COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

Tokyo Stock Exchange Prime Market

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FISCO Ltd. Analyst
Yuzuru Sato

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

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Summary

Engaged in improving profitability and enhancing shareholder return to quickly achieve a PBR of over 1.0x

SUN-WA TECHNOS CORPORATION <8137> (hereinafter, "the Company") is an independent trading company that handles equipment, devices and parts related to industrial electronics and mechatronics. The Company has steadily expanded its businesses by leveraging coverage of three major areas (electrical machinery, electronics, and general machinery) and two-way trade in which it sells equipment and materials for manufacturers' production lines and then procures the products made by these manufacturers. In terms of the number of business partners, customers amount to around 3,100 companies while suppliers amount to around 2,000 companies on a non-consolidated basis. The Company's main suppliers are YASKAWA Electric Corporation <6506> and OMRON Corporation <6645>.

1. 1H FY3/24 results achieved record highs backed by an ample orders backlog

In consolidated results for 1H FY3/24, net sales increased 5.3% year on year (YoY) to ¥88,867mn and operating profit rose 4.3% to ¥3,442mn, for increases in sales and profit that surpassed the Company's forecasts (net sales of ¥85,300mn and operating profit of ¥2,600mn) and set record highs for consecutive periods. In the overall manufacturing sector, orders received declined by 25.8% to ¥75,877mn due to a difficult business environment caused by factors such as the continuation of inventory adjustments as a repercussion of the accelerated procurement of parts. Despite this, sales and profits rose due to the capture of demand from China for products for the solar power-related industry, as well as sales recorded from previous fiscal years' backlog orders. The orders backlog as of the end of 1H FY3/24 had decreased slightly from the end of the previous fiscal year to ¥68,618mn, but this is equivalent to four to five months' worth of sales and is still relatively high compared to pre-pandemic levels (two to three months' worth).

2. In the FY3/24 full-year forecast, only net sales have been revised downward while ordinary profit has been revised upward because of factors including the recording of a foreign exchange gain due to effects of yen depreciation

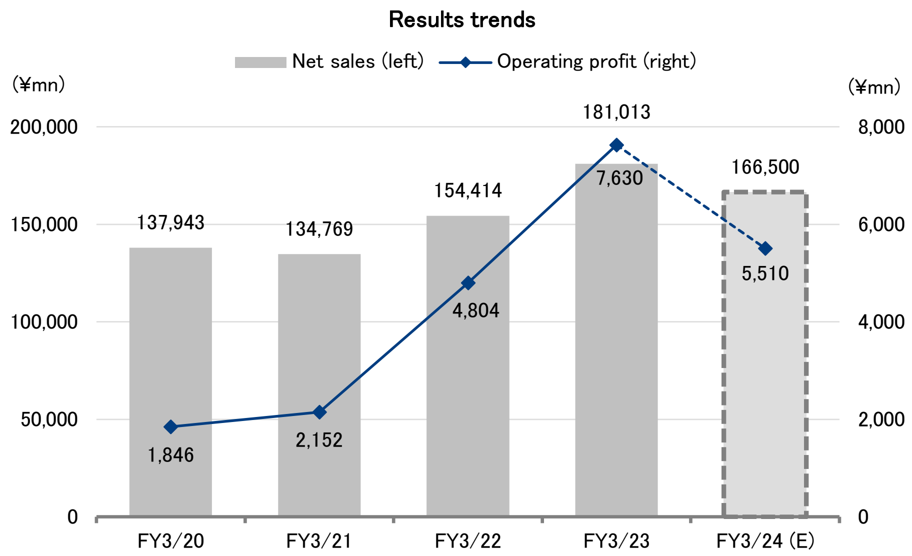
For FY3/24 consolidated results, the Company is forecasting net sales to decrease by 8.0% YoY to ¥166,500mn and operating profit to decrease by 27.8% to ¥5,510mn. In consideration of factors such as the slowdown in the Chinese economy and the effects of prolonged inventory adjustments, the forecast for net sales has been revised downward by ¥9,300mn compared to the initial forecast. However, the forecast for operating profit remains unchanged as the progress made in 1H exceeded the initial forecast. There are no indications yet that the current situation regarding orders received will bottom out, as net sales in the full-year forecast for FY3/24 have been revised downward while ordinary profit has been revised upward because of factors including the recording of a foreign exchange gain due to effects of yen depreciation. As inventory levels for parts differ for each customer, ordering levels also vary, even for customers within the same industry. This makes it extremely difficult to forecast when the orders situation will begin to recover. In 2H, it looks likely that the Company will secure sales by working through its backlog. The only area expected to perform strongly in 2H is on-board electrical parts for the automotive industry due to an increase in auto production. The average assumed exchange rate for the period is ¥137.9 to the U.S. dollar. It was ¥134.85 in FY3/23. Yen depreciation of ¥1 to the U.S. dollar positively affects profit by around ¥60mn, and given that the rate is currently trending around ¥150 to the U.S. dollar, the assumption allows some room for increases.

3. Focus on improving profitability and enhancing shareholder returns to quickly achieve a PBR of over 1.0x

Under its three-year medium-term management plan, "SNS2024 (Sun-Wa New Stage 2024)," which began in FY3/23, the Company is implementing the following as basic policies: 1) Focus on growth fields that require innovation, 2) Provide even higher value-added products and new solutions, and 3) Help to realize a sustainable society through sustainability management. For FY3/25, the plan's final year, it set the goal of operating profit of ¥7.0bn. It will allocate resources to areas that are forecast to grow, including semiconductor production equipment, robots and mounters, machine tools, factory automation equipment, on-board products, and facilities, and it will work to increase the share of sales of its products to existing customers through new products and technology proposals, while at the same time cultivating new customers. It is also engaging the new market of India through the establishment of a local affiliate, which began operation on September 1, 2023, and it plans to provide support to Japanese-owned companies developing business in the country. As a favorable market environment is forecast for FY3/25, we at FISCO see the Company's targets as achievable. Furthermore, the Company is undertaking three initiatives as part of its strategy to quickly achieve a PBR of over 1.0x. These include: 1) Enhancing profitability through the steady execution of the medium-term management plan, promoting "SNS2024 (Sun-Wa New Stage 2024)," 2) Enhancing shareholder returns, and 3) Expanding investor and shareholder relations activities. The Company is also establishing alliances and other partnerships as one of the measures under its growth strategy. On October 30, 2023, it formed a business partnership with MTEC CO.,LTD., which develops robotics systems among other operations, through which the companies will develop solutions packages aimed at enhancing the convenience of industrial robots and then use the Company's sales network to make industrial robot proposals that include these packages to companies considering introducing industrial robots. The Company is focusing on expanding sales of industrial robots, which it sees as a growth area, and it is aiming to capture new orders by offering added value. With regard to its policy on shareholder returns, the Company intends to pay a dividend based on a target payout ratio of 25-35% and will also buy back shares on a flexible basis depending on the timing and financial conditions. Net assets per share at the end of 1H FY3/24 was ¥3,056, which is a PBR of just 0.7x. The Company intends to work to rectify this.

