COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange Prime Market

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Summary

Construction projects progressed in 1H FY3/24, posted operating profit of ¥1,281mn
Balance carried forward to the next period increased 14.4% YoY and was a record high

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, manufacture, supervision, installation, sale and consultation of systems and equipment for construction facilities (mainly HVAC systems) and plant facilities (mainly water and sewage treatment and disposal plants, etc.) in office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive engineering capabilities across a diverse range of business operations, combined with advanced technology and credibility accumulated over a history of nearly 100 years.

1. 1H FY3/24: Posted operating profit based on steadily working through order backlog. Record high level of balance carried forward to the next period

The Company reported 1H FY3/24 results, with net sales of ¥89,459mn (up 21.7% YoY), operating profit of ¥1,281mn (a loss of ¥1,260mn in the same period of the previous fiscal year), ordinary profit of ¥1,878mn (a loss of ¥751mn) and profit attributable to owners of parent of ¥1,409mn (a loss of ¥770mn). The net sales growth rate was high due to the steady working through of existing projects as well as the fact that net sales were low in the year-earlier period as a result of schedule revisions for some projects. The gross profit margin was 13.4%, a big improvement from 12.5% in the year-earlier period. SG&A expenses increased only 2.6% YoY and the Company posted operating profit of ¥1,281mn, a major recovery from the year-earlier period (a loss of ¥1,260mn), and higher than the operating profit posted in 1H FY3/22 (¥1,025mn). Orders received totaled ¥125,381mn (up 5.4% YoY), a strong result, while the balance carried forward to the next period stayed at a high level of ¥224,348mn (up 14.4% YoY). This balance carried forward to the next period was the highest level ever at the end of a 1H.

2. Outlook for FY3/24 results: Operating profit forecast to increase 75.6%, which is an upward revision from the initial forecast (up 38.7%)

For FY3/24, the Company is forecasting ¥210,000mn in orders received (down 8.1% YoY), ¥215,000mn in net sales (up 12.6%), ¥9,500mn in operating profit (up 75.6%), ¥10,000mn in ordinary profit (up 60.1%), and ¥6,700mn in profit attributable to owners of parent (up 41.1%). With the 1H results, the Company upwardly revised the initial forecasts (10.0% increase in net sales, 38.7% increase in operating profit). The Company is expecting a gross profit margin of 15.1% (up 0.9ppt), and forecasting SG&A expenses to increase 6.5%. Based on the fact that 1H results (net sales, orders received, gross profit margin) were strong, there is a strong possibility that these forecasts will be achieved, and depending on the progress on project work, we at FISCO think that there is even a chance that the Company could make additional upward revisions.

3 "Century 2025" moves on to the Phase 3 medium-term management plan: Steady progress

The Company has announced "Century 2025" as its long-term vision for the 10-year period from FY3/17 to FY3/26, the 100th anniversary of its foundation. To achieve the targets of the vision, the Company has divided the 10-year period into three phases and promoted business strategies based on its medium-term management plans. The ultimate goal of the long-term vision (Phase 3 target), is to be the "Company of Choice" for even more stakeholders. The Company's quantitative targets for the final year, FY3/26, have not changed at this point in time, and are ¥220.0bn in net sales, gross profit margin of 16.5%, ¥12.0bn in ordinary profit, dividend payout ratio of 50% or higher, and ROE of 8.0% or above. These quantitative targets are probably not easy to achieve, but we at FISCO believe the important point is how the Company will change qualitatively in areas that cannot be seen, such as improvements in construction quality and productivity, work style reforms and growth investment. The further changes made by the Company going forward will be important to monitor.

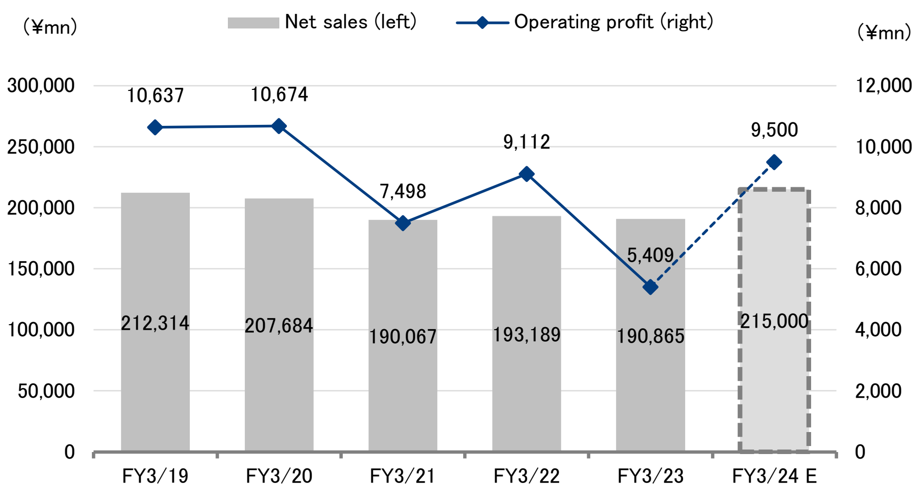
4. Actively returns profit to shareholders: Plans on dividend ratio of 56.9% in FY3/24

The Company has proactively conducted shareholder returns with stable dividends up to now, dividend hikes in recent years, and acquisition of treasury stock. The annual dividend (including extra dividends) was ¥80 in FY3/21, ¥85 in FY3/22, and ¥75 in FY3/23. With regard to treasury stock, the Company acquired 1,000,000 shares in FY3/22 and acquired another 1,500,000 shares in FY3/23. As a result, the total return ratio over the past ten years (FY3/14 to FY3/23) on a weighted average basis reached 91.6%. For FY3/24, which is ongoing, the Company is planning a regular dividend of ¥70 (forecast dividend ratio of 56.9%), and plans to acquire 1,500,000 shares of treasury stock (already acquired 48,000 shares in 1H). As such, we at FISCO believe the Company is deserving of high marks for its proactive shareholder returns policy, rather than simply aiming to increase operating results.

Key Points

- A facilities construction company affiliated with Mitsui and a domestic leader. Is currently implementing measures to improve its profit margin
- Posted operating profit in 1H FY3/24. Upwardly revised FY3/24 operating profit forecast to a 75.6% increase
- Actively returns profits to shareholders. Plans to pay a dividend of ¥70 (dividend ratio: 56.9%) and acquire 1,500,000 shares of treasury stock in FY3/24

Results trends



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

Company outline

A comprehensive engineering company conducting the Facilities Construction Business and the Plants & Machinery Systems Business with strengths in advanced technology and credibility cultivated over a long history

Sanki Engineering is a facilities company that was established in 1925 as a spin-off of the machinery division of the former Mitsui & Co., Ltd. The first large projects for the Company started with the Shiga manufacturing plant of Toyo Rayon Co., Ltd. (currently, Toray Industries, Inc. <3402>), and a refrigerated warehouse for Aomori Seihyo Co., Ltd. Initially, the Company engaged in heating, plumbing, and the supply of construction materials. It has subsequently branched out into electrical work, developing integrated facilities construction planning, design and installation as its main operations.

