COMPANY RESEARCH AND ANALYSIS REPORT

Elematec Corporation

2715

Tokyo Stock Exchange First Section

9-Jul.-2018

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Summary

Return to a growth trajectory by switching from smartphone-related to automotive-related business as the driver

Elematec Corporation <2715> (hereafter, also "the Company") is an electronics trading company that specializes in electronic materials. It was formed through the merger of Takachiho Electric Co., Ltd. and Ohnishi Denki Co., Ltd. in 2009 and entered the Toyota Tsusho Corporation <8015> Group in FY2011.

1. Posted higher profits in FY3/18 as automotive-related business and other areas offset decline in smaller LCD materials business

The Company reported higher profits on a decline in sales with ¥196,238mn in net sales (-3.3% YoY) and ¥6,085mn in ordinary income (+14.5%). Sales of materials used in smaller LCDs, a core business, dropped sharply due to slowdown in smartphone market growth. However, sales increased for products used in automobiles and industrial equipment as well as products used in consumer electronics equipment. While overall sales fell because gains in these other areas were not enough to fully offset the impact of lower sales to the smartphone market, earnings rose by more than expected in guidance thanks to improved profitability from change in product mix. We think the FY3/18 results effectively leveraged the Company's strengths of having a large number of customers on procurement and sales sides as well as robust adaptability in quickly addressing changes in a broad range of products and growth markets.

2. Healthy progress with the longer-term growth strategy focused on globalization and creating added value

The Company aims to be an "electronic materials trading company that consistently delivers high value-added business globally" and is pursuing 1) real globalization, 2) creation of high added value, and 3) reinforcement of the business foundation. It appears to be making steady progress in each of these areas thus far. The Company's goals in three years from now (FY3/21) are ¥250bn in net sales and ¥8bn in ordinary profit. While these levels are the same as its previous goals, breakdown of sales by markets has changed considerably and Automotive and Broad Market segments cover a majority of business. This scenario relies on nimble response to changes in growth markets to drive business expansion. We expect the Company to beat its profit goal if the sales outlook is met because of anticipated improvement in margin from changes in the growth driver.

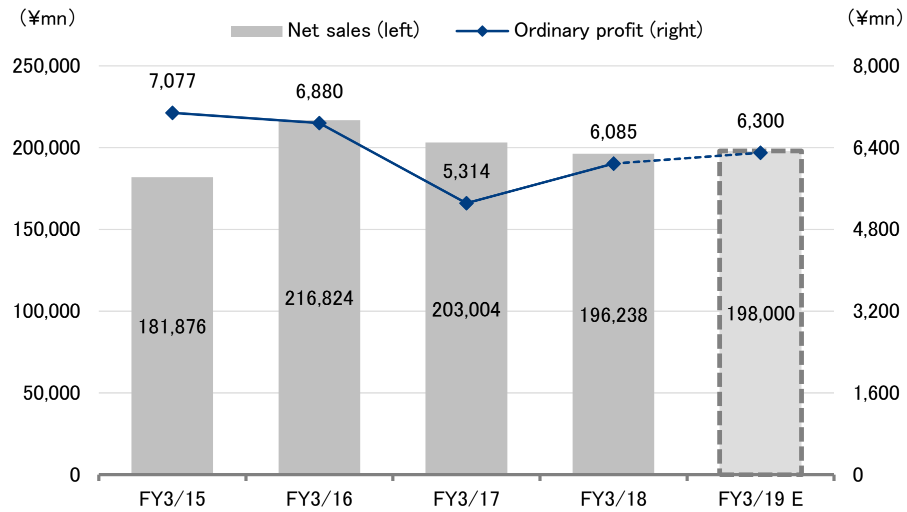
3. Targeting higher sales and profits in FY3/19 with gains in growth areas

The Company is targeting higher sales and profits in FY3/19 at ¥198,000mn in net sales (+0.9% YoY) and ¥6,300mn in ordinary income (+3.5%). It expects the same growth scenario as seen in FY3/18 with clear restoration of an upward trajectory, despite further shrinkage of smartphone-related business, on continued growth in products used by automobiles, industrial equipment, and other areas. While it only projects single-digit profit gain due to use of a ¥105/$ forex assumption (roughly ¥6 of yen appreciation YoY), we think earnings could overshoot depending on actual trends. This is the first fiscal year of the medium-term outlook that lasts through FY3/21. We will be paying close attention to the extent to which the Company can expand Automotive and Broad Market sales with heightened expectations as growth engines.

Key Points

- Key strength is agility in addressing waves of change in growth markets and leveraging them to generate higher income
- Implementing a longer-term growth strategy with the aim of being an "electronic materials trading company that consistently delivers high value-added business globally"
- Making steady progress in genuine globalization, creation of added value, and reinforcement of the business foundation

Results trends



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

Company profile

Two companies with specialties in electronic materials merged in 2009 Strengthened the automotive field by entering the Toyota Tsusho Group

1. History

The Company's predecessors were Takachiho Electric, established in 1947 in Tokyo, and Ohnishi Denki, founded in 1958 in Kyoto. Both companies began by handling insulation materials, subsequently broadened the scope of their product offerings to electronic materials used in electronic products following technology and development trends, and grew into independent technology trading companies.

These companies merged in 2009 (with Takachiho Electric as the surviving entity) and adopted the Elematec name. The Company has steadily grown since the merger, even though both predecessors mainly handled electronic materials, thanks to complementary geographical positions in Tokyo and Kyoto. It became a subsidiary of Toyota Tsusho through a TOB transaction in FY2011, and this is its current position.