Key Points

- In 1H FY3/24, new record-high sales and profits achieved as results exceeded targets, backed by an ample orders backlog
- In the FY3/24 full-year forecast, only net sales have been revised downward while ordinary profit has been revised upward because of factors including the recording of a foreign exchange gain due to effects of yen depreciation
- The Company is engaging in alliances and other partnerships to achieve its goal of operating profit of ¥7.0bn in FY3/25



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

Results trends

In 1H FY3/24, new record-high sales and profits achieved as results exceeded targets, backed by an ample orders backlog

1. 1H FY3/24 results overview

In 1H FY3/24, the Company achieved consolidated results that exceeded its forecast, with net sales of ¥88,867mn (up 5.3% YoY), operating profit of ¥3,442mn (up 4.3%), ordinary profit of ¥3,700mn (up 3.5%) and profit attributable to owners of parent of ¥3,075mn (up 21.7%), which set new record highs for consecutive 1H.

1H FY3/24 results (consolidated)

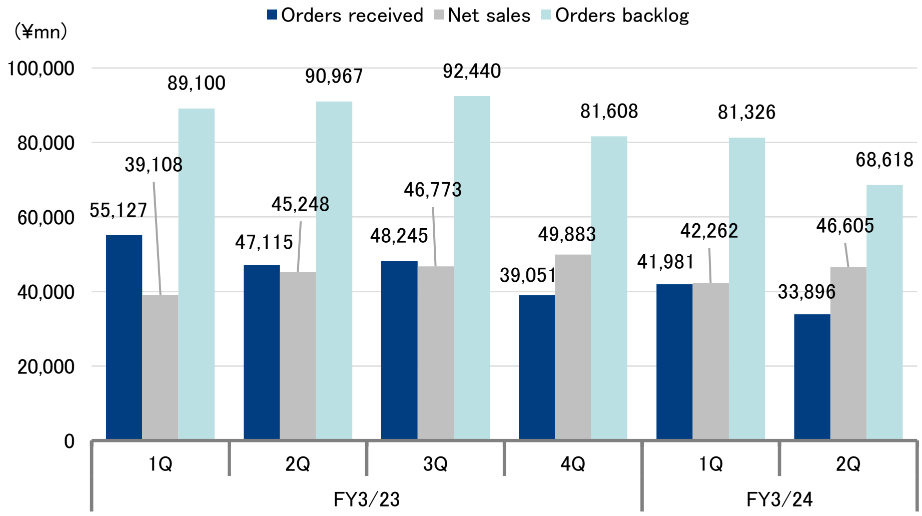
(¥mn)

	1H FY3/23		1H FY3/24				
	Results	% of sales	Company's forecast	Results	% of sales	YoY	vs. forecast
Net sales	84,356	-	85,300	88,867	-	5.3%	4.2%
Gross profit	10,733	12.7%	-	11,179	12.6%	4.2%	-
SG&A expenses	7,433	8.8%	-	7,736	8.7%	4.1%	-
Operating profit	3,299	3.9%	2,600	3,442	3.9%	4.3%	32.4%
Ordinary profit	3,575	4.2%	2,700	3,700	4.2%	3.5%	37.0%
Extraordinary profit and loss	34	-	-	566	-	-	-
Profit attributable to owners of parent	2,528	3.0%	1,870	3,075	3.5%	21.7%	64.4%
Orders received	102,242	-	-	75,877	-	-25.8%	-
Orders backlog	90,967	-	-	68,618	-	-24.6%	-

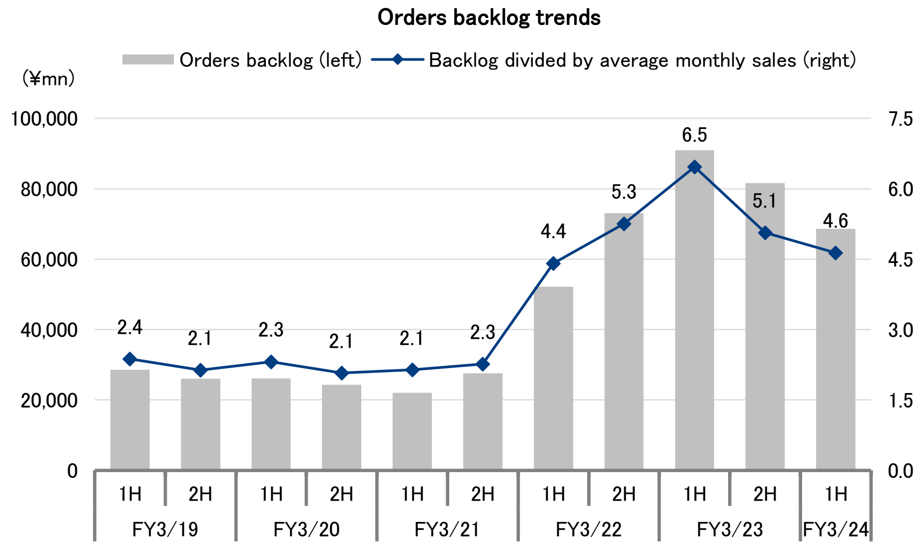
Source: Prepared by FISCO from the Company's financial results

In the overall manufacturing sector, orders received declined by 25.8% to ¥75,877mn due to the continuation of inventory adjustments as a repercussion of the accelerated procurement of parts. Despite this, sales and profits rose due to the capture of demand from China for products for the solar power-related industry, as well as sales recorded from previous fiscal years' backlog orders. Looking at order trends on a quarterly basis, there has been a downward trend since orders peaked in 1Q FY3/23 at ¥55,127mn, and as of 2Q FY3/24, orders had returned to roughly the same level as three years ago at ¥33,896mn. Although this was still a fine performance, it shows that the demand created by accelerated procurement has disappeared. From the start of the COVID-19 pandemic onward, the effects of semiconductor shortages and mounting supply chain risks led to accelerated procurement by companies in order to secure parts and up to the first half of 2022, the Company rapidly accumulated orders. At the end of 2Q FY3/23, the orders backlog was equivalent to about six months' worth of sales. As of the end of 2Q FY3/24, the Company has been working through its backlog and it is now equivalent to over four months' worth of sales. Considering that pre-pandemic levels were at a level equivalent to just over two months' worth of sales, for the time being, even if orders received continues to decline, the Company can still secure sales by working through the orders backlog.