After World War II, the Company steadily grew on robust construction demand and surpassed ¥1.0bn in capital in 1958. In subsequent years, the Company participated in projects undertaken in preparation to host the Tokyo Olympic Games in 1964, and grew in tandem with the expansion of the Japanese economy. The Company diversified from the Facilities Construction Business, such as air-conditioning, plumbing, and electrical systems, into other types of facilities, such as transport equipment, conveyance systems, water treatment facilities and waste treatment facilities. Today, it is a leading comprehensive facilities construction company. The Company's shares were listed on the Tokyo Stock Exchange (TSE) in 1950. Currently it is listed on the TSE Prime market.

Prior to the 90th anniversary of its establishment in FY3/16, the Company announced the "Century 2025" long-term vision headed toward its 100th anniversary in 2025. It completed Phase 1 in FY3/19, and since April 2020, it has been promoting Phase 2, and in FY3/22, it can be said to have mainly achieved the initial targets. The Company has entered Phase 3, the final phase of "Century 2025," in FY3/23. The Company's activities going forward to its 100th anniversary in 2025 when this plan ends will be a focus point.

History

1925	Sanki Engineering Co., Ltd. established as a spin-off of the machinery division of the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branches, 6 sub-branch offices, 3 affiliated companies, and around 300 employees
1958	Capital exceeded ¥1,000mn
1963	Completed the Sagami Plant (currently, the Yamato Plant)
1964	Participated in projects relating to the Tokyo Olympic Games, including the Yoyogi National Gymnasium, and the NHK Broadcast Center
1982	Newly established Technical R&D Institute in Yamato City, Kanagawa Prefecture, equipped with facilities for basic research and for large-scale experiments
2000	Opened the Shonan Training Center (Yokosuka City, Kanagawa Prefecture) and strengthened human resource development
2011	Relocated its head office to the current location in the Tsukiji area of Tokyo
2016	Announced its long-term vision "Century 2025"
2018	Opened Sanki Techno Center, a comprehensive training and research facility (Yamato City, Kanagawa Prefecture)
2019	Opened the Yamato Product Center, and completed the STeP (Sanki Techno Park) project

Source: Prepared by FISCO from the Company's website, etc.

Business description

Three main segments, particularly strong in industrial HVAC

1. Outline of business by segment

The Company's main businesses come under three segments – Facilities Construction Business, Plants & Machinery Systems Business, and Real Estate Business. Its main activities are design and construction management of various facilities. The Company obtains about half of its orders directly from facility owner clients and half indirectly through general contractors.

Just as the size of the orders varies widely from a few million yen to a few billion yen, the order completion time varies from a few weeks to a few years for longer orders. The profitability of an order varies depending on factors such as labor and material costs and the management construction schedule, and some orders end up more or less profitable than originally planned.

(1) Facilities Construction Business

The Facilities Construction Business engages in activities including planning, design, installation, maintenance, and repair of facilities including office buildings, schools, hospitals, shopping centers, factories, R&D centers, and other facilities. The scope of activities handled by this business is extensive and can be further divided into the following sub-segments.

a) HVAC and plumbing for buildings

The HVAC and plumbing for buildings business provides HVAC, water supply and wastewater systems, plumbing, area heating and cooling systems, kitchen systems, and disaster readiness systems for general buildings and facilities, such as office buildings, schools, hospitals, department stores, hotels, and warehouses.

b) Industrial HVAC

The industrial HVAC business provides HVAC for factories and research facilities of all industries, especially clean room systems for semiconductor plants and pharmaceutical and food processing plants, which are areas of strength for the Company, as well as special air-conditioning systems and appurtenances for chemicals manufacturers, and manufacturers of medical equipment and the like, in addition to environmental control systems and so forth for automobile manufacturers. This is a particularly strong field for the Company, partly because of its historical background.

c) Electrical systems

The electrical systems business provides electrical equipment systems, communications-related systems, electrical civil works, and so forth.

d) Facility systems

The facility systems business offers project management and consulting services for the construction or relocation of offices and dealing rooms of financial institutions and other industries. It also provides central monitoring and automatic control systems, internet protocol (IP) solutions, network solutions, business continuity plan (BCP) solutions and other services for large-scale buildings.

(2) Plants & Machinery Systems Business

The Plants & Machinery Systems Business encompasses machinery systems and environmental systems as two sub-segments.

a) Machinery systems

The machinery systems business supplies materials handling systems, including various transportation equipment (conveyors, sorting systems, etc.), and conveyance systems for factories and automated warehouses. Demand is centered on private-sector companies and is affected by capital investment trends.

b) Environmental systems

The environmental systems business provides facilities such as for water treatment (including water and sewage treatment and disposal, industrial wastewater disposal, and sludge treatment and incineration), waste treatment (including waste incineration and landfill wastewater treatment), and others. Customers are mainly local government entities and so forth.

(3) Real Estate Business

The Real Estate Business utilizes vacant land, such as former factory sites, and manages the real estate lease business and building management business.

2. Strengths, distinguishing traits, and competitors

(1) Broad business domain and one-stop solutions

Many companies in Japan provide similar facilities construction services, but the Company's strength lies in the wide range of its businesses, which includes HVAC for building, plumbing, industrial HVAC, electrical systems, facility systems, automated control systems for buildings, transportation systems, and water treatment facilities. The Company can provide services for many types of facilities and solutions covering all phases from planning and design to installation, maintenance, repair, and replacement, depending on the life cycle of the building. This capability allows its customers to place one-stop orders to resolve their problems. Making use of "total engineering" and "life-cycle engineering," which combines a wide variety of businesses horizontally, enables the Company to provide optimal systems with high added value, which is its notable feature and the Company's strength.

(2) Top-class technology and high-quality customer base

One of the Company's main strengths is the advanced technology it has accumulated since before World War II, and this top-class technology spans a wide range of fields. Sanki Engineering has earned a reputation for reliability over decades of business, which underpins its extensive, high-quality customer base. This can also be considered a strength of the Company. In addition to its prewar achievements, the Company's involvement in numerous post-war projects, including the construction of facilities for the Tokyo Olympic Games in 1964, has enabled it to obtain orders for recent large projects, such as the ABENO HARUKAS in Osaka and Tokyo Midtown Hibiya.