The Company had 1,179 employees on a consolidated basis as of the end of FY3/18. It operates 62 sites in Japan and overseas. The regional sales breakdown consists of Japan at 54.9%, China (including Hong Kong) 23.1%, other Asia (Taiwan, Korea, India, and Southeast Asia) 17.1%, and the US and Europe (US, Mexico, and Czech Republic) 4.9%.

Strength in having many products customers and the ability to convert these resources into income through organic linkage as five services and functions

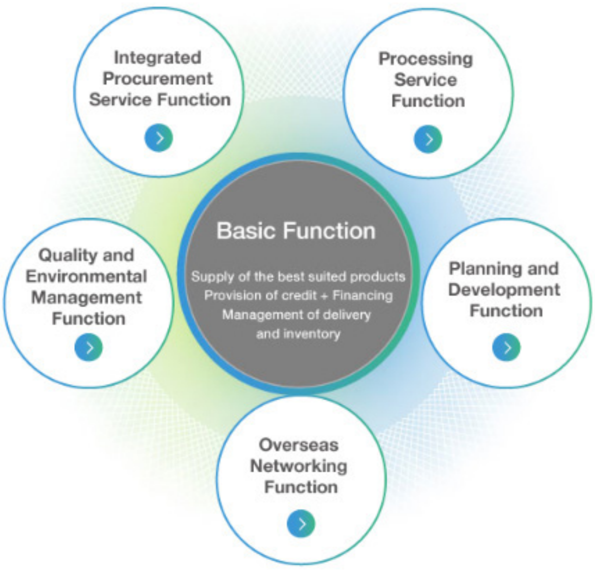
2. Company features and strengths

Customer and product diversity is an important feature of Elematec. It operates 62 sites in Japan and overseas and handles a wide range of transactions of primarily electronic materials and components among about 7,200 suppliers ("makers") and 6,100 sales destinations ("users"). Another major characteristic is its flexible response to growth markets. We believe that effective interaction of these two traits supports realization of stable earnings growth potential and robust earnings stability.

Behind the scenes, however, is the vital role of functions and mechanisms that match a massive number of products and an extensive customer network to customer needs.

The Company goes beyond just the basic services and functions of an electronics trading company of optimal supply of parts and materials, credit provision and financing, and delivery timing and inventory management. It also supplies processing services, integrated procurement services, and other more advanced services and functions that generate higher added value. The Company highlights five services and functions, and we think the presence of these functions is precisely why it can develop diverse products into businesses and deliver results.

Services and functions the Company provides



Source: Company website

While each of the five services and functions highlighted by Elematec is important, processing services and planning and development functions stand out as defining features. We also think the overseas networking function is a key point in regards to the growth strategy explained below.

(1) Processing services

The Company is a trading company and adheres to a stance of avoiding competition with manufacturers, who are transaction counterparts. However, customers (sales destinations) often request delivery of processed items. The Company has its own processing sites to accommodate these needs – one in Japan and two in China.

In Japan, Elematec Logi Serve Corporation (based in Yokohama) processes and manufactures electric materials and other products, conducts acceptance inspections, and handles environment-related material measurements. In China, Elematec Electronics (Dalian) Co., Ltd. implements surface mounting of parts into electronic circuit boards and Elematec Wuxi Technology Co., Ltd. handles silk-screen printing for plastic panels, cutting and processing, and assembly.

The Company starts generating added value and increasing profitability once it gets to the point of supplying customized products that it has planned and designed utilizing new product development information and information about the latest technology trends and other developments that it possesses.

This is what the Company refers to as “modularization.” Its promotion of modularization often overlaps with promotion of planning and development functions explained below. If planning and development functions work well and deals are arranged, modularization business naturally occurs.

The Company does not limit manufacturing and processing in modularization business to only its own processing sites. However, it is beneficial to outsource from a position of having its own processing and manufacturing technologies. We will be looking for the Company to accumulate experience and technologies in processing services and apply them to module processing at its own plants.

(2) Planning and development function

Planning and development business begins with appropriate understanding of customer needs. Fundamental flow in this business involves the Company identifying optimal parts and materials from its roughly 7,200 domestic and overseas suppliers to meet the wide-ranging needs of customers for electronics, mechatronics, exteriors, design, and other aspects; planning products that satisfy requirements (even creating product prototypes in some cases); and submitting proposals to customers.

Two essential ingredients in this business are grasping and realizing needs. Not many rival companies have both of these capabilities, and we believe this function is another source of differentiation for the Company versus other companies. Additionally, adoption of new products based on the Company’s plans and designs means that it becomes the one and only to customers. We think this is a very effective way of strengthening relationships with customers. As explained above, these new products should generate high profitability due to the Company’s role of modularization for delivery. This kind of planning and development content nearly overlaps with the below efforts to generate added value.

Elematec fully leverages these five services and functions in its provision of added value to customers and thereby earns customer trust and makes itself a vital presence to customers. We think diversity in its customers and products plays a major role in Elematec's ability to build strong relationships of trust. While a chicken-or-egg dynamic exists, we believe the "positive cycle" of product and customer diversity and an organization that can deliver added value to customers are the biggest advantages.