Orders received, net sales, and orders backlog by quarter



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



Note: Average monthly sales = Total sales for the six-month period divided by 6
Source: Prepared by FISCO from the Company's supplementary material on financial results

Operating profit increased by around ¥143mn YoY. Looking at the main factors behind changes, the worsening of the gross profit margin (down 0.1ppt YoY) to ¥272mn was the result of an increase in SG&A expenses to ¥186mn as a factor decreasing profit, while factors increasing profit were the effects of a ¥510mn increase in sales and ¥91mn increase due to the depreciation of the yen. The average exchange rate was ¥134.8 to the U.S. dollar. The yen has accordingly weakened by ¥12 to the U.S. dollar compared to the previous fiscal year, when it stood at ¥122.8 to the U.S. dollar, which has resulted in a ¥127mn increase in profits for the Company's Japanese business companies. Furthermore, although its overseas business companies have seen a ¥100mn decrease in profits through stocking and selling transactions, as the year-end exchanges rate had a cheaper yen price than the previous fiscal year's year-end rates, this difference boosted profit by ¥64mn. This exceeds the Company's forecast by ¥842mn. In addition to an increase in gross profit driven by an upswing in sales, another factor was the curbing of SG&A expenses through measures to enhance profitability, such as the use of online meetings and the streamlining of operations through the introduction of RPA.

Also, the Company has been actively revising its cross-shareholdings portfolio as a means of increasing corporate value and in 1H FY3/24, it recorded an extraordinary income of ¥557mn in gain on sale of investment securities. Funds from these sales will be allocated to growth investments and shareholder return and the Company intends to continue selling its cross-shareholdings going forward.

Sales increased in all three business segments of electrical machinery, electronics, and general machinery, and by region, sales and profits both grew by double figures in Asia

2. Segment and regional trends

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

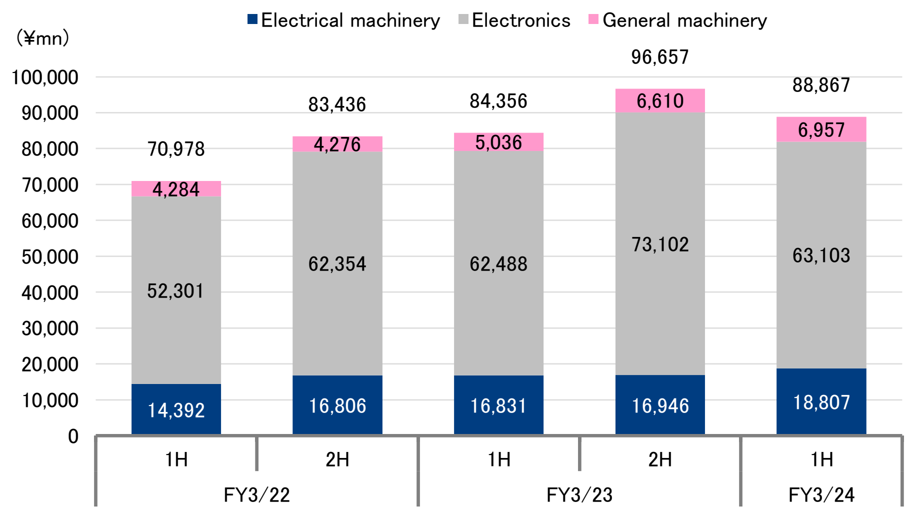
(1) Trends in net sales by business segment

Main products handled by the electrical machinery segment are servo motors, motion controllers, inverters, machine controllers and power conditioners. The Company primarily handles products from YASKAWA Electric Corporation. Despite decreases in sales by electrical machinery for the semiconductor production equipment industry as well as factory automation industry and control equipment for the solar power-related industry, net sales expanded by 11.7% YoY to ¥18,807mn, a record high, due to an increase in sales by electrical machinery for the solar power-related industry in China.

The main products in the electronics segment are wide ranging, including general electronic parts such as capacitors, connectors, relays and switches, as well as fan motors, stepping motors, LEDs, and power supplies. Net sales in this segment increased slightly by 1.0% YoY to ¥63,103mn. Decreases in sales of electronic parts for the home electrical appliance-related industry and the amusement-related industry, connectors and electronic devices for the semiconductor production equipment industry and the factory automation industry were offset by increases in sales of electronic parts for the factory automation industry, precision equipment-related industry and automotive on-board product industry, and connectors for the office machinery industry. However, there was a decline of 13.7% compared to 2H FY3/23 due to inventory adjustments by customers becoming more widespread.

The main products in the general machinery segment include robots from YASKAWA Electric Corporation, as well as transfer device and reduction gears. Net sales rose 38.1% YoY to ¥6,957mn, setting a record high. This was thanks to increased sales of facilities equipment to the automotive-related industry, and transfer device to the semiconductor production equipment industry.

Net sales by business segment



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

(2) Trends in net sales and profits by segment

In Japanese business, net sales decreased 6.8% to ¥60,577mn and operating profit declined 8.5% to ¥2,087mn. Although sales of electronic parts to the automotive-related and precision equipment-related industry, facilities equipment to the automotive-related industry, and conveyers to the semiconductor production equipment industry all increased, sales of electrical machinery and electronic parts to the factory automation industry, electrical machinery and connectors to the semiconductor production equipment industry, and control equipment to the solar power-related industry decreased.

In the Asian business, net sales increased 19.8% to ¥34,136mn and operating profit rose 14.7% to ¥1,305mn. Sales of electrical machinery to the solar power-related industry, electronic parts to the factory automation industry, and connectors to the office machinery industry increased, covering a decrease in sales of electronic parts to the home electrical appliance-related industry and electrical machinery to the semiconductor production equipment industry. In China, which accounts for more than 70% of the Company's sales in Asia, although the sales for local Japanese companies was sluggish, the Company captured demand for facilities investment from solar panel manufacturers, which made a significant contribution to the increases in sales and profits. In the global SCM solutions business*, which had experienced booming demand in the same period of the previous fiscal year driven by semiconductor shortages and mounting supply chain risks, net sales decreased as efforts by customers to secure parts came to an end. Additionally, the Company has established a local affiliate in India (Bengaluru), which began operations with a staff of four in September 2023. The plan is to develop business with Japanese companies expanding into the area and the Company is considering establishing more locations going forward. The Indian government is supporting the cultivation of not only auto manufacturers, but also electronics manufacturers, so demand for products such as electrical machinery, electronic parts, and facilities equipment is expected to grow, presenting a considerable business opportunity.

* The global SCM solutions business is a contract service that handles materials procurement and distribution for customers using the Company's global network. More companies are using the service in part because supply chain risk materialized during the COVID-19 pandemic, meaning it was difficult for them to procure parts and materials. There are also increasing cases of the service being utilized by companies when relocating their production sites because of the complexity of coordinating with suppliers. Customers also benefit from the service because it lowers procurement costs and shortens lead times.

In Europe and the U.S., net sales increased by 0.8% YoY to ¥3,341mn, and operating profit turned positive at ¥133mn (compared to a loss of ¥40mn in the same period last year). Net sales increased slightly as increases in sales of electronic parts for the factory automation and automotive-related industries covered decreases in sales of electronic parts for the amusement-related industry and facilities equipment for the automotive-related industry. Factors behind the profit increase include the effects of lower logistics costs accompanying a fall in ocean freight rates.