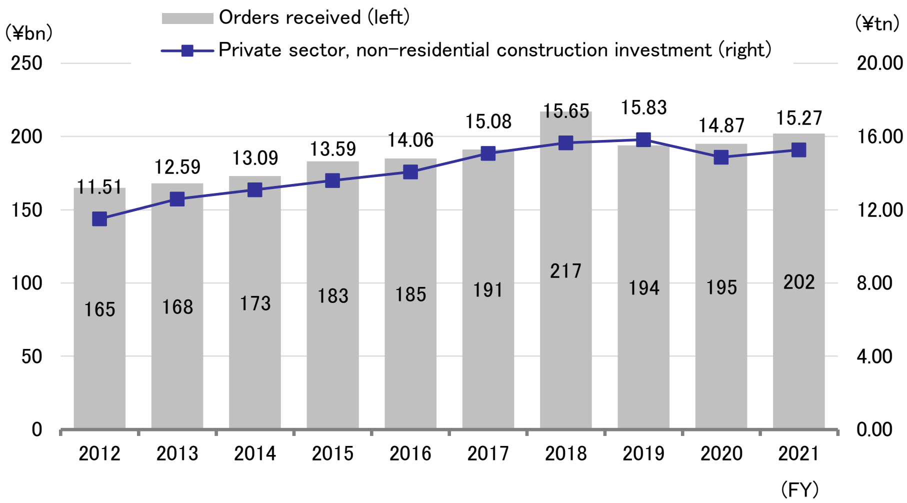
3. Main competitors

Strictly speaking, Sanki Engineering's competitors vary by project, but its main competitors among the comprehensive facilities construction companies are other large companies such as Takasago Thermal Engineering Co., Ltd. <1969>, Shinryo Corporation (unlisted), Dai-Dan Co., Ltd. <1980>, and Taikisha Ltd. <1979>. Compared to these competitors, Sanki Engineering's strengths can be said to lie in its broad business domain and its superiority in industrial HVAC systems, such as clean rooms and other factory air conditioning.

4. Trend in orders received and the economic environment

Orders received is the most important factor affecting results. Annual orders received are thought to be greatly affected by the Company's sales efforts, as well as the overall Japanese market, or the Japanese macro-economy. As the Company's main business is facilities construction, its orders received follows nearly the same trend as the macro indicator of private sector, non-residential construction investment. For this reason, the correlation between orders received and private sector, non-residential construction investment is arguably very high.

Orders received versus private sector, non-residential construction



Source: Prepared by FISCO from the Company's financial results and the Ministry of Land, Infrastructure, Transport and Tourism's "Estimate of Construction Investment"

Business trends

Posted an operating profit of ¥1,281mn in 1H FY3/24. Orders received rose 5.4% YoY, while balance carried forward to the next period was the highest level ever

1. 1H FY3/24 results overview

(1) Earnings

The Company reported 1H FY3/24 results with ¥89,459mn in net sales (up 21.7% YoY), ¥1,281mn in operating profit (a loss of ¥1,260mn in the same period of the previous fiscal year), ¥1,878mn in ordinary profit (a loss of ¥751mn), and ¥1,409mn in profit attributable to owners of parent (a loss of ¥770mn).

The net sales growth rate was high due to the steady working through of existing projects as well as the fact that net sales were low in the year-earlier period as a result of schedule revisions of some projects. The gross profit margin was 13.4%, an improvement of 0.9 ppt YoY, due to the steady working through of comparatively high profit margin projects. SG&A expenses increased 2.6% YoY due to factors such as an increase in expenses accompanying the increase in personnel expenses and higher sales, as well as higher depreciation in conjunction with DX investment, but stayed within budget. As a result, operating profit was ¥1,281mn, a major recovery from the year-earlier period (a loss of ¥1,260mn), and it is worth noting that this also exceeded the profit posted in 1H FY3/22 (¥1,025mn).

Orders received totaled ¥125,381mn (up 5.4% YoY), a strong result, while the balance carried forward to the next period stayed at a high level of ¥224,348mn (up 14.4% YoY). This balance carried forward to the next period was the highest level since the Company began announcing interim financial results.

1H FY3/24 results

(¥mn)

	1H FY3/23		1H FY3/24		YoY	
	Results	Vs. net sales	Results	Vs. net sales	Amount	Change %
Orders received	118,914	-	125,381	-	6,466	5.4%
Balance carried forward	196,142	-	224,348	-	28,205	14.4%
Net sales	73,510	100.0%	89,459	100.0%	15,949	21.7%
Gross profit	9,161	12.5%	11,969	13.4%	2,808	30.6%
SG&A expenses	10,422	14.2%	10,688	11.9%	266	2.6%
Operating profit	-1,260	-1.7%	1,281	1.4%	2,541	-
Ordinary profit	-751	1.0%	1,878	2.1%	2,629	-
Profit attributable to owners of parent	-770	1.0%	1,409	1.6%	2,179	-

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

(2) Earnings by segment

The Facilities Construction Business posted net sales of ¥74,014mn (up 25.0% YoY). By sub-segment, in HVAC and plumbing for buildings, sales declined to ¥22,431mn (down 5.0%) due to projects becoming larger (meaning a longer period of time from when the order is received to when the sale is recorded) and because sales in FY3/23 were strong, but the level remains high and is not cause for concern. Industrial HVAC, an area of strength for the Company, posted sales of ¥34,623mn (up 59.2%), a significant increase as the Company worked through its ample order backlog. Semiconductor-related sales, etc. were particularly strong. Electric systems posted sales of ¥10,035mn (up 0.8%). The Company worked through its order backlog centered on large data center projects which it acquired over the past two years. Facility systems recorded a large increase in sales, up 78.0% to ¥6,923mn, with the completion of office relocation projects contributing in particular.

The Plants & Machinery Systems Business reported net sales of ¥14,193mn (up 8.6% YoY). By sub-segment, machinery systems posted sales of ¥4,637mn (up 47.1%). This was primarily due to a reversal from the year-earlier period when sales were weak due to fewer orders of conveyance equipment construction projects. The level of sales returned to being generally on par with FY3/22 (¥4,952mn). Environmental systems posted sales of ¥9,556mn (down 3.6%), which was a slight YoY decline, but this can be said to have been not necessarily a poor result considering large projects involving industrial waste treatment plants were completed the previous period, and sales remained around the ¥10,000mn level. Real Estate Business sales totaled ¥1,242mn (up 0.5%) and Others sales were ¥283mn (up 18.1%).

Regarding profit (gross profit) by segment, the Facilities Construction Business reported ¥9,583mn (up 34.3% YoY). There was a reversal from the year-earlier period when profit declined due to a drop in sales, and it was 9.6% higher than 1H FY3/22. In the sub-segments, gross profit for HVAC and plumbing for buildings, industrial HVAC, and electrical systems increased 27.5% to ¥8,308mn, mainly due to ongoing growth in industrial HVAC. Facilities systems posted gross profit of ¥1,275mn (up 104.4%) due to strong sales resulting in higher profit.

The Plants & Machinery Systems Business reported gross profit of ¥1,974mn (up 24.8%), a strong result. By sub-segment, machinery systems posted ¥417mn (up 71.0%), a high level of profit growth in conjunction with higher sales. This was mainly the result of the very low level of profit in the year-earlier period due to the impact of rising material prices for mainstay conveyors and other items. Meanwhile, environmental systems posted a solid result, contributing ¥1,556mn (up 16.4%). Water treatment-related projects performed particularly well. In the Real Estate Business and Others, gross profit was ¥488mn (down 0.5%) and ¥17mn (up ¥13mn), respectively.