Nimbly addresses waves of change in growth markets and realizes steady growth over the long term

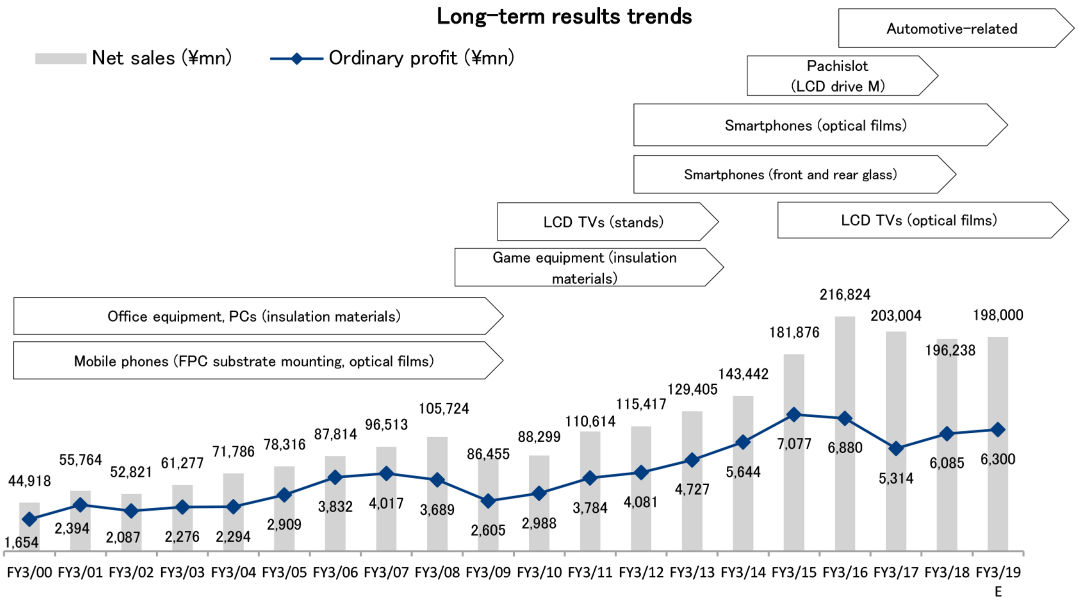
3. Stable growth potential and earnings stability

The Company has a track record of realizing steady income growth over the long term. We think this has been one of its main characteristics. During these years, meanwhile, growth markets and products changed dramatically, including mobile phones, game machines, LCD TVs, and smartphones. The Company consistently realized upward growth through supply of parts and materials to respective growth industries and markets at the various times.

The Company recorded all-time high sales in FY3/16 and ordinary income in FY3/15 due to its smartphone-related business. However, its smartphone-related sales dropped by about ¥30bn in the two years from FY3/16's peak to FY3/18.

Although Elematec's sales and profits weakened YoY in FY3/17, they turned increases in FY3/18. Details are reviewed below. However, the main driver of improved momentum, meanwhile, is cultivation of new growth markets and growth business (for Elematec), such as the automotive field. We think Elematec can successfully capitalize on these growth industry waves because of its product and customer diversity and also organizational strength of organically connecting this diversity to business, as explained above.

Long-term results trends



Source: Prepared by FISCO from the Company's financial results, interviews, etc.

Business performance

Profit increased (YoY) thanks to improved margin on change in product mix, despite decline in sales due to weaker smartphone-related product business

1. Overview of FY3/18 results

Elematec posted lower sales yet sharply higher profits in FY3/18 with net sales at ¥196,238mn (-3.3% YoY), operating income at ¥6,480mn (+19.9%), ordinary profit at ¥6,085mn (+14.5%), and profit attributable to owners of parent at ¥4,376mn (+226.0%).

Net sales missed the latest guidance by 4.3%, but operating profit and other profit items overshot by about 10% each. Sales and profits were all at the Company's third highest levels. We believe this was a healthy outcome.

Summary of FY3/18 results

(¥mn)

	FY3/17			FY3/18					
	1H	2H	Full-year results	1H	2H	Full-year forecast	Full-year results	YoY growth rate	vs. forecast
Net sales	94,966	108,038	203,004	104,134	92,104	205,000	196,238	-3.3%	-4.3%
Gross profit	7,759	9,368	17,127	9,700	9,186	-	18,886	10.3%	-
Gross margin	8.2%	8.7%	8.4%	9.3%	10.0%	-	9.6%	-	-
SG&A expenses	5,569	6,151	11,720	6,354	6,051	-	12,405	5.8%	-
SG&A expenses ratio	5.9%	5.7%	5.8%	6.1%	6.6%	-	6.3%	-	-
Operating income	2,190	3,216	5,406	3,345	3,135	5,800	6,480	19.9%	11.7%
Operating margin	2.3%	3.0%	2.7%	3.2%	3.4%	2.8%	3.3%	-	-
Ordinary profit	2,160	3,154	5,314	3,103	2,982	5,600	6,085	14.5%	8.7%
Profit attributable to owners of parent	-879	2,221	1,342	2,175	2,201	3,900	4,376	226.0%	12.2%

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

Industry output of electronic parts and other products was vibrant in FY3/18 due to tailwinds from IoT-related demand and increase in automotive use of electronic systems. The white-good consumer appliances market also expanded as a whole. Smaller LCDs, however, came under pressure from a slump in smartphone sales in China, the world's largest market, and a rise in models utilizing OLEDs.

Given these market conditions, the Company's overall sales fell 3.3% YoY to ¥196,238mn, even with focus on and increased sales of automotive-related products, TV display-related products, and other areas, because of a heavy impact from rapid changes in the environment for the smaller LCD market.

In profits, meanwhile, gross income increased 10.3% YoY to ¥18,886mn on a 1.2ppt rise in gross margin from 8.4% in the previous fiscal year to 9.6% mainly due to improved product mix. Operating income grew 19.9% YoY to ¥6,480mn as SG&A expenses only climbed 5.8%, even with increases in personnel costs and packing and freight costs. Operating margin was up by 0.6ppt from 2.7% in the previous fiscal year to 3.3%.