Net sales and operating profit by segment

(¥mn)

(Net sales)	FY3/22		FY3/23		FY3/24	YoY
	1H	2H	1H	2H	1H	
Japan	54,222	61,589	64,994	68,718	60,577	-6.8%
Asia	22,810	29,406	28,498	35,866	34,136	19.8%
Europe/ U.S.	3,010	3,204	3,313	3,799	3,341	0.8%
Other	375	373	335	511	273	-18.5%
Adjustment	-9,440	-11,135	-12,784	-12,238	-9,460	-
Total	70,978	83,436	84,356	96,657	88,867	5.3%

(Operating profit)	FY3/22		FY3/23		FY3/24	YoY
	1H	2H	1H	2H	1H	
Japan	1,187	1,862	2,280	3,074	2,087	-8.5%
Asia	892	1,032	1,138	1,443	1,305	14.7%
Europe/ U.S.	13	-121	-40	-8	133	-
Other	9	-25	-10	7	-19	-
Adjustment	5	-49	-68	-185	-64	-
Total	2,108	2,696	3,299	4,331	3,442	4.3%

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

Net sales in 1H FY3/24 (○ = positive YoY change, × = negative YoY change)

	Japan			Asia			Europe/ U.S.		
	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery
Semiconductor-related industry	×	×	○		×				
Solar power-related industry	×			○					
Factory automation industry	×	×			○			○	
Automotive-related industry (on-board products)		○						○	
Automotive-related industry (equipment)			○						×
Precision equipment-related industry		○							
Office machinery industry					○				
Home electrical appliance-related industry					×				
Amusement-related industry								×	

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

In the FY3/24 full-year forecast, only net sales have been revised downward while ordinary profit has been revised upward because of factors including the recording of a foreign exchange gain due to effects of yen depreciation

3. Outlook for FY3/24 results

In terms of the outlook for FY3/24 consolidated results, the Company forecasts decreased net sales and profits, with net sales of ¥166,500mn (down 8.0% YoY), operating profit of ¥5,510mn (down 27.8%), ordinary profit of ¥5,860mn (down 23.6%), and profit attributable to owners of parent of ¥4,570mn (down 16.8%). In consideration of factors such as the slowdown in the Chinese economy and the effects of prolonged inventory adjustments by manufacturing companies, the forecast for net sales has been revised downward by ¥9,300mn compared to the initial forecast. However, the forecast for operating profit remains unchanged as the progress made in 1H exceeded the initial forecast. The forecast for ordinary profit has been revised upward by ¥170mn the recording of a foreign exchange gain resulting from yen depreciation, while profit attributable to owners of parent has been revised upward by ¥620mn due to the recording of gain on sale of investment securities.

FY3/24 consolidated results forecast

(¥mn)

	FY3/23		FY3/24					
	Results	% of sales	Initial forecast	Revised forecast	% of sales	YoY	Revised value	Progress as of 2Q (%)
Net sales	181,013	-	175,800	166,500	-	-8.0%	-9,300	53.4%
Operating profit	7,630	4.2%	5,510	5,510	3.3%	-27.8%	-	62.5%
Ordinary profit	7,675	4.2%	5,690	5,860	3.5%	-23.6%	170	63.1%
Profit attributable to owners of parent	5,493	3.0%	3,950	4,570	2.7%	-16.8%	620	67.3%
Earnings per share (¥)	355.08		255.14	299.74				

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

Currently, the level of orders received is about 30% lower than 1H FY3/23 and shows no sign of bottoming out. As inventory levels for parts differ for each customer, ordering levels also vary, even for customers within the same industry. This makes it extremely difficult to forecast when the order situation will begin to recover. However, even if customers continue to adjust their ordering situations going forward, at FISCO, we think that the Company can still achieve its sales targets by working through its ample orders backlog. Although profits have declined by double digits year on year, the growth experienced in FY3/23 was the result of special demand created by an industry-wide accelerated procurement of parts, so the results for FY3/24 can be seen as a rebound from this. In its three-year medium-term plan starting in FY3/23, the Company set operating profit targets of ¥5.0bn in FY3/23, ¥6.0bn in FY3/24, and ¥7.0bn in FY3/25. Combining the results for operating profit in FY3/23 and FY3/24 gives ¥13.1bn, more than 20% higher than the ¥11.0bn that results from combining the plan's targets, so from a medium-term perspective, performance is on track.

The assumed exchange rate for FY3/24 has been revised from ¥129 to the U.S. dollar in the initial plan to ¥137.9 to the U.S. dollar, and given that the rate is currently trending around ¥150 to the U.S. dollar, the assumption allows some room for increases*1. Additionally, the Company is planning to continue selling its cross-shareholdings, and this trend means that it is possible that it will exceed its target for profit attributable to owners of parent*2.

*1 The average exchange rate for FY3/23 was ¥131.4 to the U.S. dollar. Assuming that rates for other currencies change in line with the dollar rate, depreciation of ¥1 to the U.S. dollar will increase annual revenue by ¥550mn, increasing profit by ¥60mn.
*2 As of September 30, 2023, valuation difference on available-for-sale securities was ¥3,874mn.

Long-term vision and medium-term management plan

Aiming to be the best manufacturing partner to make possible our customers' wants and needs

1. Long-term vision

The Group's Corporate Creed is "Develop Talents, Build Business, Contribute to Society." Guided by this creed, the Group utilizes its global network to provide its customers with the most up-to-date information, needs-oriented solutions, and the most reliable services, along with collaborating with partner companies. Through these efforts, the Group has helped to promote industrial development and to realize a sustainable society. In the past few years, there have been significant changes in global social conditions, and the market environment has been changing drastically. In this environment, to set an even clearer direction for the Group, it formulated "Sun-Wa Vision 2030" as its long-term vision for FY3/31 and "SNS2024 (Sun-Wa New Stage 2024)" as its three-year medium-term management plan beginning in FY3/23 (announced in May 2022). The Group's Mission (Mission and Purpose), Vision (the Group's Ideals), Values (Values for Fulfilling the Mission and Realizing the Vision) are described below.

The Group has defined its Mission as follows: "We connect technologies in the world to create new value and support the development of a prosperous society." Leveraging its global network, the Group intends to contribute to the development of a sustainable society by offering the latest technology proposals and optimal products. Moreover, the Group has embraced the following as its Vision: "We are the best partner in manufacturing to make our customers' wants and needs possible, and connect businesses around the world with relationships of trust."

The Group has identified the following three concepts as its Values to carry out its mission and achieve its Vision: "Customer First" "Spirit of Challenge" and "Teamwork and Communication." With "Customer First" the Group makes every effort to serve as a partner who has the best understanding of the customer – a partner who identifies true customer needs by always considering things from the customer's perspective and sharing values with customers. With "Spirit of Challenge," the Group sets high goals to drive its own growth, enhances its creativity and professionalism by tackling challenges positively without fearing change, and strives to boost the enterprise's energy and vitality. Finally, with "Teamwork and Communication," the Group creates new value by respecting others, understanding differences, and recognizing their value. In addition, the Group attaches importance to partner companies as it aims to improve its collective capabilities.