Net sales and gross profit by segment

(¥mn)

	1H FY3/23		1H FY3/24		YoY	
	Results	Vs. net sales	Results	Vs. net sales	Amount	Change %
Net sales	73,510	100.0%	89,459	100.0%	15,949	21.7%
Facilities Construction Business	59,208	80.5%	74,014	82.7%	14,806	25.0%
HVAC and plumbing for buildings	23,612	32.1%	22,431	25.1%	-1,181	-5.0%
Industrial HVAC	21,751	29.6%	34,623	38.7%	12,872	59.2%
Electrical systems	9,953	13.5%	10,035	11.2%	82	0.8%
Facility systems	3,890	5.3%	6,923	7.7%	3,033	78.0%
Plants & Machinery Systems Business	13,068	17.8%	14,193	15.9%	1,126	8.6%
Machinery systems	3,151	4.3%	4,637	5.2%	1,486	47.1%
Environmental systems	9,916	13.5%	9,556	10.7%	-360	-3.6%
Real Estate Business	1,235	1.7%	1,242	1.4%	7	0.5%
Others	240	0.3%	283	0.3%	43	18.1%
Adjustments	-242	-	-274	-	-32	-
Gross profit	9,161	12.5%	11,969	13.4%	2,808	30.6%
Facilities Construction Business	7,138	12.1%	9,583	12.9%	2,445	34.3%
Building HVAC, industrial HVAC, and electrical systems	6,514	11.8%	8,308	12.4%	1,794	27.5%
Facility systems	623	16.0%	1,275	18.4%	652	104.4%
Plants & Machinery Systems Business	1,581	12.1%	1,974	13.9%	393	24.8%
Machinery systems	244	7.7%	417	9.0%	173	71.0%
Environmental systems	1,337	13.5%	1,556	16.3%	219	16.4%
Real Estate Business	491	39.8%	488	39.3%	-3	-0.5%
Others	4	-	17	-	13	264.4%
Adjustments	-53	-	-93	-	-39	-

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

Larger projects being ordered

(3) Orders received by segment

In the Facilities Construction Business, overall orders received fell slightly by 5.5% YoY to ¥95,333mn, but increased by 37.8% compared to 1H FY3/22, thus this can be said to be a high level. By sub-segment, HVAC and plumbing for buildings booked orders received of ¥27,063mn (down 25.6%), but in the previous 1H the Company received large orders which led to the big decline YoY. However, this was still 0.9% higher than 1H FY3/22, so it was not a bad result. Industrial HVAC saw orders received of ¥42,792mn (down 1.3%), but this was 95.0% higher than in 1H FY3/22, and it continued to see a high level of orders, primarily related to the semiconductor industry and EV batteries. Electrical systems had orders of ¥16,938mn (up 29.0%), which was strong. Facility systems had orders received of ¥8,539mn (up 29.0%), which also continued to be solid.

The Plants & Machinery Systems Business reported orders received of ¥28,885mn (up 69.7%), which was strong, and large-scale and long-term orders in environmental systems contributed to this result. By subsegment, machinery systems was decent, with orders received of ¥5,028mn (down 6.1%). Meanwhile, in environmental systems, orders received increased a significant 104.5% to ¥23,856mn. This can be said to be a very high level, as despite a rebound drop in the previous year due to an intentional curbing of orders received to a certain extent based on ample existing projects, it was higher than the level in 1H FY3/22, when large orders were received and orders received totaled ¥21,331mn. In areas other than facilities work segments, orders received in the Real Estate Business totaled ¥1,242mn (up 0.5% YoY) and in Others totaled ¥301mn (up 24.3%).

As a result, total orders received in 1H FY3/24 (including adjusted amounts) was ¥125,381mn (up 5.4% YoY), and balance carried forward to the next period at the end of 1H FY3/24 was ¥224,348mn (up 14.4%). What is notable is that this level is the highest level ever since the Company began announcing financial results for interim periods. By industry, there was high growth in industries including automobiles, pharmaceuticals, machinery, finance and insurance, services, and the public sector.

Orders for large-scale projects (orders exceeding ¥1.0bn) included 10 projects totaling ¥41,415mn. Order volume declined from 13 projects in the year-earlier period to 10 projects, but the order value increased 17.0% YoY, and the average value per deal was ¥4,142mn (compared to ¥2,724mn in the year-earlier period), which shows that projects have gotten larger.

Orders received by segment

(¥mn)

	1H FY3/23		1H FY3/24		YoY	
	Results	Compared to orders received	Results	Compared to orders received	Amount	Change %
Orders received	118,914	100.0%	125,381	100.0%	6,467	5.4%
Facilities Construction Business	100,893	84.8%	95,333	76.0%	-5,560	-5.5%
HVAC and plumbing for buildings	36,361	30.6%	27,063	21.6%	-9,298	-25.6%
Industrial HVAC	43,334	36.4%	42,792	34.1%	-542	-1.3%
Electrical systems	14,578	12.3%	16,938	13.5%	2,360	16.2%
Facility systems	6,618	5.6%	8,539	6.8%	1,921	29.0%
Plants & Machinery Systems Business	17,021	14.3%	28,885	23.0%	11,864	69.7%
Machinery systems	5,353	4.5%	5,028	4.0%	-325	-6.1%
Environmental systems	11,667	9.8%	23,856	19.0%	12,189	104.5%
Real Estate Business	1,235	1.0%	1,242	1.0%	7	0.5%
Others	242	0.2%	301	0.2%	59	24.3%
Adjustments	-477	-	-381	-	-	-

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

Breakdown of large-scale projects with orders exceeding ¥1.0bn

(projects)

	1H FY3/22	1H FY3/23	1H FY3/24
Offices	-	3	-
Factories	-	4	7
Research institutes	-	1	-
Hospitals and clinics	1	1	-
Other building interiors	2	1	-
School buildings and auditoriums	-	1	-
Multipurpose building	-	1	-
Waste processing facilities	2	-	2
Water and sewage treatment plants	2	1	1
Total	7	13	10
Amount (¥mn)	19,863	35,409	41,415

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

Increase in cash and deposits and investment securities, with a period-end equity ratio of 55.0%

2. Financial condition

Looking at the Company's financial condition at the end of 1H FY3/24, current assets totaled ¥109,562mn (down ¥5,950mn compared to the end of FY3/23). This was mainly due to an increase of ¥4,990mn in cash and deposits and an increase of ¥1,999mn in investment securities, along with a decrease of ¥14,306mn in sales receivables (notes and accounts receivable, electronic record claims, notes and accounts receivable on completed construction contracts and other and contract assets). Noncurrent assets were ¥62,030mn (up ¥5,237mn). This was primarily because of a decrease of ¥142mn in property, plant and equipment due to depreciation, a decrease of ¥95mn in intangible assets, and an increase of ¥5,474mn in investments and other assets due to an increase in investment securities. As a result, total assets at the end of 1H FY3/24 were ¥171,592mn (down ¥713mn). Because this is a comparison of FY3/23-end and 1H FY3/24-end, the recovery of sales receivables resulted in an increase in cash and deposits and investment securities.

