifted on June 1, 2022) and the situation in Russia and Ukraine. For those reasons, the operating profit margin is projected to decline by 0.1pp YoY. The Company aims to achieve its targets by promoting profit structure reform through sales price revisions, cost reductions and enhancement to its product supply capabilities. It has stated that in the future, it will make revisions going as needed when it discloses quarterly financial results, so attention must be given to future developments.

Consolidated outlook for FY3/23

(¥mn)

	FY3/22		FY3/23		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	26,599	100.0%	29,300	100.0%	2,700	10.2%
Operating profit	1,383	5.2%	1,500	5.1%	116	8.4%
Ordinary profit	1,407	5.3%	1,450	4.9%	42	3.0%
Profit attributable to owners of parent	1,427	5.4%	950	3.2%	-477	-33.4%

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

Medium- to long-term growth strategy

As its medium-term growth strategy, the Company will seek to grow its overseas market share, expand overseas business domains, and create added value by developing next-generation businesses. FY3/26 targets include net sales of ¥30bn and operating profit of ¥3.1bn

In June 2021, the Company released its "Medium-Term Management Policy" which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this the Company will promote a "business growth strategy" and an "efficient capital strategy." In terms of numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, ROE of 8% in FY3/26, and will aim to maintain a stable dividend payout ratio of 50% (DOE of 4%). Net sales developed at a pace exceeding the plan in the first year, but the policy currently remains the same, and the Company had kept these numerical targets unchanged.

1. Business strategy

(1) Domestic market: Create added value through stabilization and developing next-generation businesses

The domestic market for road rollers is already in its mature phase and the Company's market share is large. Therefore, the Company will aim to grow by adding new value to existing products (high-performance, etc.), in other words, by developing next-generation businesses. Specifically, the Company plans to do the following.

a) To enhance safety, the Company will horizontally roll out models equipped with automatic emergency brake systems. This performs an emergency stop of operating equipment if a person or obstacle is in the movement path of the equipment. This function has already been added as an optional setting to the main models in Japan (the rate of emergency brake attachment is approximately 30% for medium-size rollers), and the Company's policy going forward is to horizontally roll out this function to overseas markets.

b) The Company aims to improve compaction quality with a rolling compaction management system (with CCV). This system remotely links work managers with worksites, allowing compaction quality to be confirmed and managed (e.g., number of rolling compactions) in real time. It is expected that management in the Ministry of Land, Infrastructure, Transport and Tourism ICT roadbed work will be streamlined through the acceleration response method.

c) The Company aims to improve productivity by commercializing autonomous (unmanned) driving rollers. In the autonomous driving standard equipment development project, the Company is advancing commercialization through worksite implementation testing with multiple general contractors. Specifically, through unmanned construction work, the Company aims to create safe worksites, improve productivity through efficient compaction operations, and stabilize and improve quality, independent of operator skill.

(2) Overseas markets: Increase market share and expand business domains

In overseas markets, there are many regions (countries) where demand is increasing, and there is significant room for growth given the Company's low market shares. Therefore, the Company will seek growth through the two strategies of more fully cultivating existing markets and expanding its business domains by deploying road maintenance machinery to overseas markets.

a) In Southeast Asia, the Company aims to cultivate the market and increase its product domain. Specifically, it will move ahead on deepening market activities within Indonesia as well as the ASEAN region as a central base for sales, manufacturing and services for the Indonesian base where a new plant began operating in 2019.

b) In North America, aiming to expand its market share, the Company will strengthen its North America logistics strategy and advance measures to increase its market share. Specifically, the Company will seek to expand its market share through the niche marketing strategy based on the Lanchester/Blue Ocean strategy and through engineering sales focused on improved pavement quality.