Started initiatives through the implementation of alliances, etc. to achieve operating profit of ¥7.0bn in FY3/25

2. Progress of Medium-term plan, "SNS2024 (Sun-Wa New Stage 2024)"

(1) Management goals

In its three-year medium-term plan starting in FY3/23, the Company changed its KGI from net sales to operating profit. In addition, it announced additional measures in May 2023 aimed at achieving a PBR of over 1.0x as quickly as possible.

The Company has not changed its performance targets for FY3/25, the final year of the plan. They are net sales of ¥195.0bn and operating profit of ¥7.0bn. The target for operating profit was surpassed in FY3/23 thanks to early orders and yen deprecation, as was explained above, but profit is expected to decline in the absence of these factors in FY3/24, so the final year's targets were not changed. As long as macroeconomic factors do not deteriorate further in FY3/25, the Company appears to be in a position to achieve its targets.

The Company is forecasting the operating profit margin to rise from 3.1% in FY3/22 to 3.6% in FY3/25, primarily from an increase in the gross profit margin. In Japan, there are concerns that the introduction of regulations governing total working hours from fiscal 2024 will raise logistics costs, but the Company plans to introduce a warehouse management system (WMS)* that has been brought in at its Nagoya Service Center, and in stages at other facilities. The aim is to mitigate rising logistics costs by visualizing logistics operations and making them more efficient.

* A system that enables the real-time centralized management and visualization of all processes within a logistics facility (receipt of goods, storage, distributive processing, issuance of slips, shipping, inventory taking, etc.), thereby supporting efforts to reduce working hours and improve productivity.

The overseas sales ratio* is projected to increase from 33.7% in FY3/22 to 40% in FY3/25. On a real basis, annual growth of 13% is being projected. Approximate regional shares in FY3/22 were China around 70%, other Asian countries around 19% and the Europe and the U.S. around 11%. For FY3/25, these are projected to be China around 65%, other Asian countries around 25% and Europe and the U.S. around 10%, so the most growth is expected from other Asian countries. Over the last few years, risk associated with China has been rising and customer companies have been responding by reviewing their production frameworks. Growth is particularly anticipated in the Indian market, where the Company established a local affiliate in September 2023. The Company plans to continue its business activities while carefully monitoring the situation in China, and it will further strengthen efforts to gather market information so that it can respond flexibly to various risks. If the Company is able to achieve its performance targets for FY3/25, for its next step, it will aim for net sales of ¥250.0bn and operating profit of ¥10.0bn by FY3/28.

* Overseas sales ratio is net sales from overseas business (overseas affiliates) divided by consolidated net sales (before consolidation eliminations)

Management goals in the “SNS2024(Sun-Wa New Stage 2024)”

(¥mn)

	FY3/22 Results	FY3/23 Results	FY3/24		FY3/25 Target	Average annual growth rates	FY3/28 Target
			Initial forecast	Revised forecast			
Net sales	154,414	181,013	175,800	166,500	195,000	8.1%	250,000
Operating profit	4,804	7,630	5,510	5,510	7,000	13.4%	10,000
(profit margin)	3.1%	4.2%	3.1%	3.3%	3.6%		4.0%
Overseas sales ratio*	33.7%	35.9%	38.0%	-	40.0%		

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

(2) The strategic policy as well as progress

In terms of the basic policies that the Company will implement in “SNS2024 (Sun-Wa New Stage 2024),” the Company has set forth three basic policies: a) Focus on growth fields that require innovation, b) Provide even higher value-added products and new solutions, and c) Help to realize a sustainable society through sustainability management. By implementing these policies, the Company intends to reach its performance targets. Progress made thus far on the policies is described below.

a) Focus on growth fields that require innovation

The Company has classified the customer segments where it will allocate resources based on the dual axes of its strengths and market appeal (market size, growth rate, and profitability). These customer segments are classified into the following three fields: fields where resources are actively allocated (semiconductor production equipment, robots and mounters, machine tools), fields where resources are selectively allocated (factory automation equipment, on-board products, and facilities), and other fields. By formulating and executing business strategies tailored to each customer segment, the Company seeks to increase gross profit and strengthen profitability. Also, in additions to creating new businesses that leverage its strengths and investing in growth areas, it is working to enhance its brand power through PR, IR, and SR activities.

Looking at the compositions of sales by field for 1H FY3/24, factory automation equipment field accounted for the biggest portion at about 30%, followed by semiconductor production equipment field and automotive on-board products field at just over 10% each, while robots and mounters, facilities, and machine tools field each accounted for less than 10% of sales. The Company is aiming for a three-year average annual growth rate for gross profit of at least 10% (and at least 15% for semiconductor production equipment) but looking at the two-year average annual growth rates up to FY3/24, only factory automation equipment field is on track to achieve 14.0%, while other fields are expected to fall short of growth rate targets due to the rebound from the excessive growth experienced in FY3/23. However, with the market environment moving toward a recovery in FY3/25, at FISCO we think there is a sufficient possibility that the Company will catch up to its growth targets.

Progress and results of strategic policies by customer segment

Source: The Company's results briefing materials

Looking at the status of initiatives carried out in each field in 1H FY3/24, in the fields for active investment of resources, the semiconductor production equipment field strengthened relationships with customers by holding interviews with executives from customer companies and exploring joint development themes, and also advanced unit assembly proposals, received concrete inquiries about these, and turned them into orders. Also, in its efforts to cultivate business with major global companies, it is using pinpoint-targeted product proposals and seems to be on the verge of establishing accounts. In regards to pinpoint-targeted products, it is aiming for highly novel and innovative products developed by venture companies and companies based overseas. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is growth of 6.4%, which is fairly behind schedule. However, considering that the Japanese government is committed to supporting the semiconductor industry as a national priority and that Japanese companies have a large share of the global market, there is plenty of room for further growth and it will continue to be one of the Company's main focuses going forward.

In the robots and mounters field, the Company worked to increase the in-house share for each product by capturing orders under focus themes and identifying technical issues, and it also held sales talks for PCs and network devices and explored new proposal products. In addition to this, it shared customer issues and held meetings to exchange information with manufacturers in order to understand industry needs. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is considerably lower than anticipated, as it declined by 19.7% due to the effects of the poor business performance of the chip mounter manufacturers that are its main customers. However, production of PCs and smartphones is set to recover in FY3/25 which will also lead to a recovery in orders from chip mounter manufacturers and the Company has also successfully established an account with a major robotics manufacturer, so the gross profit growth rate is expected to recover sharply.

In the machine tools field, the Company proposed solutions and components for process integration, automation, and energy-saving equipment and carried out activities for understanding application needs and coordinating with regional sales teams. It also strengthened marketing efforts aimed at the local affiliates of global production company customers. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is a decline of 0.7% due to the effects of a cool down in investment in facilities.