Current liabilities were ¥63,126mn (down ¥6,523mn compared to the end of FY3/23). This was mainly due to decreases of ¥3,329mn in accounts payable (accounts payable on construction contracts, including electronic record liabilities), a decrease of ¥430mn in short-term loans payable, and an increase of ¥786mn in contract liabilities. Noncurrent liabilities were ¥13,927mn (up ¥2,185mn), with the main factors including a decrease of ¥175mn in long-term loans payable, an increase of ¥356mn in liability for retirement benefits, and an increase of ¥2,077mn in deferred tax liabilities. As a result, total liabilities at the end of 1H FY3/24 were ¥77,053mn (down ¥4,339mn). Total net assets totaled ¥94,538mn (up ¥3,625mn), mainly due to a decrease of ¥2,918mn in retained earnings due to the payment of dividends, a decrease of ¥2,175mn in treasury shares accompanying retirement of shares, and a ¥4,115mn increase in unrealized gains on securities. As a result, the equity ratio at the end of 1H FY3/24 was 55.0% (versus 52.6% at the end of FY3/23).

Balance sheet

(¥mn)

	FY3/22	1H FY3/24	YoY change
Cash and deposits	24,949	29,939	4,990
Investment securities	4,000	5,999	1,999
Notes and accounts receivable on completed construction contracts and other, contract assets, and electronic record claims	77,141	62,835	-14,306
Costs on construction contracts in progress	2,801	4,341	1,540
Current assets	115,512	109,562	-5,950
Tangible noncurrent assets	13,037	12,895	-142
Intangible noncurrent assets	2,302	2,207	-95
Investments and other assets	41,453	46,927	5,474
Noncurrent assets	56,793	62,030	5,237
Total assets	172,305	171,592	-713
Accounts payable on construction contracts, electronic record liabilities	36,741	33,412	-3,329
Short-term loans payable	6,674	6,244	-430
Contract liabilities	15,027	15,813	786
Current liabilities	69,649	63,126	-6,523
Long-term loans payable	1,400	1,225	-175
Liability for retirement benefits	3,861	4,217	356
Deferred tax liabilities	64	2,141	2,077
Noncurrent liabilities	11,742	13,927	2,185
Total liabilities	81,392	77,053	-4,339
Total net assets	90,913	94,538	3,625

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

3. Cash flow conditions

In 1H FY3/24 net cash provided by operating activities was ¥9,402mn. The main inflows included profit before income taxes of ¥2,148mn, depreciation of ¥866mn, and a ¥14,386mn decline in trade receivables and contract assets, while the main outflows were a decrease of ¥3,353mn in trade payables. Net cash used in investing activities was ¥612mn. The main inflows included ¥566mn from the sale of investment securities, while the main outflows included ¥1,000mn for the purchase of investment securities and ¥458mn for the purchase of property, plant and equipment. Net cash used in financing activities was ¥2,930mn. The main outflows were ¥617mn in repayments of long-term borrowings, ¥79mn for the purchase of treasury shares, and ¥2,177mn for dividends paid.

Cash and cash equivalents hence increased ¥5,989mn in 1H FY3/24 to a period-end balance of ¥30,939mn.

Statement of cash flows

(¥mn)

	1H FY3/23	1H FY3/24
Cash flows from operating activities	-1,201	9,402
Profit before income taxes	-896	2,148
Depreciation	735	886
Change in trade receivables and contract assets (- indicates increase)	19,201	14,386
Change in notes and accounts payable on construction contracts and other (- indicates decrease)	-12,235	-3,353
Cash flows from investment activities	216	-612
Purchase of investment securities (net)	1,000	-1,000
Purchase of property, plant and equipment	-245	-458
Proceeds from sale of investment securities	109	566
Cash flows from financing activities	-3,668	-2,930
Change in short- and long-term loans payable (net)	-695	-617
Purchase of treasury shares	-134	-79
Cash dividends paid	-2,788	-2,177
Change in cash and cash equivalents (- indicates decrease)	-4,540	5,989
Cash and cash equivalents at end of period	40,238	30,939

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

Outlook

Upwardly revised operating profit forecast for FY3/24, now forecasting a 75.6% YoY increase

For FY3/24, the Company is forecasting orders received of ¥210,000mn (down 8.1% YoY), net sales of ¥215,000mn (up 12.6%), operating profit of ¥9,500mn (up 75.6%), ordinary profit of ¥10,000mn (up 60.1%), and profit attributable to owners of parent of ¥6,700mn (up 41.1%). These all represent upward revisions to the initial forecasts (orders received: ¥190,000mn; net sales: ¥210,000mn; operating profit: ¥7,500mn).

Uncertainties remain, including the Russia/Ukraine situation, the situation in the Middle East, and the impacts of trade friction between the U.S. and China, but the Company plans to achieve its targets by steadily accumulating sales through existing projects. Orders received have been solid the past few years and the balance of carried over projects is also at a high level, so the Company's forecasts are conservative.

In the Facilities Construction Business, the Company is forecasting net sales of ¥175,000mn (up 12.3% YoY). By sub-segment, sales from HVAC and plumbing for buildings are projected to decrease 2.3% to ¥58,000mn. There are ample existing projects, but with projects becoming larger and construction periods lengthening as a result, many will be completed after FY3/24. There are ample existing projects in industrial HVAC, and the Company expects steady progress on these, so sales are forecast to increase 29.0% to ¥76,000mn. Sales from electrical systems are expected to increase 5.2% to ¥27,000mn as a result of existing projects being steadily completed, and sales from facility systems are projected to rise 18.8% to ¥14,000mn due to steady orders received. Net sales in the Plants & Machinery Systems Business are forecast at ¥38,000mn (up 15.6%). By sub-segment, sales from machinery systems are expected to increase by 56.6% to ¥12,000mn, partly in reversal of the large decline in FY3/23. Net sales from environmental systems are projected to increase 3.2% to ¥26,000mn. Net sales in the Real Estate Business and Others are expected to be ¥2,400mn (down 2.9%) and ¥500mn (down 10.1%), respectively, both generally on par with the previous fiscal year.

Orders received were initially expected to be ¥190,000mn because orders have been solid the past two years and existing projects are at a high level, so the level was significantly curbed from the previous year, but due to receiving multiple large orders in environment systems, the Company upwardly revised this to ¥210,000mn (down 8.1% YoY). In the mainstay Facilities Construction Business, orders received are expected to be ¥164,000mn (down 15.8% YoY) due to having been at a high level in the previous fiscal year. Sub-segment forecasts are for ¥43,000mn in HVAC and plumbing for buildings (down 42.5%) due to the high level in the previous year and other factors, ¥82,000mn in industrial HVAC (up 5.0%) due to projections for continued solid performance, ¥25,000mn in electrical systems (down 12.4%) based on the high level in the past three years, and ¥14,000mn in facility systems (up 4.6%) due to the forecast for continued solid orders received in 2H for central monitoring control system-related projects. The Company expects ¥44,000mn in orders in the Plants & Machinery Systems Business (up 39.3% YoY). Sub-segment forecasts are for ¥12,000mn in machinery systems (up 3.0%), which is flat YoY. Environmental systems are forecasting orders received of ¥32,000mn (up 60.6%) as the level of orders in the previous year had been low. In the Real Estate Business and Others, the Company is expecting orders received of ¥2,400mn (down 2.9%) and ¥500mn (down 7.7%), respectively, both generally on par with the previous fiscal year.