The hefty 226.0% YoY rise in profit attributable to parent shareholders came as a rebound from heavy pressure on FY3/17's profit attributable to parent shareholders due to booking extraordinary losses.

We think the Company delivered healthy quantitative results in FY3/18 as mentioned earlier. The outcome also confirmed robust adaptability to changes in the business environment. Sales of materials used in smaller LCDs, a core business, fell sharply because of changes in the environment for smartphone market. Nevertheless, the Company secured higher profits due to steady expansion of products used in automobiles, industrial equipment, and other areas. While details are explained below, the Company retained its overall sales goal from a year ago in the final fiscal year (FY3/21) of the rolling three-year medium-term plan but substantially altered breakdown by markets. We believe the ability to make this type of change is the Company's biggest strength.

Healthy expansion of Automotive and Broad Market businesses likely to offset sales decline in Digital Electronics
Large contribution to improved gross margin too

2. Trends by market

Breakdown of net sales trends by market

(¥mn, %)

Segment by market	FY3/17		FY3/18						
	Results	Composition	Initial forecast	Revised forecast	Results	Growth rate	Composition	Main target markets	Change
Digital Electronics	129,308	63.7%	122,852	119,108	112,123	-13.3%	57.1%	LCDs, touch panels, and backlight	-22,890
								Mobile terminal	-1,615
								Home electronics (TVs, monitors, audio, etc.)	5,602
								Toys and hobbies	1,286
Automotive	18,785	9.3%	22,730	24,605	24,966	32.9%	12.7%	Automotive	6,181
Broad Market	54,910	27.0%	59,417	61,287	59,148	7.7%	30.1%	Industrial machinery, etc.	2,362
								Aftermarket	1,210
								Medical equipment	926
								Infrastructure and energy	-1,072
Total	203,004	100.0%	205,000	205,000	196,238	-3.3%	100.0%		

Note: The Company moved "supercomputers, servers, and storage" from Broad Market to Digital Electronics in FY3/18 and also updated FY3/17 values using the same standard.
Source: Prepared by FISCO from the Company's results briefing materials

Digital Electronics sales dropped 13.3% (¥17,184mn) YoY to ¥112,123mn. It missed the revised target from the 1H announcement (¥119,108mn) by ¥6,985mn. This shortfall was the majority of the ¥8,762mn miss in overall sales (vs. guidance).

The ¥22,890mn YoY decline in LCD, touch panel (TP), and back light (BL) sales was the main cause of the steep drop in Digital Electronics business. These products are used in smaller LCDs that have smartphones and tablets as final-demand applications. While the Company anticipated sharply lower FY3/18 sales at period-start in light of maturing in the smartphone market and increased adoption of OLEDs in smartphones, these negatives did not materialize in 1H results. During 2H, meanwhile, concerns surfaced and sales ended up slipping more than initially expected. Higher sales (YoY) of products for consumer electronics (mainly large LCDs for TVs and monitors in Asian countries) and toys and hobby equipment (materials and parts used in game machines and other equipment) were not enough to fully cover sales decline in LCD, TP, and BL business.

Automotive sales increased 32.9% (¥6,181mn) YoY to ¥24,966mn, beating guidance by ¥361mn. This business expanded to 12.7% of total sales, moving above 10% for the first time. It handles a wide range of products, including headlight parts and materials, interior parts and materials, sensors, and various electronic components. We think sales generally improved in these product areas. Automotive business requires sales activities and joint developments tailored to the cycle of model changes. The Company has steadily addressed these areas and has moved into a phase of benefiting from the results.

Broad Market sales expanded 7.7% (¥4,237mn) YoY to ¥59,148mn, though this undershot guidance by ¥2,139mn. Sales of products used in industry equipment climbed on higher sales by machinery and factory automation manufacturers amid vibrant capital investments in China. In aftermarket business, the Company increased sales of parts and materials utilized in back monitor cameras and driver recorders. Weaker solar power-related business resulted in infrastructure and energy sales decline.

Gross margin in the three above-mentioned market categories was relatively low in Digital Electronics business and relatively high in Automotive and Broad Market areas. With decline in Digital Electronics sales and increase in sales to the other two market categories in FY3/18, overall gross margin moved upward on favorable change in product mix.

Longer-term growth strategy and progress

Aims to be an “electronic materials trading company that consistently delivers high value-added business globally”

1. Overview of the “elematec x (cross)” longer-term business strategy

The Company does not prepare medium-term business plans with a fixed period, but formulates basic policies for initiatives related to a medium- to long-term strategy and proceeds with business on this basis. It updated the internal slogan in FY3/18, switching from “elematec + (plus)” to “elematec x (cross).” Compared to the previous “elematec + (plus)” slogan, it wants to emphasize accelerated pursuit of synergies and timely action.

As its future vision achieved through “elematec x (cross),” the Company aims to be an “electronic materials trading company that consistently delivers high value-added business globally.” Three specific themes for accomplishing this are 1) real globalization, 2) creation of added value, and 3) reinforcement of the business foundation.

In annual guidance, the Company discloses targets for the current fiscal year and goals for two years later. This style resembles a rolling medium-term business plan. Therefore, at the start of FY3/19, the Company presented current fiscal year target and FY3/21 goals. It hopes to reach ¥250bn in sales and ¥8bn in ordinary income in FY3/21, setting all-time high profits.