In the fields for selective investment of resources, in regards to initiatives in the factory automation equipment field, the Company made proposals to expand sales to the next generation of major global customers and effectively carried out sales activities for electronic devices. It also monitored changes and trends in the factory automation market to create strategic products. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is growth of 14.0%, roughly in line with plans.

In the on-board products field, the Company worked to develop deeper relationships with main Tier 1 customers and cultivated new Tier 1 customers. It also strengthened PR activities in the on-board products field and increased the number of sales personnel. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is growth of 3.7%, which is fairly behind schedule. However, it is expected to catch up in FY3/25 as the inclusion of advanced driver-assistance systems (ADAS) in vehicles becomes more widespread.

The facilities field is positioned as a segment that covers a wide range of industries and one with heightened engineering needs to address automation and sustainability. The Company's main initiatives were to develop and launch facilities packages that offer added value, advance activities to capture facilities orders related to efforts by small retailers to automate and reduce staff numbers, and advance activities to win orders from untapped divisions at existing customer companies. The forecast two-year average annual gross profit growth rate up to FY3/24 for this segment is behind schedule, as there was a decline of 6.1%. However, it is forecast to catch up through initiatives such as investing in new package products.

b) Provide even higher value-added products and new solutions

With regard to providing even higher value-added products and new solutions, the Company intends to identify fields of focus and secure resources through development of a technology strategy, raise business efficiency and provide value by formulating and promoting Sun-Wa DX (SDX), and raise the overseas sales ratio by providing solutions for bolstering the resilience of global supply chains.

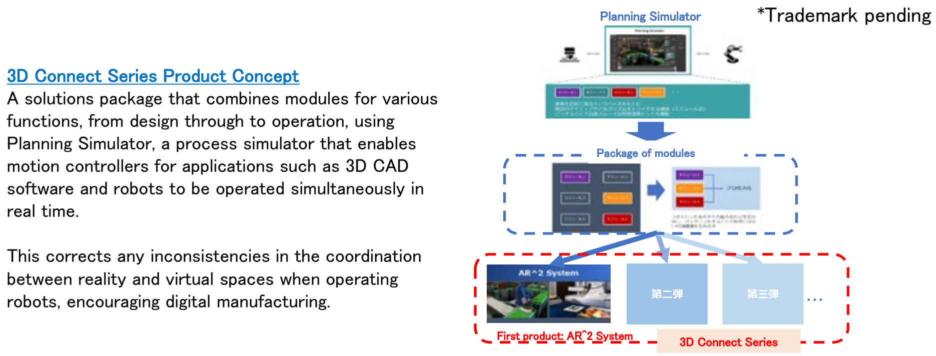
In particular, the Company's approach to the development of new solutions using high-added-value products is to advance development while making active use of external resources through alliances and the like. Accordingly, on October 30, 2023, it formed a business partnership with MTEC. MTEC is headquartered in Kitakyushu and its strength is its ability to develop systems that combine robotic systems technologies, including technologies related to motion, control, processing, image processing, software customizing technologies, as well as custom-built technologies, in a highly sophisticated manner. This business partnership will create synergies between MTEC's technological development capabilities and the Company's marketing capabilities to cultivate new customers and markets through package-based products that combine technological solutions tailored to customers' needs in the robotics field.

Specifically, the Company is developing the 3D Connect Series of digital manufacturing products that use virtual space and it has launched its first product, AR^2 System, a robotics solution package that uses AR markers*. The 3D Connect Series is a solutions package that combines modules for various functions, from design through to operation, using Planning Simulator, a process simulator that enables motion controllers for applications such as 3D CAD software and robots to be operated simultaneously in real time. This corrects any inconsistencies in the coordination between reality and virtual spaces when operating robots, encouraging digital manufacturing. The newly launched AR^2 System has two distinctive features. One is that a camera mounted onto a robot can read AR markers and automatically orient itself, enabling the relative positioning of the robot to be corrected with high precision. The other is that operating conditions (recipes for behavior) can be planted in AR markers, enabling operational instructions that let the robot make decisions. Usually, the operation of robots requires teaching data for a specific operation to be created and applied, but this solution enables this process to be carried out efficiently using 3D CAD software and AR technology. Its advantage is that it is relatively easy to use, even for companies that do not have robot operational know-how.

* AR markers are markers that display information in augmented reality (AR) by showing digital content in a virtual space. Various things, including images, faces, and buildings, can be used as AR markers.

The targets for this product are companies with automation and labor-saving needs in industries in fields the Company is focusing on, including semiconductor production equipment, robots and mounters, machine tools, on-board products, and facilities. The Company is handling marketing while MTEC is responsible for development and technical support. Plans are in place to develop a second and third product in the 3D Connect Series and the Company's strategy is to differentiate itself by incorporating these products into robot sales proposals, enabling it to win orders for industrial robots.

Development of the 3D Connect Series of Robotics Solutions



Source: The Company's results briefing materials

c) Help to realize a sustainable society through sustainability management

The Company continues to view measures to realize a sustainable society as one of management's most important issues. Therefore, it will promote these measures through its business activities while working to foster the education and development of its employees. Notably, the Company carries an extensive range of electrical machinery, electronic parts, and facilities and machinery that can achieve energy and labor savings as measures to combat global warming. We at FISCO believe that the Company has substantial growth opportunities as an enterprise that will contribute to a decarbonized society through its business activities. In April 2023, it started a new sales project dedicated to growing sales of energy management systems (EMS). Specifically, it is cooperating with manufacturers to propose unique EMS, holding sales talks regarding production lines for lithium-ion batteries, growing sales of products that contribute to the achievement of carbon neutrality, and holding sales talks related to energy (energy creation, energy storage, and energy saving).

With regard to its approach to a decarbonized society, through sales of environmentally friendly products, the Company intends to create emission reduction effects that are over 100 times more than its greenhouse gas emissions (Scopes 1, 2 and 3) by fiscal 2050 (compared to fiscal 2020) and it is also targeting a 20% reduction in its own greenhouse gas emissions (Scopes 1 and 2) by fiscal 2030 (compared to fiscal 2020) by continuing initiatives to reduce its environmental impact.

With regard to diversity and inclusion, the Company has set a goal of having at least 10% female managers by FY3/30 (8.3% in FY3/23) and will work to increase employee engagement by further promoting work style reforms started by its DX promotion project and seeking to foster an awareness within each employee of improving business performance and taking part in management by encouraging their participation in the employee shareholding association.