The Company is forecasting the gross profit margin to improve from 14.2% in the previous fiscal year to 15.1%, but this is below the 15.6% recorded in FY3/22. The Company projects gross profit of ¥32,500mn (up 20.3% YoY). It projects SG&A expenses of ¥23,000mn (up 6.5%), mainly owing to growth in personnel expenses due to work style reforms and an increase in depreciation accompanying DX investment. As a result, it forecasts operating profit will rise 75.6% YoY to ¥9,500mn.

FY3/24 forecast

(¥mn)

	FY3/23		FY3/24 E			
	Result	Component ratio	Result	Component ratio	YoY change	Change %
Orders received	228,554	100.0%	210,000	100.0%	-18,554	-8.1%
Facilities Construction Business	194,809	85.2%	164,000	78.1%	-30,809	-15.8%
HVAC and plumbing for buildings	74,802	32.7%	43,000	20.5%	-31,802	-42.5%
Industrial HVAC	78,082	34.2%	82,000	39.0%	3,918	5.0%
Electrical systems	28,542	12.5%	25,000	11.9%	-3,542	-12.4%
Facility systems	13,383	5.9%	14,000	6.7%	617	4.6%
Plants & Machinery Systems Business	31,583	13.8%	44,000	21.0%	12,417	39.3%
Machinery systems	11,654	5.1%	12,000	5.7%	346	3.0%
Environmental systems	19,929	8.7%	32,000	15.2%	12,071	60.6%
Real Estate Business	2,471	1.1%	2,400	1.1%	-71	-2.9%
Others	542	0.2%	500	0.2%	-42	-7.7%
Adjustments	-853	-	-900	-	-47	-
Net sales	190,865	100.0%	215,000	100.0%	24,135	12.6%
Facilities Construction Business	155,778	81.6%	175,000	81.4%	19,222	12.3%
HVAC and plumbing for buildings	59,392	31.1%	58,000	27.0%	-1,392	-2.3%
Industrial HVAC	58,933	30.9%	76,000	35.3%	17,067	29.0%
Electrical systems	25,668	13.4%	27,000	12.6%	1,332	5.2%
Facility systems	11,784	6.2%	14,000	6.5%	2,216	18.8%
Plants & Machinery Systems Business	32,861	17.2%	38,000	17.7%	5,139	15.6%
Machinery systems	7,661	4.0%	12,000	5.6%	4,339	56.6%
Environmental systems	25,200	13.2%	26,000	12.1%	800	3.2%
Real Estate Business	2,471	1.3%	2,400	1.1%	-71	-2.9%
Others	556	0.3%	500	0.2%	-56	-10.1%
Adjustments	-802	-	-900	-	-98	-
Gross profit	27,012	14.2%	32,500	15.1%	5,488	20.3%
SG&A expenses	21,603	11.3%	23,000	10.7%	1,397	6.5%
Operating profit	5,409	2.8%	9,500	4.4%	4,091	75.6%
Ordinary profit	6,247	3.3%	10,000	4.7%	3,753	60.1%
Profit attributable to owners of parent	4,750	2.5%	6,700	3.1%	1,950	41.1%

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

Medium-term management plan

Entered Phase 3, the final stage of "Century 2025" and target values are unchanged

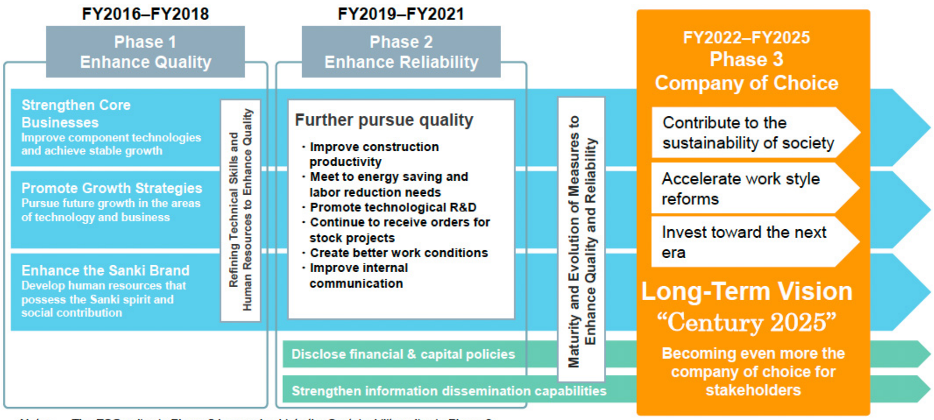
1. What is the "Century 2025" long-term vision?

In March 2016, the Company announced the long-term vision "Century 2025," which covers the 10-year period until the 100th anniversary of its establishment. The first three years of this plan (FY3/17 to FY3/19) are Phase 1, the next three years (FY3/20 to FY3/22) are Phase 2, and the final four years (FY3/23 to FY3/26) are Phase 3. In each phase, the Company has set various qualitative and quantitative goals, and it can be said to have mainly achieved these up to the completed Phase 2. The Company has entered Phase 3, starting from FY3/23, which is the finishing phase of "Century 2025."

2. Basic policy of Phase 3

Phase 3 is the finishing medium-term plan for the long-term vision "Century 2025." The basic policy of the plan is to further mature and evolve its existing strategies for increasing quality and reliability, adding the three new strategies of "contribute to the sustainability of society," "accelerate work style reforms," and "invest toward the next era," aiming to be the "Company of Choice" for even more stakeholders.

Overview of Phase 3 measures



Note: The ESG policy in Phase 2 has evolved into the Sustainability policy in Phase 3
Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

3. Phase 3 results and management targets

● "Century 2025" final year results and management targets

The Company's quantitative targets for the final year, FY3/26, are net sales of ¥220.0bn, a gross profit margin of 16.5%, ordinary profit of ¥12.0bn, a dividend payout ratio of 50% or higher, and ROE of 8.0% or higher. While these are by no means easy targets, we at FISCO believe that what is important is not just simply attaining the quantitative targets, but also how the Company goes about making qualitative changes that are out of sight, including construction quality and productivity enhancements, work style reforms, and growth investments.