Making steady progress in genuine globalization, creation of added value, and reinforcement of the business foundation

2. Status of progress for the medium- to long-term strategy

(1) “Real globalization” initiatives and progress

This theme addresses promotion of global direct accounts. The Company’s overseas business until now has been supplying electronic materials and other parts and materials to Japanese device and electronic component manufacturers and these firms sold parts and materials they produced to overseas assemblers and final product manufacturers. This approach limited direct transactions with overseas companies. In the shift to direct global accounts, meanwhile, the Company will establish its own accounts with overseas assemblers and final product manufacturers and conduct transactions directly.

The relative decline in the standing of Japanese electronics firms, the Company’s direct customers, serves as the background for the Company’s efforts towards real globalization. Looking at smartphones as an example, Japan lacks companies with sufficient business scale in not only the global market, but even in the Japanese market. In Automotive and Broad Market segments too, customers have a global presence and the Company must establish direct global accounts in these areas too, similar to Digital Electronics. We think these concerns provided the catalyst for Elematec to move forward with real globalization.

In progress thus far, the Company has begun transactions of automotive parts and materials with European Tier-1 manufacturers. While this currently only applies to some products, transaction value is steadily rising. Furthermore, the Company is focusing on establishment of overseas sites and enhanced fostering of local staff from the standpoint of developing operations. A recent case is the launch of an office in Houston (US). We expect spread to and widening influence on transactions with new customers of these ground-level initiatives and European successes.

(2) “Added value creation” initiatives and progress

Added value truly becomes a reality when it benefits both customers and the Company. We thus think creation of added value is likely to lead to business expansion too. The Company’s initiatives in developing modules are a specific example of creating added value.

Added value creation as a process begins by gaining appropriate understanding of customer needs. The Company looks for optimal products to meet the needs of customers in electronics, mechatronics, exterior, design, and other areas from its 7,200 domestic and overseas suppliers. It might also plan, design, and prototype products that address customer needs and propose solutions.

If customers select proposals (products) that Elematec has prepared and developed, Elematec delivers modularized products and can expand earnings in comparison to selling electronic materials and other items just as materials. Understanding customer needs, the first step in this process, needs to take place at the customer's development stage that defines specifications. While Elematec has handled many products adopted at this early stage, we think it is important to increase this even more.

In recent progress, the Company has been strengthening personnel in its technology group directly involved in planning, design, and development. These additions have bolstered its understanding of customer needs and prototyping capabilities. The Company also appears to be steadily expanding activities to arrange build-to-specifications opportunities in Automotive and Broad Market areas. These businesses offer a better fit with the build-to-specifications approach than Digital Electronics. We hence expect advances to actual transactions.

(3) "Reinforcement of the business foundation" initiatives and progress

While the previous two topics involve initiatives that target income growth, reinforcement of the business foundation is mainly an effort to strengthen the Company's own operations. Nevertheless, the Company obviously needs to establish reliability and trust in order to realize the global direct accounts it is targeting in real globalization. Trading company business naturally involves some risk, such as counterparty risk. We think reinforcement of the business foundation is similar to an athlete's training of the body core. It is an important component of the growth strategy, even though it does not stand out.

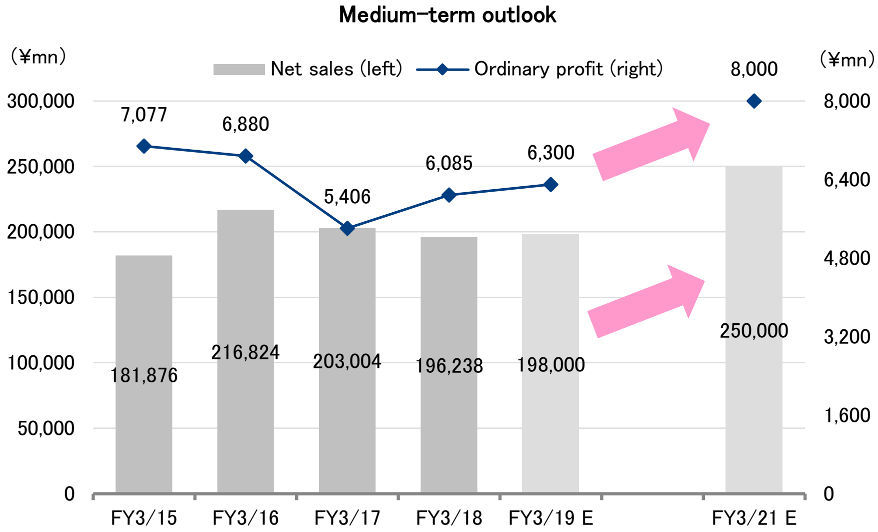
The Company booked about ¥3bn in extraordinary losses for the building materials business in China in FY3/17. Following this experience, it invested heavily to bolster risk management capabilities and improve governance at overseas sites, including personnel additions. These activities do not have a "completion" point or goal because trading company business always comes with some risk as mentioned above. However, we think the Company's establishment of operations vital to the longer-term growth strategy based on painful experience in FY3/17 indicates that it is making healthy progress in strengthening the business foundation.

Targeting ¥250bn in net sales and ¥8bn in ordinary profit for FY3/21 Possibility of earnings upside if profit margin improves

3. Stance in the medium-term outlook

The Company's medium-term outlook presented at the start of FY3/19 (April 2018) calls for ¥250bn in net sales and ¥8bn in ordinary income in FY3/21. A year earlier it disclosed ¥250bn in net sales and ¥8bn in ordinary income as FY3/20 goals. The Company seems to have postponed timing to attain the medium-term outlook by a year.

Closer analysis of sales outlook breakdown by markets and the Company's initiatives in the various markets, however, suggests something else. Regarding the FY3/21 outlook, we conclude that the Company is capable of attaining the sales goal, though it will not be easy, and expect ordinary income to overshoot if it is met.