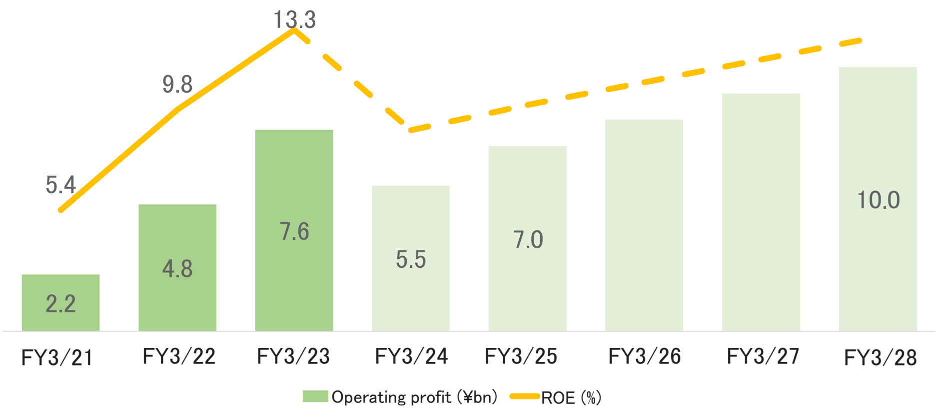
Engaged in improving profitability, enhancing shareholder return, and enhancing investor and shareholder relations activities to quickly achieve a PBR of over 1.0x

3. Measures to raise corporate value

On October 30, 2023, the Company announced a policy for realizing management that is conscious of capital cost and share price. Currently, its share price is in the ¥2,000-2,500 range, which means it has doubled since 2020 when it was in the ¥1,000-1,500 range, but PBR is less than 1.0x and is appraised to be lower than its net asset value. The Company thinks its share price has been stuck at comparatively low levels compared to its strong profitability for some time, so it has once again announced measures to raise its corporate value (and therefore share price).

The Company sees the reasons for its share price being stuck at comparatively low levels as being that its business and growth strategies aimed at sustainable growth are not sufficiently understood by investors, that the liquidity of its shares are low (FY2022 average: 40,308 shares/day), and that its market capitalization is at levels just over ¥30bn which makes it a difficult prospect for major institutional investors. Therefore, first of all, it will work to raise profitability by steadily implementing the measures in its medium-term plan so it can maximize consolidated operating profit in order to maintain high levels of ROE, while at the same time enhancing shareholder return and investor and shareholder relations activities with the aim of quickly achieving a PBR of over 1.0x. At FISCO, we basically share the same opinion as the Company and in particular, we think that one of the factors making it a difficult investment target is that individual investors are generally unfamiliar with trading companies that specialize in industrial electronics and mechatronics. In fact, many other companies in the same industry are appraised as having a PBR below 1.0x. If, for example, its collaboration with MTEC can establish expectations of considerable growth in robotics-related business, we think that this will raise awareness of the Company within the stock market, leading to a rise in corporate value.

Consolidated operating profit targets



Source: The Company's results briefing materials

(1) Raise profitability by steadily advancing the "SNS2024 (Sun-Wa New Stage 2024)" medium-term plan

The Company will raise profitability by implementing the following five priority measures of its medium-term plan.

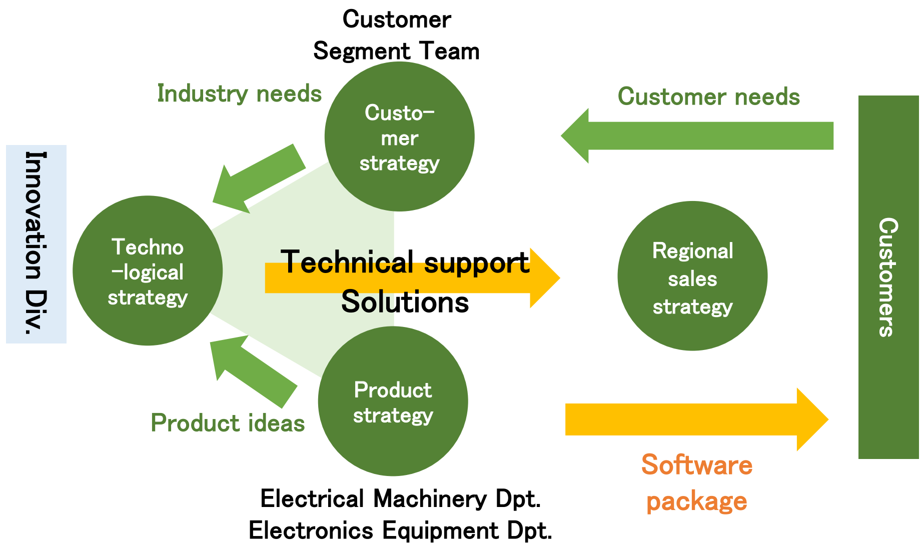
a) Raise profitability by merging customer segment strategies with regional sales strategies

As mentioned previously, the Company has divided customer segments into fields for active investment of resources and fields for selective investment of resources, and the strategic investment of resources into measures is decided by a specialized cross-regional team, which collaborates with each sales location to cultivate priority customers and deepen business with existing customers.

b) Advance initiatives through the establishment of the Innovation Div.

The Company established the new Innovation Div. in April 2023 through which it is advancing initiatives such as investment in the development of unique technical support and solutions aimed at solving customers issues, the establishment of business models and creation of new businesses in growth areas, and formation of alliances as a means of growth that utilizes external resources. The business partnership with MTEC mentioned previously is being led by the Innovation Div.

Initiatives to solve customer issues by the Innovation Div.



Source: The Company's results briefing materials

c) Strengthen robotics sales by capturing automation and labor-saving needs

The adoption of industrial robots is expected to grow as the working age population shrinks, so the Company plans to strengthen its sales structures to increase sales of industrial robots (cobots, automated transport robots, etc.). Specifically, it will allocate specialist robot sales personnel to each region to increase the success rate of sales talks and grow profits. In addition to growth areas such as electric vehicles and lithium-ion batteries, it plans to strengthen sales promotion activities targeting food and logistics-related industries, where there is strong demand for automation and labor savings. Also, the Innovation Div. is leading an initiative in collaboration with the Robot Solution Team to sell products jointly developed with MTEC.

d) Capture environmental investment opportunities oriented toward decarbonization

As mentioned previously, the Company is advancing a project to enhance sales focused on EMS and proposing solutions that contribute to decarbonization.

e) Respond to efforts to move supply chains out of China amid the decoupling of the US and China

As risk related to China rises, the Company is responding to efforts to move production bases out of China or return them to Japan by proposing global SCM solutions and strengthening its organizations in India and Southeast Asia. In addition to this, it will continue to do business in China while at the same time, strengthening information gathering activities and building a framework that can respond flexibly to various risks.

(2) Enhance shareholder returns

The Company targets a consolidated payout ratio of 25-35%, its indicator of performance-linked profit distribution, and also buys back its own shares on a flexible basis depending on the timing and financial conditions (details provided below).