Phase 3 (FY3/26) results targets

(¥bn)

	FY3/26
Net sales	2,200
Gross profit	360
(%)	16.5%
Ordinary profit	120
(%)	5.5%

Source: Prepared by FISCO from the Company's "Status of Business Progress in the Medium-Term Management Plan"

Phase 3 (FY3/26) management targets

Ordinary profit margin	5.0% or above (final year)
Dividend policy	Dividend payout ratio of 50% or above Annual dividend of ¥70 or above per share
Acquisition of treasury stock	Approximately 5,000,000 shares*
ROE	8.0% or more
Growth investment	Approximately ¥20.0bn*

* Accumulative over the period of the plan
Source: Prepared by FISCO from the Company's "Status of Business Progress in the Medium-Term Management Plan"

4. Phase 3 KPI

As KPIs for Phase 3, the Company has newly established the targets as follows.

(1) Facilities Construction Business
- Analyze the root cause of problems/complaints (within 5 years after the completion of construction): 100%, report the results of root cause analysis: 4 times/year
- Develop digital and robotic technologies related to construction: 5 projects/year, actual cases of application of developed technology: 5 projects/year

(2) Facility Systems Business
- Orders received for consulting/facility engineering: ¥400mn
- Orders received related to NeWSICT (Next Work Style with ICT): ¥500mn
- Orders received for project management and construction work stemming from consulting-related activities: ¥2.1bn

(3) Machinery Systems Business
- Net sales of robot systems: ¥5.0bn (cumulative)

(4) Environmental Systems Business
- Orders received (cumulative): AEROWING ¥3.6bn; G3 decanter centrifuge ¥2.0bn; fluidized bed incinerator 2 units

(5) E (environment)
- Scope 1 and 2: 40% reduction in CO_2 emissions from FY2020 levels
- Scope 3: 10% reduction in CO_2 emissions from FY2020 levels
- Reduce CO_2 emissions based on the SANKI YOU Eco Contribution Point system by an additional 30% compared to the 3-year average for FY2018-2020

(6) S (society)

- Rate of childcare leave taken: Men 50%, women 100%
- Ratio of women in managerial positions in April 2026: 3.0%

(7) Others

- Investments for the next era (decarbonization technology, energy-saving and labor-reduction technologies, LCE business, digital transformation (DX)): ¥20.0bn

5. Phase 3 results targets and progress

As of the completion of 1H FY3/24, the progress on each quantitative target discussed above is as shown in the table below. Because Phase 3, the final stage, is four years long, the ongoing FY3/24 marks the turnaround point. Therefore, it can be said that progress towards these targets is solid at the current point in time.

Phase 3 targets and results

(¥bn)

	FY3/26 Final target	FY3/23 Results	FY3/24 Forecast	1H FY3/24 Results
Net sales	220.0	190.8	215.0	89.4
Gross profit	36.0	27.0	32.5	11.9
(%)	16.5%	14.2%	15.1%	13.4%
Ordinary profit	12.0	6.2	10.0	1.8
(%)	5.5%	3.3%	4.7%	2.1%

	Phase 3 targets FY3/23 - FY3/26	FY3/23 Results	1H FY3/24 Results
Ordinary profit margin	5.0% or above (final year)	3.3%	2.1%
Dividend policy	Dividend payout ratio of 50% or above Annual dividend of ¥70 or above per share	Dividend payout ratio 87.4% ¥75	Dividend payout ratio Announced for full fiscal year Interim period ¥35
Acquisition of treasury stock	Approximately 5,000,000 shares*	1.5 million shares (Cumulative total of 1.5 million shares)	Plan to acquire 1.5 million shares (Cumulative total of 3 million shares)
ROE	8.0% or more	5.1%	Announced for full fiscal year
Growth investment	About ¥20.0bn*	¥3.2bn (Cumulative total of ¥3.2bn)	Announced for full fiscal year

* Accumulative over the period of the plan
Source: Prepared by FISCO from the Company's "Status of Business Progress in the Medium-Term Management Plan"

Making progress on initiatives leading up to the turnaround point of the Medium-Term Management Plan

6. Update on progress of measures

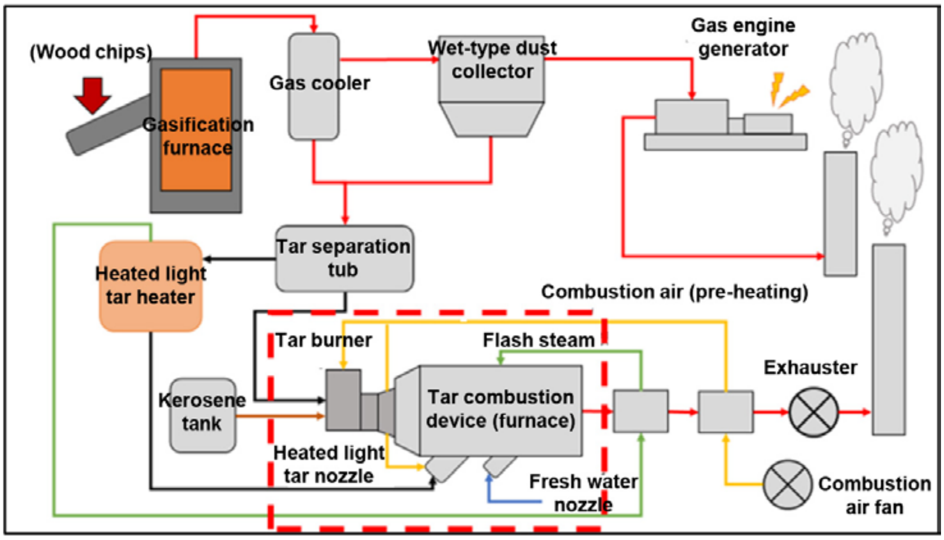
Update on progress of key measures is as follows.

(1) Technology development

- Received the Japan Society of Industrial Machinery Manufacturers President's Award for tar fuel exhaust gas treatment device

This device was developed together with Nikko Co., Ltd. <6306> as a device to detoxify the hazardous components separated from exhaust gas released in the gasification furnace at wood biomass power plants. It has been installed in the wood biomass conversion power generation equipment at NKC Nagai Green Power (Nagai City, Yamagata Prefecture) currently in operation. This award demonstrates the Company's technological superiority and reaffirms the Company's achievement of stable business operation. The Company will continue to pursue market development and contribute to achieving a decarbonized society.