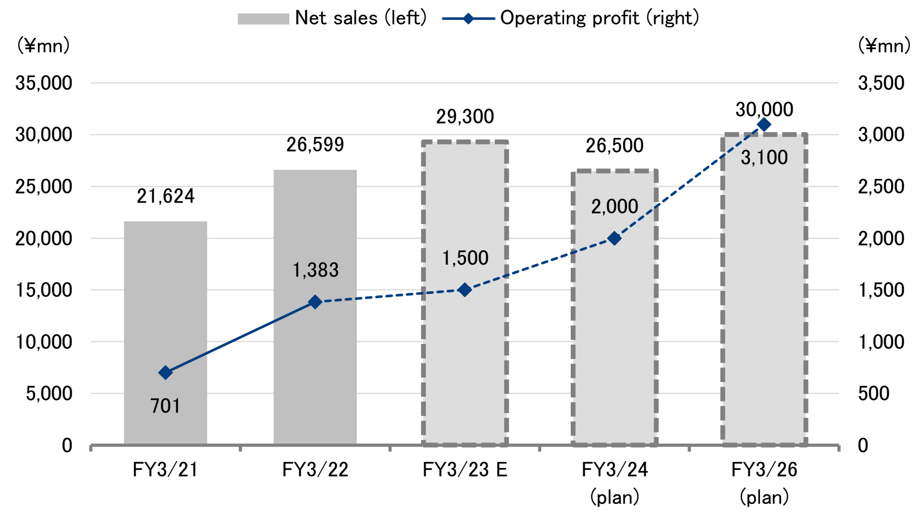
c) Aiming to expand overseas business domains, the Company will promote a strategy of cultivating markets for road maintenance machinery in ASEAN markets and ODA, along with other markets.

(3) Numerical targets

As numerical targets, the Company aims for net sales of ¥26.5bn, operating profit of ¥2.0bn, and ROE of 5.5% in FY3/24, and net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.

In terms of progress in FY3/22, net sales developed at a pace exceeding the medium-term management plan in the first year. Meanwhile, as for operating profit, the pace of improvements to the operating profit margin have slowed down in relation to the deterioration of profit structures due to fundamental increases in the prices of energy and supplies and materials and soaring logistics costs, and the Company is moving ahead with profit structure reform through sales price revision and cost reduction. The Company achieved ROE of 6.3% through the recording of ¥381mn in deferred tax assets at its North American subsidiary, but will continue to work on reforming its profit structure because the profit was recorded with temporary tax accounting methods.

Medium-and long-term targets



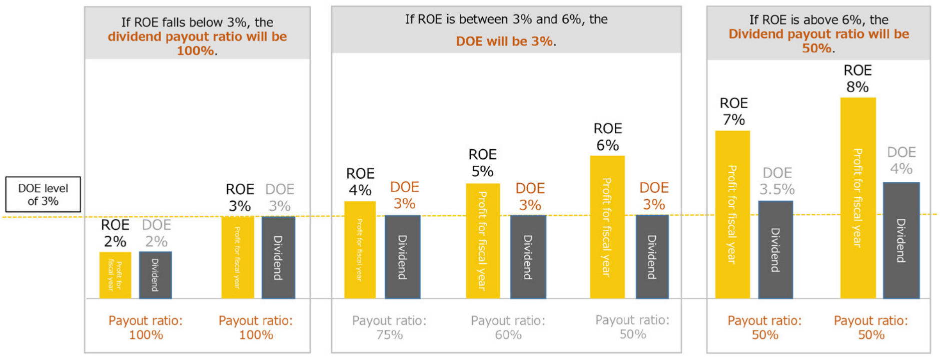
Source: Prepared by FISCO from the Company's results briefing materials

2. Capital Strategy

As its basic policy for capital strategy, the Company will return profits to shareholders at a level that supports the Company's objective of ROE of 8%, and will increase shareholder value (improve capital efficiency). As a final target for FY3/26, the Company will strive to achieve ROE of 8% and a 50% dividend payout ratio. This would be DOE of 4%.

Generally, two things need to be improved in order to increase ROE. One is of course increasing profit attributable to owners of parent, while the other is suppressing shareholders' equity (not increasing shareholders' equity more than necessary, or decreasing it). In order to increase operating profit, the Company plans to promote the business strategies discussed above, but at the same time, in order to keep from increasing shareholders' equity more than needed, the Company plans to execute a dividend policy in which, if ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%.

Basic capital policy approach



Source: Medium-Term Management Policy

In terms of share buybacks, through FY3/26 the Company will consider flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn. With respect to investment securities, the Company will review investment securities from the perspective of business strategy. Also, concerning growth investment, the Company will consider utilizing leverage with an emphasis on return on capital (ROIC).