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

The main point is decline in the overall sales share of Digital Electronics business and gains in Automotive and Broad Market sales presence, compared to the outlook from a year ago. Looking at growth rates from results posted three years ago, Digital Electronics has slowed considerably and is likely to stay in a flat range, while Automotive business has sustained 80% growth and Broad Market sales increased substantially to 52.2%. We think the growth driver from a medium-term perspective has completely switched from Digital Electronics to Automotive and Broad Market segments.

This shift reflects change in the growth scenario and is not simply opportunistic. We believe it factors in robust potential of Automotive and Board Market businesses to support the above-mentioned strong growth and a conservative stance of not at all relying on good fortune, such as the "smartphone bubble" that generated past peak earnings.

Market breakdown of the medium-term outlook

(¥mn)

Segment by market	FY3/17		FY3/18		FY3/20				FY3/21			
	Results	Compo-sition	Results	Compo-sition	Forecast	vs. FY3/17		Compo-sition	Forecast	vs. FY3/18		Compo-sition
						Growth rate	Change			Growth rate	Change	
When formulated	-		-		April 2017				April 2018			
Digital Electronics	129,308	63.7%	112,123	57.1%	142,000	9.9%	12,692	56.8%	115,000	2.6%	2,877	46.0%
Automotive	18,785	9.3%	24,966	12.7%	33,000	75.7%	14,215	13.2%	45,000	80.2%	20,034	18.0%
Broad Market	54,910	27.0%	59,148	30.1%	75,000	36.6%	20,090	30.0%	90,000	52.2%	30,852	36.0%
Total	203,004	100.0%	196,238	100.0%	250,000	23.2%	46,996	100.0%	250,000	27.4%	53,762	100.0%

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

We accept the prospect of a new growth scenario through replacement of growth drivers as explained above, though do not think strong Automotive and Broad Market growth potential built into the FY3/21 medium-term outlook can be taken for granted. The ¥115bn target for Digital Electronics, meanwhile, seems overly cautious. We think the Company is ultimately capable of attaining ¥250bn in sales even if specific segment content differs somewhat versus the outlook.

The ¥8bn in ordinary income is overly conservative, in our view. This outlook puts ordinary margin at 3.2% in FY3/21, which is almost the same as the FY3/18 result (3.1%). However, we expect improvement in overall margin due to better product mix with increased sales shares of Automotive and Broad Market businesses that generate relatively higher margin in the new growth scenario. This dynamic was already evident in FY3/18 results. While it is difficult to precisely forecast ordinary margin in FY3/21, we think the 0.5ppt YoY rise in FY3/18 ordinary margin deserves notice.

The Company's medium-term expectations by market are reviewed below.

(1) Digital Electronics

Smartphone business, which led the Company to peak results in FY3/15-16, is fading as an anticipated growth driver and becoming just one of many product areas. Products in the Digital Electronics segment tend to change quickly. A good example is change in sales for consumer electronics (TVs and monitors) equipment in the past 1-2 years. As explained in our previous reports, one of the Company's major strengths is its frank acceptance of this aspect of the Digital Electronics business and operations that respond to the rapid cycle of customer products and quickly supplies suitable materials to growing markets (products). Based on the medium-term results outlook for FY3/21, we think the Company aims to match the growth rate of the Digital Electronics market as a whole by effectively leveraging the waves of various Digital Electronics products, rather than relying on a certain growth product, such as smartphones. This strategy makes sense and the outlook seems attainable in light of the Company's strengths. However, we believe the 2.6% growth rate versus FY3/18 (0.8% average annual rate) is overly cautious, even compared to the outlook for global economic growth.

(2) Automotive

The average annual growth rate starting from FY3/18 works out to 21.7% because the Company is targeting ¥45,000mn in FY3/21 sales. As explained below, however, the anticipated growth rate in FY3/19 is less than this level at 14.9% and required growth rates in FY3/20 and FY3/21 hence are about 25% each. These are not simple hurdles.

The Company's current Automotive sales, meanwhile, mainly come from commercial flow prior to becoming part of the Toyoda Tsusho group. We expect ramp-up of transactions with automotive manufacturers affiliated with Toyota Motor Corporation (7203) and developed as customers since joining Toyoda Tsusho. This business is likely to serve as a driver of growth in Automotive income. Activities to build products based on specifications are vital in the automotive industry as mentioned earlier. We think business expansion based on these efforts is factored into the medium-term outlook too. In this sense, the certainty of the Company's medium-term targets might be stronger than generally anticipated.

(3) Broad Market

The Company is targeting ¥90,000mn in FY3/21 sales, and this requires a 15.0% average annual growth rate starting from FY3/18. Just as with the Automotive business, the FY3/19 growth rate is lower than the required average at 9.5% and the second- and third-year growth rates must reach 17.9%.

While the Broad Market segment covers a wide range of customer industries, transaction scale in industrial equipment and aftermarket businesses is relatively large and these areas also offer strong latent growth rates. This means that Broad Market growth requires expansion of income to these two markets. Given longer-term and more moderate customer product cycles in Broad Market businesses, compared to Digital Electronics, we expect the Company to broaden overall scope through accumulation of small deals. This segment also involves many customers that fit well with building products to specifications, as noted earlier. In light of these conditions, we think the Broad Market segment is capable of achieving the medium-term sales goal, though it will not be easy.