The biomass power generation process

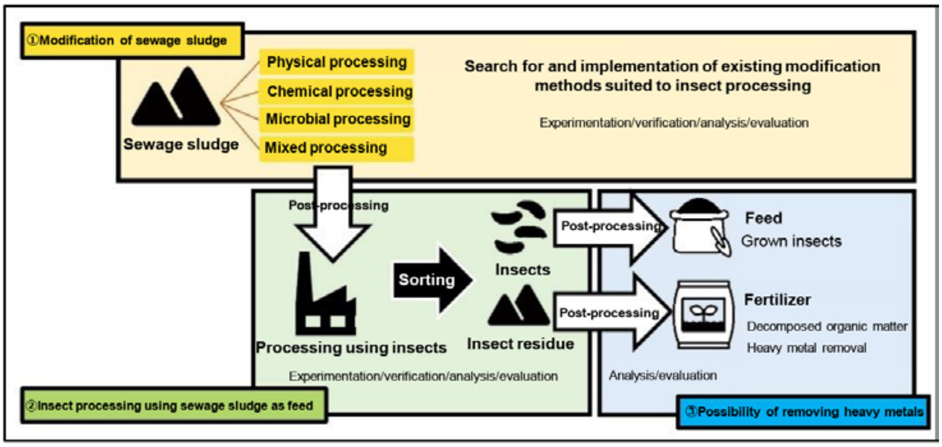


Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

- Research into the use of insects to convert sewage sludge into feed and fertilizer was selected for sewage line application research by the Ministry of Land, Infrastructure, Transport and Tourism

Amid increased global demand for grains, rising energy prices and soaring prices of feed and fertilizer due to factors including changes in the global situation, this research uses insect-treated sewage sludge as a recycled resource, converting it into feed and fertilizer. The actual research will be conducted jointly with the Okinawa Institute of Science and Technology Graduate University and BioAlchemy Co., Ltd., a startup company launched by the university. The Company will continue to provide energy-saving, energy-creation, and GX, and other technologies with high value-added to actively contribute to solving social issues.

Illustration of the proposed technology



Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

• Received the Chugoku Bureau of Economy, Trade and Industry Director's Award for continuous sterilization device and continuous sterilization method

This device was jointly developed with Shinko Industries Co., Ltd. (Yamaguchi Prefecture) for medical and pharmaceutical wastewater treatment. The wastewater from plants and other facilities that manufacture bio-pharmaceuticals and vaccines may contain bacteria and viruses. Heat treatment is required to detoxify this water, but more energy-saving methods are in demand in light of the recent need to reduce CO_2 emissions. This newly-developed device uses a heat recovery unit to collect the heat from the heat-treated water and use it to pre-heat wastewater before treatment. This enables a reduction in the use of steam and cooling water compared to previous continuous sterilization devices.

Continuous sterilization device

Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

(2) Strengthen the business base in the Facilities Construction Business and Environmental Systems Business

- Accumulated large-scale urban development projects and ongoing projects for the future in the industrial HVAC field
- Strengthened capabilities in the industrial HVAC field for semiconductor and EV battery manufacturing equipment in Japan
- Promoted the LCE business through large property orders in the water, sewage, and waste fields

(3) DX promotion

- Established the DX Promotion Division (April 1, 2023)
- Formulated the SANKI DX Vision

(4) Open innovation promotion

- Strengthened cooperation between the R&D Center and universities, research institutions, startups and others
- Collaborated with startups in the Facility Systems Business and machinery systems business

(5) Growth investment

- Invested in plant expansion at AQUACONSULT and expanded businesses through overseas market development
- Installed a cleanroom inside the Yamato Product Center in the Machinery Systems Business and strengthened the development and manufacturing of cleanroom equipment
- Relocated the office of the Facility Systems Business, aiming to expand the business by promoting sales activities utilizing the new office, based on a new concept

(6) Earth MIRAI Project

- Received over 100 responses from across the Group. Held four exchange meetings between respondents, established themes for deeper investigations, and launched initiatives to achieve this
- Collaborated with the Technical Strategy Council for a Better Future, newly established by the R&D Center, and promoted initiatives on the future direction of technological development and new business fields in step with the council

(7) Sustainability

- Updated disclosure in accordance with the TCFD*1 recommendations (aligned with the 1.5 degrees C scenario)
- Introduced solar PPAs for the Sanki Techno Center and Yamato Product Center
- Recycling of old uniforms into towels
- Held shrub-trimming events for Sanki-no-Mori and Kansha-no-Mori environmental protection initiatives
- Certified under the 2023 Certified Health & Productivity Management Outstanding Organizations Recognition Program (large enterprise category)
- Continued to dispatch employees to the Japanese Antarctic Research Expedition
- Established BCMS*2 at Group companies and will commence Group-wide operation from this fiscal year. Implemented Company-wide large-scale disaster prevention drills, and engaged in drills for each event set forth under the BCP

*1 TCFD (Task Force on Climate-related Disclosures)
*2 BCMS (Business Continuity Management System)

Shareholder return policy

Plans to pay a dividend of ¥70 and acquire 1,500,000 shares of treasury stock in FY3/24. Total return ratio of 91.6% (weighted average) over the past 10 years

The Company actively returns profits to shareholders. While its basic annual dividend was ¥15 through FY3/14, a change in profit structure prompted a dividend increase beginning in FY3/15. In FY3/20, the Company increased its dividend to ¥95 annually and then in FY3/21 it paid an annual dividend of ¥80, comprised of a regular dividend of ¥70 and an extra dividend of ¥10, in FY3/22 it paid an annual dividend of ¥85 (including an extra dividend of ¥15), and in FY3/23 it provided an annual dividend of ¥75 (payout ratio of 87.4%). For the ongoing FY3/24, it is planning an annual dividend of ¥70 (payout ratio of 56.9%), but FISCO believes this could be increased if results for FY3/24 are upwardly revised.

Additionally, the Company actively acquires its own shares in the market and retires them. In FY3/20, it acquired 1,958,000 shares and retired 2,000,000 shares of treasury stock. In FY3/21, it acquired 1,000,000 shares and retired 1,000,000 shares of treasury stock. In FY3/22, it acquired 1,000,000 shares of treasury stock. In FY3/23, it acquired 1,500,000 shares and retired 1,500,000 shares of treasury stock. The Company announced share acquisitions of 1,500,000 shares for the ongoing FY3/24, and had acquired 48,000 shares as of the end of September 2023, and had retired 1,500,000 shares by the end of September 2023. With these shareholder returns, the Company's total return ratio over the past ten years (weighed average of FY3/14 to FY3/23) was 91.6%.

Also, the Company actively responds to stakeholders other than shareholders. For the payment terms for partner companies, it had required entirely cash payments for partner companies with capital of less than ¥40.00mn from FY3/20, and it also shortened payment terms from 120 days to 60 days.

We at FISCO think the Company should be favorably assessed for its positive stance on shareholder returns and relationships with various stakeholders.

Shareholder returns

(¥mn)

	Acquisition of treasury stock		Total dividend amount (B)	Amount of shareholder returns (C)=(A)+(B)	Profit attributable to owners of parent
	Number of shares	Amount (A)			
FY3/23	1,500,000	2,347	4,132	6,479	4,750
FY3/22	1,000,000	1,438	4,773	6,211	6,489
FY3/21	1,000,000	1,171	4,568	5,739	5,901
FY3/20	1,958,000	2,899	5,543	8,442	7,576
FY3/19	1,000,000	1,191	3,595	4,786	9,046
FY3/18	3,000,000	3,679	2,136	5,815	3,906
FY3/17	0	0	1,906	1,906	4,698
FY3/16	0	0	1,906	1,906	5,327
FY3/15	2,000,000	1,604	1,270	2,874	2,461
FY3/14	4,000,000	2,408	983	3,391	1,763
			Total	47,549	51,917
			Total return ratio (weighed average)		91.6%

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

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