(3) Enhance investor and shareholder relations

In order for its stock price to appropriately reflect its corporate value, the Company believes it is necessary to not only improve its business performance but also further enhance the information it discloses to investors and shareholders. In April 2023, it established the PR/IR Office as a specialist IR organization. It is carrying out IR activities, including holding briefings for institutional and individual investors given by directors and the officer in charge of IR, and regularly sharing information with the media (radio, specialist publications). In addition to this, the opinions shared by investors and shareholders during investor and shareholder relations activities are being shared at Board of Directors meetings and other high-level meetings so that they can be incorporated when reviewing management strategy.

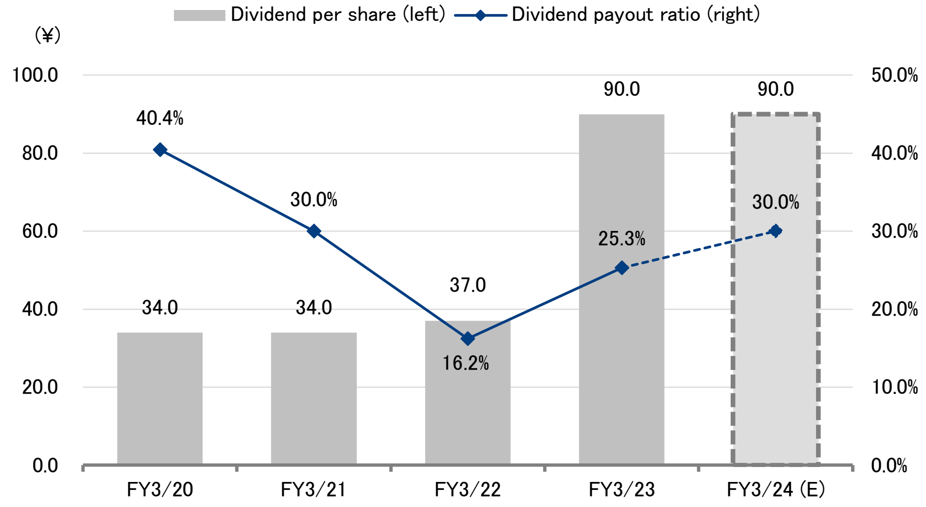
Shareholder return policy

Paying dividends targeting a consolidated payout ratio of 25-35% and considering share buybacks as necessary

The Company is working on strengthening its shareholder return policy, which is one of the measures it is taking to quickly achieve a PBR of over 1.0x. In regard to dividends, after considering how to balance investment needed to realize sustainable growth and raise corporate value with the maintaining of financial soundness needed to deal with risks, it has decided to maintain a stable dividend (since OTC, it has never lowered its dividend) while conducting shareholder returns based on consolidated results from a medium- to long-term perspective, and is therefore targeting a consolidated payout ratio of 25-35%. Based on this policy, the Company's planned per-share dividend for FY3/24 is level with the previous fiscal year at ¥90.0 (for a payout ratio of 30.0%). Going forward, the Company can be expected to increase its dividend if the consolidated payout ratio falls below 25.0%.

In addition, with regard to share buybacks, the Company has clarified its policy of flexible purchases depending on timing and financial conditions. It announced a share buyback in May 2023 and acquired 445,000 shares for ¥999mn. The total payout ratio including dividends and share buybacks is expected to be 52%. Net assets per share at the end of 1H FY3/24 was ¥3,056, for a PBR of just 0.7x, so active shareholder returns aimed at achieving a PBR of over 1.0x are expected going forward.

Dividend per share and dividend payout ratio



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

Simplified income statement and main indicators

(¥mn)

	FY3/20	FY3/21	FY3/22	FY3/23	FY3/24	
					1H	Full-year (E)
Net sales	137,943	134,769	154,414	181,013	88,867	166,500
YoY	-5.1%	-2.3%	14.6%	17.2%	5.3%	-8.0%
Gross profit	14,421	14,224	18,772	23,039	11,179	-
% of sales	10.5%	10.6%	12.2%	12.7%	12.6%	-
SG&A expenses	12,574	12,071	13,967	15,408	7,736	-
% of sales	9.1%	9.0%	9.0%	8.5%	8.7%	-
Operating profit	1,846	2,152	4,804	7,630	3,442	5,510
YoY	-45.8%	16.5%	123.2%	58.8%	4.3%	-27.8%
% of sales	1.3%	1.6%	3.1%	4.2%	3.9%	3.3%
Ordinary profit	2,144	2,567	5,195	7,675	3,700	5,860
YoY	-40.9%	19.7%	102.4%	47.7%	3.5%	-23.6%
Profit attributable to owners of parent	1,341	1,786	3,577	5,493	3,075	4,570
YoY	-49.0%	33.2%	100.3%	53.6%	21.7%	-16.8%
EPS (¥)	84.11	113.23	228.33	355.08	201.75	299.74
Dividend (¥)	34.00	34.00	37.00	90.00	45.00	90.00

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

Simplified balance sheet

(¥mn)

	End-FY3/20	End-FY3/21	End-FY3/22	End-FY3/23	End-1H FY3/24	Change amount
Current assets	62,713	64,430	82,209	94,263	94,239	-24
Cash and deposits	12,052	13,113	14,049	14,145	15,040	895
Trade receivables and contract assets	39,838	42,453	51,997	58,922	57,074	-1,848
Non-current assets	9,024	11,951	10,868	12,318	11,432	-886
Total property, plant and equipment	2,759	2,590	2,230	2,272	2,170	-102
Intangible assets	193	170	226	221	196	-25
Total investments and other assets	6,072	9,190	8,411	9,824	9,066	-758
Total assets	71,738	76,381	93,078	106,581	105,671	-910
Current liabilities	35,402	36,372	52,797	59,870	54,481	-5,389
Payment obligations	29,108	29,455	40,676	45,335	40,863	-4,472
Non-current liabilities	4,608	4,978	2,257	2,227	5,001	2,774
Total liabilities	40,011	41,350	55,054	62,097	59,483	-2,614
Interest-bearing debt	6,709	7,048	7,805	9,557	12,368	2,811
Shareholders' equity	29,552	30,802	33,277	38,202	39,369	1,167
Accumulated other comprehensive income	2,174	4,228	4,746	6,282	6,819	537
Total net assets	31,726	35,030	38,023	44,484	46,188	1,704

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

Status of Cash Flows

(¥mn)

	FY3/20	FY3/21	FY3/22	FY3/23	1H FY3/24
Cash flows from operating activities	3,238	1,589	792	-545	-868
Cash flows from investing activities	-200	-141	244	-731	749
Cash flows from financing activities	-945	-309	-580	906	527
Cash and cash equivalents at end of period	11,568	12,629	13,565	13,661	14,556

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

Management indicators

	FY3/20	FY3/21	FY3/22	FY3/23	1H FY3/24
Equity ratio	44.2%	45.9%	40.9%	41.7%	43.7%
Interest-bearing debt ratio	21.1%	20.1%	20.5%	21.5%	26.8%
ROE	4.2%	5.4%	9.8%	13.3%	-
Net cash (¥mn)	5,343	6,065	6,244	4,588	2,672

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

FISCO

Disclaimer

■ 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