Business outlook

Expecting higher sales and profits with continuation of Automotive and Broad Market segments as drivers

The Company forecasts slight increase in sales and profits of ¥198,000mn in net sales (+0.9% YoY), ¥6,600mn in operating income (+1.8%), ¥6,300mn in ordinary profit (+3.5%), and ¥4,500mn in profit attributable to owners of parent (+2.8%) in FY3/19.

Overview of the FY3/19 outlook

(¥mn)

	FY3/17			FY3/17			FY3/19	
	1H	2H	Full year	1H	2H	Full year	Full year E	YoY
Net sales	94,966	108,038	203,004	104,134	92,104	196,238	198,000	0.9%
Operating income	2,190	3,216	5,406	3,345	3,135	6,480	6,600	1.8%
Operating margin	2.3%	3.0%	2.7%	3.2%	3.4%	3.3%	3.3%	-
Ordinary profit	2,160	3,154	5,314	3,103	2,982	6,085	6,300	3.5%
Profit attributable to owners of parent	-879	2,221	1,342	2,175	2,201	4,376	4,500	2.8%

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

The Company guides for a return to an increase (YoY) in net sales in FY3/19, albeit with the same fundamental trends as FY3/18 in which growth in automotive and broad market businesses offset decline smartphone-related business. While sales dropped in FY3/18 because of the Company's inability to fully counter the large decline in smartphone-related business, the impact is likely to be smaller in FY3/19 and this should leave a sales increase effect on a net basis.

In earnings, meanwhile, the Company projects a 1.8% YoY rise in operating income to ¥6,600mn, delivering higher profits again. It expects improvement in profit margin from change in product mix of sales to continue in FY3/19. We think this target also factored in negative impact from yen appreciation by setting the forex rate assumption at ¥105/$ (vs. FY3/18's ¥110.85 actual rate).

Sales growth targets by market reflect the trends explained above at a 6.7% YoY decline for Digital Electronics and increases of 14.9% in Automotive and 9.5% in Broad Market sales.

In Digital Electronics, the Company forecasts a drop in LCD, TP, and BL sales of just over ¥10bn YoY. This includes temporary loss of demand for parts and materials used in consumer electronics equipment due to model changes at customers. Conversely, it projects higher sales in mobile handset business because of restored use of parts and materials it handles following model changes.

The Company expects Automotive and Broad Market businesses to exhibit the same trends as seen in FY3/18. Its outlook assumes steady increase in transaction volume of automotive-related products that strongly boosts overall sales. It also anticipates continuation of industrial equipment and aftermarket areas as Broad Market growth drivers.

Sales breakdown by market for FY3/19

(¥mn)

Segment by market	Segment by market		FY3/19				
	Results	Composition	Forecast	Growth rate	Composition	Main target market	Sales increase value (YoY)
Digital Electronics	112,123	57.1%	104,571	-6.7%	52.8%	LCDs, touch panels, and backlight	-10,720
						Home electronics (TVs, monitors, audio, etc.)	-2,592
						Mobile terminal	4,115
						Electronic components	1,550
Automotive	24,966	12.7%	28,690	14.9%	14.5%	Automotive	3,723
Broad Market	59,148	30.1%	64,738	9.5%	32.7%	Aftermarket	2,292
						Industrial machinery, etc.	1,430
						Medical equipment	417
Total	196,238	100.0%	198,000	0.9%	100.0%		

Note: Moved supercomputers, servers, and storage from Broad Market to Digital Electronics from FY3/18
Source: Prepared by FISCO from the Company's results briefing materials

We think earnings could overshoot FY3/19 guidance depending on trends, mainly through 1) improvement in profit margin from change in product mix and 2) the forex rate. For the former, the Company might be taking a somewhat cautious view of the FY3/19 effect. For the latter, the yen is currently trading weaker than the rate assumption and continuation at this level offers a clear profit upside factor. While it is not appropriate to raise upside expectations too much at this point because the fiscal year has just begun, we will be closely monitoring progress with emphasis on these points.

Income statement summary

(¥mn)

	FY3/15	FY3/16		FY3/17	FY3/18	FY3/19 E
		Reporting basis	12-month basis			
Net sales	181,876	216,824	205,370	203,004	196,238	198,000
Growth rate	26.8%	19.2%	12.9%	-1.2%	-3.3%	0.9%
Gross profit	18,443	18,763	17,947	17,127	18,886	-
Gross margin	10.1%	8.7%	8.7%	8.4%	9.6%	-
SG&A expenses	11,068	11,894	11,407	11,720	12,405	-
SG&A expenses ratio	6.1%	5.5%	5.6%	5.8%	6.3%	-
Operating income	7,375	6,868	6,540	5,406	6,480	6,600
Growth rate	40.6%	-6.9%	-11.3%	-17.3%	19.9%	1.8%
Operating margin	4.1%	3.2%	3.2%	2.7%	3.3%	3.3%
Ordinary profit	7,077	6,880	6,538	5,314	6,085	6,300
Growth rate	25.4%	-2.8%	-7.6%	-18.7%	14.5%	3.5%
Profit attributable to owners of parent	5,105	5,048	4,794	1,342	4,376	4,500
Growth rate	32.2%	-1.1%	-6.1%	-72.0%	226.0%	2.8%
EPS (¥)	249.38	246.58	-	65.57	213.76	219.80
Dividend (¥)	75.00	75.00	-	20.00	65.00	66.00
Net assets per share (¥)	2,095.95	2,170.74	-	2,175.80	2,346.79	-

Note: The FY3/16 financial statements consolidated 15 months for 9 overseas subsidiaries linked to changes in the fiscal year. The 12-month basis utilizes values that have been converted to 12-month statements in all cases. We calculated the FY3/17 YoY growth rates using a 12-month basis for FY3/16.
Source: Prepared by FISCO from the Company's financial results

Balance sheet summary

(¥mn)

	FY3/14 year-end	FY3/15 year-end	FY3/16 year-end	FY3/17 year-end	FY3/18 year-end
Current assets	68,426	79,170	74,935	87,662	86,363
Cash and deposits	14,809	10,004	12,551	10,282	25,893
Notes and accounts receivable	43,617	57,575	50,599	66,955	49,673
Fixed assets	4,999	5,021	5,636	5,621	5,472
Tangible fixed assets	2,962	2,627	2,465	2,398	2,363
Intangible fixed assets	228	236	1,349	1,115	886
Investments, etc.	1,808	2,156	1,821	2,107	2,222
Total assets	73,425	84,191	80,572	93,284	91,835
Current liabilities	36,374	40,931	35,892	48,521	43,597
Notes and accounts payable	34,094	36,199	33,419	42,734	40,829
Short-term loans, etc.	-	1,598	466	2,884	53
Fixed liabilities	107	349	238	217	191
Long-term loans	-	-	-	-	-
Shareholders' equity	35,681	39,672	42,980	43,401	47,061
Capital	2,142	2,142	2,142	2,142	2,142
Capital surplus	3,335	3,335	3,335	3,335	3,335
Retained earnings	30,897	34,888	38,196	38,618	42,278
Treasury shares	-694	-694	-694	-694	-694
Accumulated other comprehensive income	1,017	3,238	1,462	1,143	984
Non-controlling interests	245	-	-	-	-
Net assets	36,943	42,910	44,442	44,545	48,046
Total liabilities and net assets	73,425	84,191	80,572	93,284	91,835

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

Cash flow statement

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18
Cash flow from operating activities	2,132	-5,942	7,573	-3,309	19,257
Cash flow from investing activities	21	-290	-1,387	-85	-51
Cash flow from financing activities	-1,145	318	-2,837	1,504	-3,547
Effect of exchange rate change on cash and cash equivalents	1,007	1,109	-876	-305	-46
Net increase (decrease) in cash and cash equivalents	2,016	-4,805	2,473	-2,195	15,611
Cash and cash equivalents at beginning of period	12,793	14,809	10,004	12,477	10,282
Cash and cash equivalents at end of period	14,809	10,004	12,477	10,282	25,893

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

Shareholder return policy

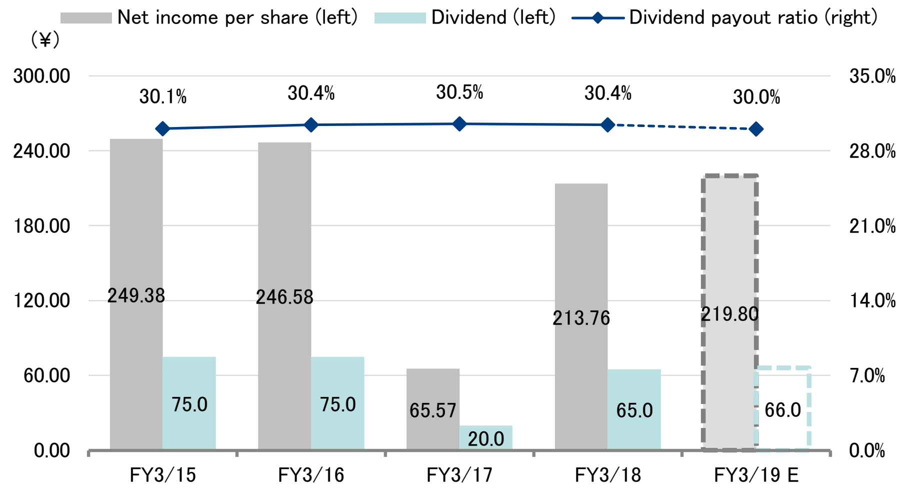
Steep dividend hike to ¥65 in FY3/18 on increased profits

The Company primarily pays dividends as its shareholder return policy and aims to keep the dividend payout ratio at 30% while taking into account the earnings outlook (short term and medium term), growth investments, cash flow, and other factors.

The Company reported stronger profits than planned in FY3/18 with EPS at ¥213.76. It raised the annual dividend by ¥7 from the previous ¥58 target to ¥65 (¥25 at end-1H, ¥40 at period-end) in accordance with its fundamental policy explained above of maintaining a dividend payout ratio of 30%. This resulted in a sharp dividend hike of more than three-fold versus the previous period's ¥20 dividend. The payout ratio worked out to 30.4%.

In FY3/19, the Company presented a dividend target of ¥66 (¥30 at end-1H, ¥36 at period-end). It is aiming for ¥219.8 EPS in FY3/19 and this level along with the 30% dividend payout policy puts the dividend target at ¥66. Actual FY3/19 profit might fluctuate versus current guidance due to changes in the business environment. We think the Company might adjust the dividend to reflect such fluctuation if profit varies from guidance by more than a certain amount.

Trends in net income per share, dividend, and dividend payout ratio



Source: Prepared by FISCO from the Company's materials

Information security

Strong awareness of information security

Elematec interacts with more than 7,000 suppliers and over 6,000 sales destinations and possesses technology information and other important customer-related information. The Company has a strong awareness of information management and has established an information security system expected of a listed company, including limiting parties with information access rights and setting passwords. Nevertheless, it is a BtoB company and does not have personal information, credit card details, or other data for large numbers of customers as seen at BtoC companies. We thus see relatively less risk of cyber terrorism that targets such information as well as information leaks from within the Company.

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