Shareholder return policy

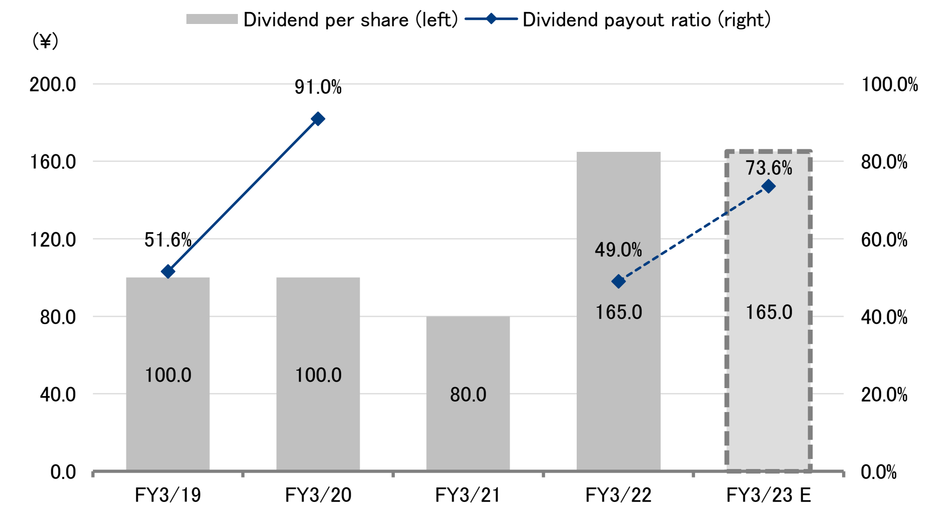
In FY3/22, paid a ¥165.0 annual dividend, up ¥85.0 YoY. Plans to pay the same dividend amount (a dividend payout ratio of 73.6%) in FY3/23 as well

The Company works to secure a stable management base over the long term, and also places importance on the continuation of stable dividends, and makes it a basic policy to distribute results that are supported by business performance and a sound financial structure. Based on this basic policy, the Company decides dividends and conducts share buybacks. As discussed above, the Company's medium-term shareholder return policy is as follows. If ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%. With respect to share buybacks, the Company is considering flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn by FY3/26.

Based on the above dividend policy, for FY3/22, the Company paid a ¥165.0 annual dividend (a dividend payout ratio of 49.0%), and plans to pay a ¥165.0 annual dividend in FY3/23 (a planned dividend payout ratio of 73.6%). Furthermore, with regard to the acquisition of treasury shares, it conducted a buyback of 130,000 shares (¥340mn) in FY3/22, but currently has no plans to conduct buybacks for FY3/23.

The Company's stance of announcing a clear policy to improve ROE and carrying out shareholder return policy in line with that is commendable, and attention should be given to its shareholder return policy going forward.

Dividend per share and dividend payout ratio



Note: FY3/21 dividend payout ratio is not shown due to the fact that it was 8,602.2%.
Source: Prepared by FISCO from the Company's financial results

Disclaimer

FISCO Ltd. (“FISCO”) offer stock price and index information for use under the approval of the Tokyo Stock Exchange, the Osaka Stock Exchange and Nikkei Inc.

This report is provided solely for the purpose of offering information, and is not a solicitation of investment nor any other act or action.

FISCO prepared and published this report based on information which it considered reliable; however, FISCO does not warrant the accuracy, completeness, fitness nor reliability of the contents of this report or the said information.

The issuers’ securities, currencies, commodities, securities and other financial instruments mentioned in this report may increase or decrease in value or lose their value due to influence from corporate activities, economic policies, world affairs and other factors. This report does not make any promises regarding any future outcomes. If you use this report or any information mentioned herein, regardless of the purpose therefor, such use shall be made based on your judgment and responsibility, and FISCO shall not be liable for any damage incurred by you as a result of such use, irrespective of the reason.

This report has been prepared at the request of the company subject hereto based on the provision of information by such company through telephone interviews and the like. However, the hypotheses, conclusions and all other contents contained herein are based on analysis by FISCO. The contents of this report are as of the time of the preparation hereof, and are subject to change without notice. FISCO is not obligated to update this report.

FISCO and its affiliated companies, as well as the directors, officers and employees thereof, may currently or in the future trade or hold the financial instruments or the securities of issuers that are mentioned in this report.

Please use the information in this report upon accepting the above points.

■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp