COMPANY RESEARCH AND ANALYSIS REPORT

Elematec Corporation

2715

Tokyo Stock Exchange First Section

16-Jan.-2020

FISCO Ltd. Analyst

Hiroyuki Asakawa

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

The Company added "creating added-value" in addition to "pursuing growth markets" as its medium- to long-term strategy. Aiming to expand earnings with the two-pronged approach.

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 2012.

1. Sales and profits declined in 1H FY3/20, but the decline in net sales was small.

The Company announced 1H FY3/20 results with lower sales and profits at ¥88,057mn in net sales (-1.7% YoY) and ¥2,326mn in operating profit (-23.7%). Sales declined due to the impact on some products of the US-China trade friction, and also as in mobile terminals, sales fell further because of conditions at customers. However, the extent of the decline in sales was relatively small with the steady growth in some fields and products including automotive and drive recorders for the aftermarket.

2. Is utilizing the "five functions" to pursue the creation of high added-value, aiming for acceleration on earnings growth

The Company is utilizing its strength, of having many business partners and numerous products, to realize stable growth by skillfully overcoming the wave of change in growth markets. In its growth strategy for the future, it intends to aim for growth with the two-pronged approach; creating high added-value and pursuing growth markets. The specific forms of high added-value are various, but some examples include the Company conducting planning, development, processing and manufacturing in-house. These initiatives are not entirely new challenges, and in terms of the elemental technologies and skills in order to realize them, it has been accumulating them in the form of the "five basic functions (procurement agency service function, manufacturing service function, planning and development function, overseas networking, and quality and environmental management)" as a trading company. Its efforts to organically combine and utilize these five functions can be said to be an initiative for high added-value (namely, creating added-value)

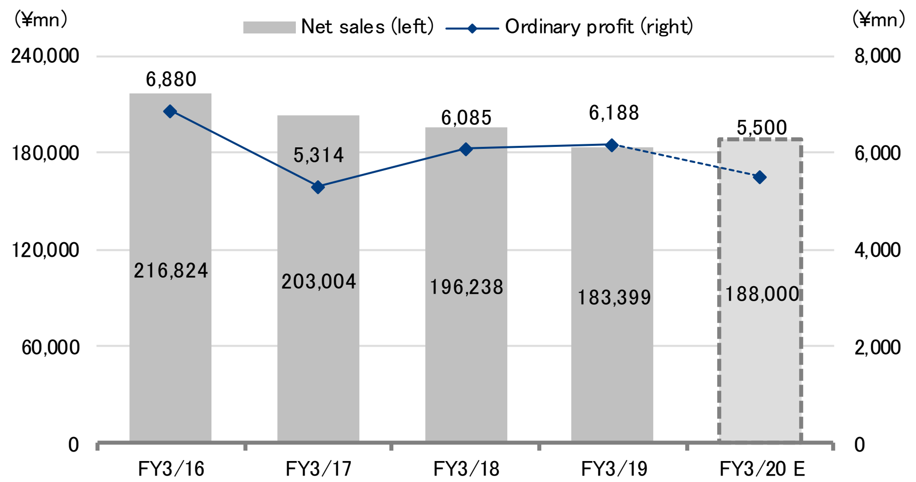
3. The forecasts are for higher sales and lower profits in FY3/20, but sales of growth products are steadily increasing

The Company downwardly revised the FY3/20 full year forecasts when it announced the 1H results, and the new forecasts are for net sales of ¥188,000mn and operating income of ¥5,700mn. So although the forecasts are for higher sales and lower profits, the extent of the decreases are relatively small, and in terms of the earnings level also, it is maintaining a high level compared to other companies. In terms of the growth strategy, among the priority initiatives, the outlook for the automotive field is that the strong growth will continue from the progress made in the shift to electronics. In sales of robots for automation and labor-saving, the Company conducts sales of "robot-related systems" and it is establishing a model to realize the creation of high added-value. In the B-to-B-to-C area, the outlook is that consumer and industrial applications of drive recorders will continue to grow. So although the forecasts are for higher sales but lower profits, growth products are steadily developing toward the next growth stage.

Key Points

- Aiming for earnings growth with the two-pronged approach of pursuing growth markets and creating added-value
- The automotive-related business has grown to a ¥50bn scale, while the increase in demand from “CASE” will also be added
- Is realizing the creation of high-value added in robots / robot-related systems

Results trends



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

Company overview

Two companies with specialties in electronic materials merged in 2009
Operates 64 locations in Japan and overseas and addresses three main markets - Digital Electronics, Automotive, and Broad Market)

1. History and business description

(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 it grew into independent technology trading companies.

These companies merged in 2009 (with Takachiho Electric as the surviving entity) and changed to the name, Elematec Corporation. 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 2012.

(2) Business description

In light of this history, the Company handles a wide range of electronic materials and parts used in electronic products and facilities. It has 1,174 employees and 64 sites in Japan and other countries in consolidated operations as the business foundation (as of the end of September 2019). The business sites include three operations with processing services (one in Japan and two in China).

While the Company has developed business globally, its overseas activities are mainly in China and Asia because this is where Japanese companies largely operate. Sales breakdown by domestic and overseas categories in 1H FY3/19 was 42.5% in Japan and 57.5% in other countries. Overseas sales breakdown consists of China (including Hong Kong) at 20.9%, the rest of Asia at 31.6%, and others (Europe, US, etc.) at 5.0%. Reflecting the decline in production in China, the percentage provided by China has been trending downward recently.

Grouping is important for management purposes because the Company has many customers on procurement and sales sides and handles a wide range of products. It previously based management on the products handled (procurement source standard), but it switched to market grouping with production items at customer companies as the standard (sales destination standard) from FY3/15. It hence currently uses internal management and information disclosure for three segments - Digital Electronics, Automotive, and Broad Market.

Capable of strong performance and stable growth due to rapid response to opportunities in growth markets by leveraging numerous commercial materials and business partners. Plans to add “creating added-value” as its second growth engine going forward

2. Features and strengths

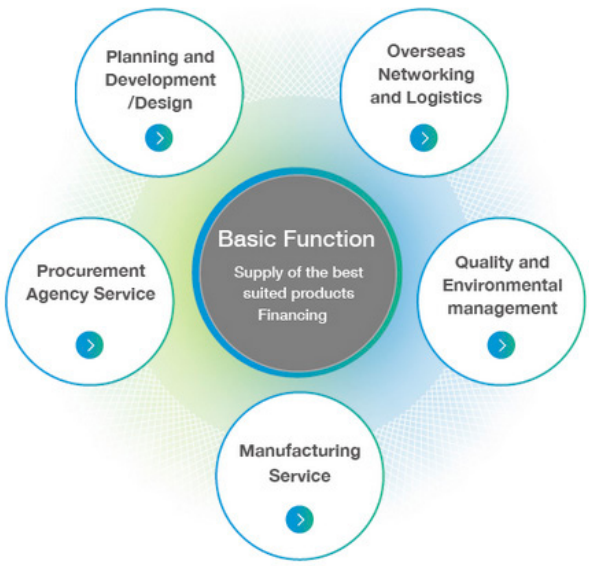
Customer and product diversity are important features of Elematec. It operates 64 sites in Japan and overseas and handles a wide range of primarily electronic materials and components among about 7,100 suppliers (manufacturers) and 6,600 sales destinations (users). Another major characteristic is its 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.

The details are given below, but the Company is currently in a transition period, transitioning its business footholds from smartphones to automotive and robots. It goes without saying that it has responded to the changing growth potential of each of these markets. Presently, due to the intensification of the US-China trade friction, the business environment certainly cannot be said to be ideal. But the Company can be said to be demonstrating its true abilities by skillfully controlling the two change factors, of the business environment and growth markets, so that a large dip is not created in its results and to overcome the wave of change.

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 management of delivery timing and inventory. It also supplies manufacturing services, procurement agency service, 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.

The Company aims to bolster efforts to "create added-value" by combining its core characteristics and strengths with its functions and knowhow as an independent technology trading company. It also intends to harness the ability to create added-value as a primary engine of growth. It previously drove income gains with nimble responsiveness to growth markets, but it will focus on creating added-value as another engine. We review detailed initiatives and direction related to creation of added-value in the section that discusses medium- to long-term growth strategy. The Company essentially plans to reinforce and further utilize the five basic functions it possesses as a unique strength to accomplish this.

Services and functions the Company provides



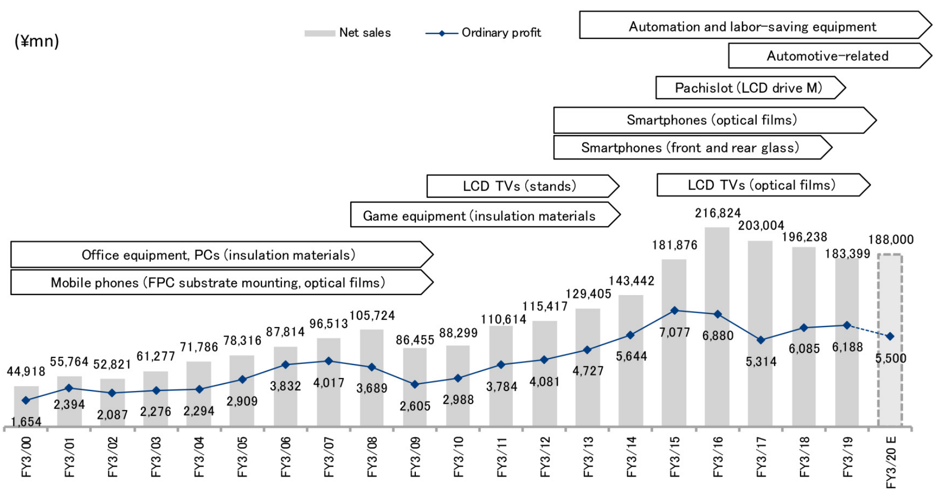
Source: The Company's website

Effectively leveraged functionality as a trading company to realize income growth during the past long-term stable growth process

3. Long-term results trends

The Company's success in realizing stable growth, despite being in the electronics industry with harsh volatility and encountering economic and products cycles, is even more pronounced in a review of its long-term results trends. In the early 2000s, mobile phone business grew with key products such as printed circuit board (FPC) materials, substrate mounting, and optical films. Around 2010, LCD TV-related products were a major business thanks to the transition to terrestrial digital service and other factors. Smartphones and tablets emerged as fast-growing products from 2010. The Company sold various films, glass products, and other items and achieved a rapid recovery from the Lehman shock and set consecutive all-time high profits. While results have flattened in recent years due to maturation of the smartphone market, the automotive-related business is steadily growing as the next driver. The Company has clearly shifted to the automotive-related and automation and energy-saving related businesses, which are future growth areas. After this is the next generation (5th generation) mobile communication system called 5G. On transitioning to 5G, everything will be updated, from base stations to terminals, and also the fielding range of "communication" will widen to another level and everything will become networked. We can expect this to lead to a further increase in business opportunities for the Company, which has many business partners both in terms of suppliers and customers, and also a variety of products.

Long-term results trends



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

The Company has a strong image of being a materials supplier due to its roots as an "electronic materials trading company," but many customers it supplies are assemblers (assembly plants). From a process perspective, this is the portion close to final products. Deliveries to these customers typically do not just provide materials and instead supply processed or semi-finished products. We expect this experience to be a major factor in the Company's initiatives to attain higher added-value as a focus. The Company needs to fully engage its five functions in order to meet customer requests in the process of fulfilling responsibilities in areas near final products. Over many years of business, it has accumulated knowhow related to the five functions at a high level. We think it should be capable of realizing high added-value business with the five functions in automotive and automation/labor-saving areas deemed to be growth markets.

Business performance

Sales and profits decreased, but the extent of the decreases was small
The impact of the US-China trade friction was partial, and in addition, made steady progress in capturing demand in the next growth markets

1. Overview of 1H FY3/19 results

The Company posted lower sales and profits in 1H FY3/20 with net sales at ¥88,057mn (-1.7% YoY), operating income at ¥2,326mn (-23.7%), ordinary income at ¥2,262mn (-22.7%), and profit attributable to owners of parent at ¥1,671mn (-21.4%).

The Company manages its forecasts on a full fiscal year basis, so it does not release results forecasts for a 1H. Therefore, a comparison with the initial forecasts is not possible. However, on October 28, 2019, it downwardly revised the FY3/20 full year results forecasts. In light of this, at FISCO we estimate that the 1H FY3/20 results were also short of the Company's internal forecasts.

Summary of 1H FY3/20 results

(¥mn)

	1H FY3/19	FY3/20			
		1H	YoY	vs. Initial forecast	Full year (Initial forecast)
Net sales	89,619	88,057	-1.7%	43.8%	201,000
Operating income	3,048	2,326	-23.7%	34.5%	6,750
Operating margin	3.4%	2.6%	-	-	3.4%
Ordinary income	2,926	2,262	-22.7%	34.8%	6,500
Profit attributable to owners of parent	2,125	1,671	-21.4%	36.7%	4,550

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

For the 1H FY3/20 business environment, above all there were concerns about the impact of the intensification of the US-China trade friction. In this situation, the Company was only partially affected by this trade friction and it seems that conditions specific to the Company, such as the fall in demand for smartphone-related parts, had a larger impact in terms of reducing sales. Conversely, there were also businesses and products in which sales grew quite considerably. The details are given below, but at FISCO we think that the steady growth of the businesses related to the next growth markets contributed to results. As a result of the above, net sales declined YoY, but the extent of the decline was small at only 1.7% (¥1,562mn).

In profits, in addition to the impact of the lower sales, in 1H FY3/20, the gross profit margin declined from 10.2% in the same period in the previous fiscal year to 9.7% and gross profit decreased 6.4% (¥585mn). For the decline in the gross profit margin, at FISCO we estimate that the impact from differences in the product mix was greater than the deterioration of the terms of trade. SG&A expenses increased 2.2% (¥136mn). The business environment was severe, and the Company increased the number of personnel and raised wages in its focusing fields to improve employee morale and to prevent their outflow, and therefore personnel expenses increased ¥128mn, which pushed-up SG&A expenses. As a result, operating income declined 23.7% (¥722mn).

The Company conducted a two-for-one stock split during the period, with June 1, 2019, as the effective date. As a result, earnings per share (EPS) was ¥40.82, declining by ¥11.09 from the EPS of ¥51.91 in the same period in the previous fiscal year, after being adjusted for the stock split. On the other hand, the Company paid an interim dividend of ¥17. After being adjusted for the stock split, the interim dividend in the previous fiscal year was ¥15, so in actuality, this was an increase of ¥2 YoY.

In the Automotive and the Broad Market, secured a steady increase in sales even in unfavorable business environments

2. Net sales trends by market

Breakdown of net sales trends by market in 1H FY3/20

(¥mn)

	1H FY3/19		1H FY3/20				
	Results	Composition	Results	YoY	Composition	Main target markets	Change
Digital Electronics	44,817	50.0%	40,655	-9.3%	46.2%	Mobile	-1,972
						Electrical and electronic parts	-1,633
Automotive	13,359	14.9%	13,609	1.9%	15.5%		250
Broad Market	31,442	35.1%	33,792	7.5%	38.4%	Aftermarket	1,999
						Medical equipment	587
Total	89,619	100.0%	88,057	-1.7%	100.0%		

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

In the Digital Electronics in 1H FY3/20, net sales were ¥40,655mn (-9.3% YoY). Looking at the details by product and markets, trends in LCDs, TPs, and BLs,* which in the last few years have been major change factors, had bottomed out in the previous fiscal year so it had almost no impact in 1H FY3/20. The biggest change was in mobile terminals, with sales declining ¥1,972mn YoY. This was not due to the impact of the US-China trade friction, but because of conditions at business partners. The next biggest change was in electrical and electronic parts, with sales decreasing ¥1,633mn. These are the various products that are sold to numerous customers, and it seems that the decrease was due to the decline in production activities in China because of the impact of the US-China trade friction.

* LCDs, TPs, and BLs refer to liquid crystal displays, touch panels and backlights. This term expresses the combined sales to customers of liquid crystal displays and their main parts of touch panels and backlights.

In the Automotive in the 1H FY3/20, net sales increased 1.9% YoY to ¥13,609mn. The Company has expectations for the automotive-related market and products as a growth field in the future, and it is focusing on this field. Therefore, the impression is that the sales-increase rate of 1.9% (¥250mn) is a little low. However, the business for automotive is affected not only by production and sales trends in the automotive market as a whole, but also by the model cycles at delivery destinations, so earnings fluctuation each year tend to be quite large. The increase in sales in 1H FY3/20 can be evaluated as sound when considering the low levels of automotive production in Japan and China.

In the Broad Market in 1H FY3/20, net sales increased 7.5% (¥2,350mn) YoY to ¥33,792mn. This segment includes all businesses other than the Digital Electronics and Automotive, but among them, in 1H FY3/20, sales grew in the aftermarket (+¥1,999mn YoY) and medical equipment (+¥587mn) businesses. This segment was named aftermarket based on the sales channel, but in terms of content, it is mainly drive recorder-related products. Conversely, medical equipment is mainly ultrasound diagnosis equipment-related products at the present time. Continuing on from the previous fiscal year, these two businesses are driving the growth of the Broad Market.

The medium- to long-term growth strategy, and the progress made

The Company added "creation of added value" to "pursuing growth markets" as its medium- to long-term strategy. Aiming to expand earnings with the two-pronged approach.

1. Overall vision in the medium- to long-term growth strategy

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

For performance plans, the Company discloses a forecast at the start of the current fiscal year and for another two years into the future. Its style is essentially like a rolling medium-term business plan. At the start of FY3/20, the Company disclosed a forecast for the fiscal year and a mid-term forecast for FY3/22 of ¥230bn in sales and ¥7.5bn in ordinary income.

Medium- to long-term growth strategy "elematec x (cross)"

Source: The Company's results briefing materials

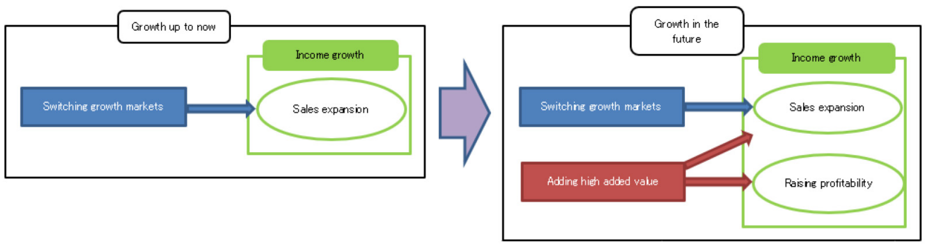
The Company's slogan for the medium- to long-term growth strategy is becoming an "electronic materials trading company that continuously delivers high added-value business globally" with "high added-value business" as the key term. This is essentially the same meaning as "aiming to bolster efforts to "create added-value" by combining core attributes and strengths as well as functions and knowhow as an independent technology trading firm" mentioned above in the company overview section.

What does "added-value" mean to the Company? There is no simple answer and explaining why tends to be complicated. One example is being a presence close to manufacturers. By shouldering responsibility for planning, design, and assembly and processing itself, the Company obtains added-value related to these steps and can raise margin. In this case, it obviously does not own manufacturing facilities and consigns production to external parties. An important point is that this is not a new challenge for the Company, and it is already equipped with five basic functions. Initiatives to create added-value could be understood as an effort to broaden "opportunities" to utilize the five functions. Or to say this in another way, they might be understood to be "a set of applications."

Broadening "opportunities" to leverage these functions does not rely just on circumstances at the Company, but also depends on the customer situation. In the previous example, "added-value" transfers upstream from the customer. While it could just be passed through, the Company wants to capture this portion. We think the diversity of the Company's products and customers makes a difference in this respect. This enables the Company to handle material selection and selection of process outsourcing parties on its own and secure added-value. We believe it has steadily accumulated related experience and technology, as explained in the section on long-term results.

We expect this high added-value strategy to deliver large contributions in medium- to long-term growth. The Company previously achieved growth by doing a good job of switching "growth markets." However, it is now aiming for growth with a two-pronged approach of pursuing growth markets and creating high added-value. Pursuit of growth markets lifts top-line growth (increase in net sales), while creation of high added-value contributes to net sales and profits.

Conceptual impact of a growth strategy with a two-pronged approach of pursuing growth markets and creating high added-value



Source: Prepared by FISCO

The final fiscal year of "elematec X," the current medium- to long-term growth strategy, is FY3/20. We expect the Company to begin formulation of a new medium- to long-term growth strategy from FY3/21. Furthermore, the Company's business environment has been rapidly changing since 2018. Changes are occurring in areas too numerous to mention, such as weaker demand following widespread inroads by smartphones, tougher competition in the compact panel market between LCDs and OLEDs, and slowdown in China's manufacturing activity due to growing trade friction with the United States.

The Company is addressing three themes as growth strategies in light of this situation – 1) automobiles, 2) automation and labor-saving equipment, 3) strengthening B-to-B-to-C business. These are long-lasting themes from the product cycles and their essential qualities, and they can be expected to occupy important positions in the growth strategy in the next medium-term business plan as well. The details are given below, but in 1H FY3/20, the Company made steady progress for each of the three strategies, and the situation is that it is steadily preparing the systems that will lead seamlessly to the medium-term business plan.

In the automotive-related business, which has grown to a scale of ¥50bn from the steady business conducted in the past, growth is accelerating with the addition of the increased demand from the shift to electronics, as symbolized by "CASE"

2. Initiatives for "automotive" and progress made

(1) Scope of the automotive-related business

We think it is evident that automobiles are viewed as the next "growth market" for the Company, particularly with the use of Automotive as a separate item in the breakdown of sales by market.

The Company's intention to expand its business in the automotive area can be said to be natural, in a certain sense. Automotive, which is an enormous market whose industry base is very wide, is broadly composed of two elements; mechanical parts, of the engine and the suspension, and electrical and electrical-system parts (so-called electronic products). But due to the progress made in shifting to CASE* for automotive, the demand for electronic products is forecast to increase even more in the future. For the Company, which is an electronics trading company, the area of activities is expanding. Furthermore, it is a member of the Toyota Tsusho Group, so regardless of how the smartphones market will change in the future (it may boom once again thanks to 5G), it is considered that for the Company, the position of the automotive-related business as an important field will not be shaken.

* CASE is an anacronym of the four words that indicate the direction that the automotive industry will take in the future, of Connected (utilizing IoT to connect vehicles to other things), Autonomous (or Automated, meaning the realization of automated driving, etc.) Shared & Service (sharing vehicles, the expansion of vehicle delivery services, etc.), and Electric (the shift from gasoline vehicles to electric vehicles (EV)).

The Company's automotive-related business has steadily grown. It estimates that automotive-related sales should reach about ¥50bn in FY3/20. This takes into account the Automotive segment sales (¥29,725mn in FY3/20 forecast) and many products for the automotive-related industry in the Digital Electronics and Broad Market segments too. In the Digital Electronics, LCDs, TPs, and BLs for the automotive-related business are slated to grow substantially in FY3/20. (However, developments at the present time seem to be a little slower than planned). In Broad Market, content of the aftermarket sub-segment mainly consists of drive recorders, truck back-eye cameras, and other items. When added up, the Company expects automotive-related sales to increase to ¥50bn. (But in the Broad Market, drive recorders have been separated as a growth strategy due to the growth of the B-to-B-to-C business, as is described below, so it is necessary to be aware of double counting).

We think smartphone-related sales, which fueled the Company's overall growth in the past 10 years, reached ¥80-90bn at the peak, but have recently dropped to around one-third of the peak at about ¥30bn. The main sales driver has been completely replaced. At FISCO, we think that in the medium- to long-term, it is fully possible that automotive-related sales will surpass the peak of smartphone-related sales.

(2) The automotive-related business strategy and recent conditions

As previously explained, the automotive industry is in the midst of shifting to CASE, which means that demand for electronic products in this industry will further increase. The Company is an electronics trading company that began its business by handling insulation materials, a typical electronic material, and the recent industry trend is an opportunity for the Company to expand its business.

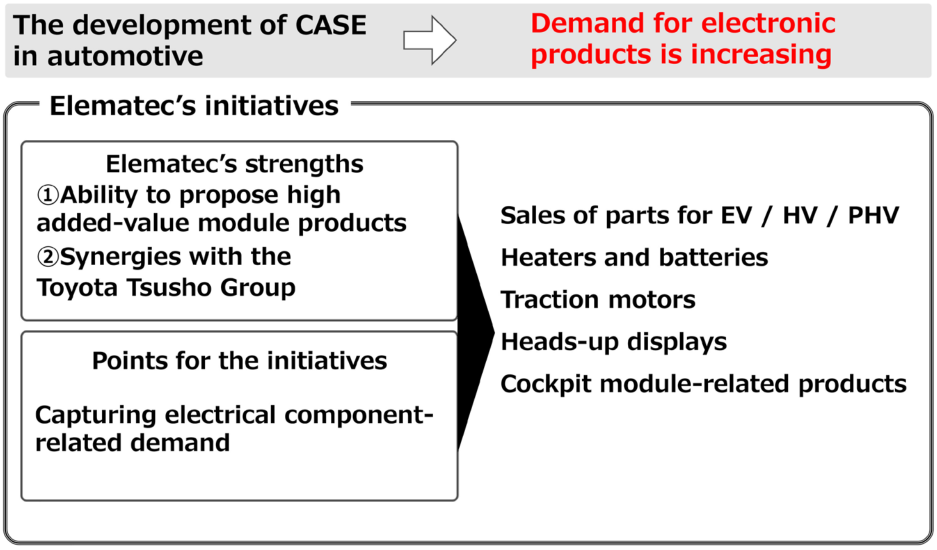
Toward further expanding the automotive-related business, the first strength we look at is its ability to propose module products. As previously explained, it has positioned the creation of high added-value as the core of its growth strategy, and the Company's specific action for this is to conduct the planning, design, assembly and processing in-house, and to deliver in the form of module products and half-finished products (or in some cases, finished products). It is already conducting parts of these tasks, but it is considered that needs for them in the automotive-related business will further increase in the future, which can be said to be an opportunity for the Company to demonstrate its essential qualities.

The second strength is the synergies with the Toyota Tsusho Group. At the current time, the Company's automotive-related sales are composed of the sales of numerous products that it has accumulated over many years. It joined the Toyota Tsusho Group in 2012, and there were great expectations for the series of synergies arising from this, such as large-scale deliveries to the Toyota Group, although the outlook is that these synergies will be realized from now on. With regards to this, at FISCO we did not think it is necessary to complain that "synergies have been slow to appear," but rather that the Company should be evaluated as demonstrating the strengths it intrinsically possesses (a diverse range of products and business partners) for the automotive industry. We think that the synergies with the Toyota Tsusho Group will be realized based on this and can be positioned, so to speak, as "plus alpha."

In terms of the specific products the Company handles, they are wide ranging, including parts relating to heaters, batteries, traction motors, and heads-up displays. Among them, currently a large percentage of total net sales are provided by heaters, and it seems they form a large base for this business. Going forward, it intends to capture demand for electronic products, such as cockpit modules, which is growing due to the progress made for CASE, and to expand the business scope. In this process, the scale of LCDs, TPs, and BLs products may once again increase (the final customer was previously smartphones, but it seems that they are being frequently adopted for automotive panels (the display devices near to the driver's seat)), and it can be said to be necessary to focus on points such as responding to the changes to the customers where demand is generated.

In 1H FY3/20 net sales by market, automotive net sales increased slightly, up 1.9% YoY, but on full fiscal year basis, they are forecast to grow by double digits, up 11.0%. The details of this have not been clarified, but it seems that the Company is steadily broadening the scope of products and also steadily expanding deliveries, such as for module products and already processed products.

Initiatives for the "automotive" market



Source: The Company's results briefing materials

Benefitting from the change to the social structure of labor shortage, the Company is strengthening robots / robot-related systems
Realizing the creation of high added-value, as targeted, from sales as systems

3. Initiatives for automation and labor-saving equipment and the progress made

In Japanese society, the population is getting older and decreasing, which is creating the structural problem of a labor shortage. So demand for robots is increasing as one solution to this problem, and the Company has positioned this field as a next-generation growth market and its business is rapidly growing.

Industrial robots have various sizes and applications, but the general image is of robots on an automotive production line, welding steel materials in manufacturing the body parts. The robots and robot-related systems handled by the Company are not large-scale ones, and they are mainly small scale and used for light work. So the image is of robots replacing the part-time workers who manually carry out bagging and boxing work.

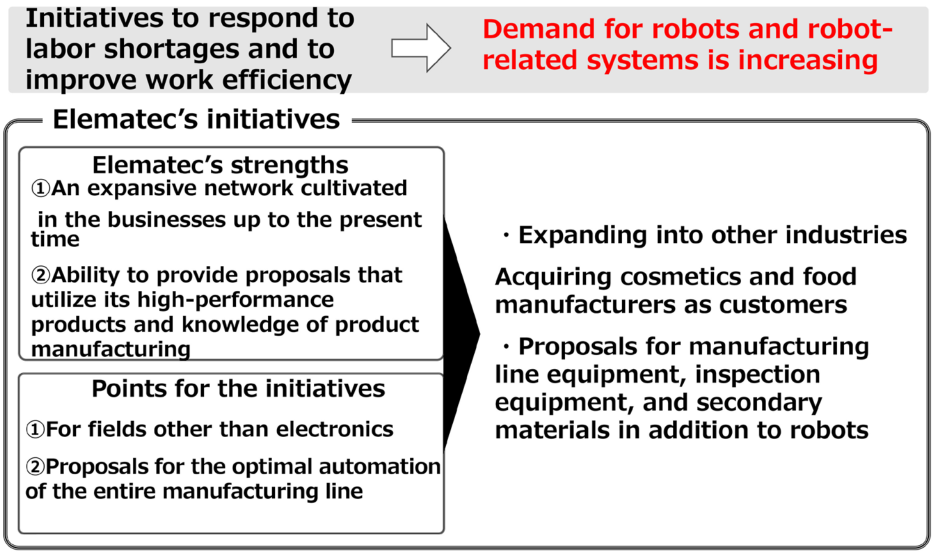
The background to the Company entering-into the robot business is the previously mentioned social background, of the labor shortage, and also that it strengths include its ability to provide proposals that utilize its wide ranging network of customers, suppliers and products, and its knowledge of product manufacturing that it has cultivated in its businesses up to the present time. It is aiming to leverage these strengths to change into business opportunities the need for automation and labor-saving products, mainly robots.

For the target markets, in addition to the electronics industry, the Company intends to develop this business into fields with light work such a cosmetics and foods.

In this business, the Company is realizing the "creation of high added-value," which is one of the Company's growth initiatives, in the ideal form. It sells the robots that it purchases from their manufacturers. However, it would not stand out if its role was to simply deliver them to customers' plants and turn on the power. Rather, it plays an essential role in this process, including installing and configuring the software so that it matches the production line. For this part also, the Company provides solutions by partnering with SIers (System Integrators). As a result, it seems it realizes high added-value (in other words, profits) by purchasing "robots" but selling "robot systems."

In the 1H FY3/20 results, it seems it sold dozens of units. In terms of scale, this business has only just begun, but the aim is to further increase the number of units sold in 2H FY3/20.

Initiatives for the automation and labor saving-related markets



Source: The Company's results briefing materials

Support capabilities for the end user was the decisive factor for entering-into "B-to-B-to-C"
As one successful pattern for realizing the creation of added-value, we focus on its future developments

4. Initiatives for B-to-B-to-C and progress made

The Company mainly engages in B-to-B transactions as a trading company, but this time it focused on B-to-B-to-C as a growth strategy. It cites drive recorders and back-eye cameras (truck cameras to confirm what is happening behind the vehicle) as specific examples. This business is booked in the "aftermarket" sub-segment under Broad Market.

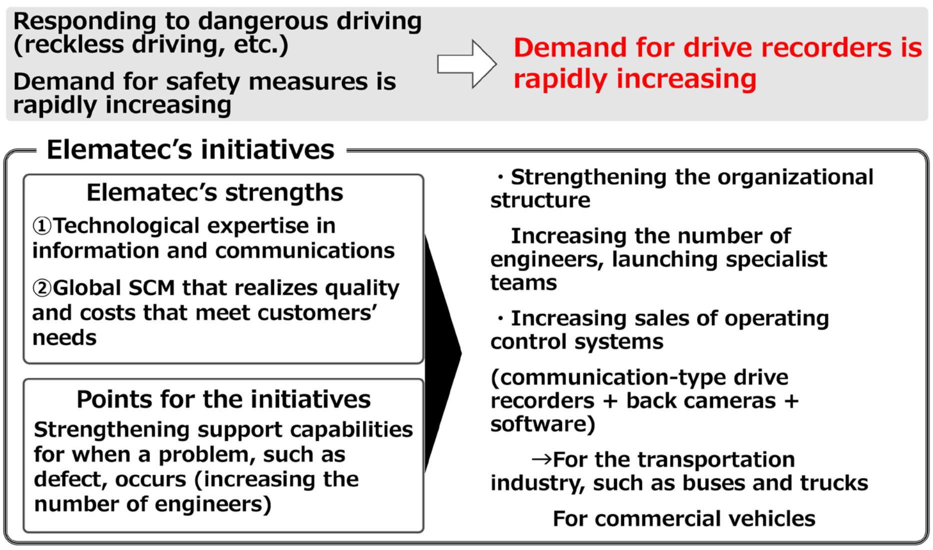
For these products, the Company not only delivers their parts, it also externally outsources their manufacturing and delivers them as practically finished products. In other words, the business form can be the active progress of its core growth strategy to create added-value. As previously explained, the Company has an expansive network in terms of materials and business partners, which has become its strength. But in addition to this, it is also able to sufficiently respond in areas such as providing support should a defect occur. Having this strength would seem to be the biggest factor behind the Company's decision to enter-into the B-to-B-to-C business. Or in other words, this is also a differentiating factor and a reason why it cannot be easily imitated by other companies in the same industry.

Currently, the main products in this field are drive recorders. These drive recorders are intended for the private cars of individuals, and the structure is that the Company adds back-eye cameras and sells them for commercial vehicles, like trucks and buses.

In 1H FY3/20, aftermarket net sales increased ¥1,999mn YoY. For the FY3/20 full year, they are forecast to increase ¥2,952mn. On looking at factors such as the current product lineup (drive recorders and back-eye cameras), the distribution channels (sales channels), and the rates of market penetration, the Company thinks there still remains room for this upward growth to continue.

Demand is rapidly increasing for drive recorders and back-eye cameras from the perspectives of preparing for traffic accidents and safety measures, and there is no doubt that the potential demand is enormous. It is fully possible that they will be installed as standard in new vehicles in the future. It seems that as long as automotive production continues, demand for drive recorders will also continue. However, even while realizing "growth," the reality is that demand will hit a ceiling at some point in time. Also, an inherent feature of products with "C" as the other party is that demand for them fluctuates greatly. The Company itself is strongly aware of this point, and it seems that it is already working below the surface on the planning and development of the next products to follow on from drive recorders. It is thought that the progress made for this will also be an important point to keep an eye on in the future.

Initiatives for the B-to-B-to-C business



Source: The Company's results briefing materials

Outlook

Based on the current situation, the Company has downwardly revised the forecasts to higher sales but lower profits. The uncertainty about external factors will continue, but it seems the Company will maintain relative earnings stability.

The Company downwardly revised the FY3/20 full year forecast on October 28, 2019 when it solidified its outlook for 1H FY3/20.

The Company forecasts increase in sales and decrease in profits with ¥188,000mn in net sales (+2.5% YoY), ¥5,700mn in operating income (-10.0%), ¥5,500mn in ordinary income (-11.1%), and ¥3,950mn in profit attributable to owners of parent (+17.4%) after revision.

The stronger growth rate in net profit attributable to parent shareholders occurred because of the special circumstance of booking roughly ¥1.1bn in corporate tax and other adjustments for FY3/19. On adjusting for this point, profit attributable to owners of parent in FY3/19 becomes ¥4,448mn. Compared to this, profit attributable to owners of parent decreased 11.2%, similar to results for operating income and ordinary income.

Overview of FY3/20 outlook

(¥mn)

	FY3/19			FY3/20					
	1H	2H	Full year	1H	2H (forecast)	YoY	Full year (Initial forecast)	Full year (Revised forecast)	YoY
Net sales	89,619	93,780	183,399	88,057	99,943	6.6%	201,000	188,000	2.5%
Operating income	3,048	3,287	6,335	2,326	3,374	2.6%	6,750	5,700	-10.0%
Operating margin	3.4%	3.5%	3.5%	2.6%	3.4%	-	3.4%	3.0%	-
Ordinary income	2,926	3,262	6,188	2,262	3,238	-0.7%	6,500	5,500	-11.1%
Profit attributable to owners of parent	2,125	1,239	3,364	1,671	2,279	83.9%	4,550	3,950	17.4%

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

The Company downwardly revised the net sales forecast due to the deterioration of the business environment, including the impact of the slowdown of the Chinse economy because of the prolonging of the US-China trade friction, and also that, as Company-specific factors within this situation, delays occurred in orders for new projects in the automotive-related business and sales in the smartphones-related business trended at a lower-than-expected level.

The net sales trends by market are described below.

In the Digital Electronics, net sales are forecast to decrease 7.3% YoY to ¥83,614mn, which is a downward revision of approximately ¥10bn from the initial forecast of ¥93,425mn. The main change factors are a ¥4,050mn YoY decline in sales of mobile terminals. The same as in the 1H results, this is from the impact of conditions at the Company's business partners. For LCDs, TPs, and BLs, the final-destination market is transitioning from smartphones to automotive-related, and in this situation, sales are expected to decline YoY due to the impact of the launches of LCD panels for automotive being later than planned. Sales of electrical and electronic parts are set to decline because of the effects of the economic slowdown in China.

In the Automotive, net sales are forecast to increase 11.0% to ¥29,725mn, which despite being a double-digit increase, is still a slight downward revision (¥335mn) from the initial forecast. Automotive-related net sales as a whole are continuing to steadily grow, and at FISCO, we see this downward revision as occurring within the scope of minor adjustments based on the 1H results.

In the Broad Market, net sales are forecast to increase 12.5% YoY to ¥74,660mn, which is a downward revision of ¥2,854mn compared to the initial forecast. Sales will continue to be strong in the aftermarket for drive recorders and other products, rising ¥2,952mn YoY, while the outlook is for sales of products like motors, infrastructure- and energy-related, and medical equipment to increase YoY. On the other hand, it seems that sales for industrial machinery and related will decline YoY, mainly due to the US-China trade friction and the slowdown in production activities in China as a result of this. But at FISCO, we estimate that sales are increasing more than expected.

Sales breakdown by market for FY3/20

(¥mn)

	FY3/19			FY3/20							
						Full year					
	1H	2H	Full year	1H	2H (forecast)	Initial forecast	Revised forecast	YoY	Composition	Main target market	Change
Digital Electronics	44,817	45,423	90,240	40,655	42,959	93,425	83,614	-7.3%	44.5%	Mobile terminals	-4,050
										LCDs, touch panels, and backlights	-1,765
										Electrical and electronic parts	-1,732
										Amusement	837
Automotive	13,359	13,421	26,780	13,609	16,116	30,060	29,725	11.0%	15.8%		2,945
Broad Market	31,442	34,937	66,379	33,792	40,868	77,514	74,660	12.5%	39.7%	Aftermarket	2,952
										Motors	907
										Infrastructure- and energy-related	856
										Medical equipment	753
Total	89,619	93,780	183,399	88,057	99,943	201,000	188,000	2.5%	100.0%		

Note: TP=touch panels, BL=back lights
Source: Prepared by FISCO from the Company's results briefing materials

The outlook is as described above. But in 2H FY3/20, there are uncertain factors that do not occur in a typical year, so it is highly possible that results will rise or fall compared to the forecasts. It goes without saying that the impact of the US-China trade friction will be huge. In the positive version of the scenario for this, the US moves toward putting this issue to rest. The US has conducted four rounds of tariff measures, and the situation is that basically the entire value of imports from China have already been targeted for tariffs. It is possible that this friction will further intensify in the future in the form of the tariff rate being raised, but it is also possible that the US will feel a sense of accomplishment on having conducted a full set of tariff measures, and that consultations and various agreements toward easing the tension will be progressed in the future.

Naturally, the negative direction of this scenario includes the US raising the tariff rate and expanding the number of Chinese companies subject to tariffs (a de-facto trade embargo). The background factors that may cause this include the US presidential election and a human-rights bill in Hong Kong relating to the democracy movement there. So it is extremely difficult to read what the situation will be in the future.

At FISCO, we think that the Company’s relatively superiority remains unshaken on the point of the strength of its earnings, of being able to resist such changes to the external environment.

Income statement

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20 1H	FY3/20 Full year (forecast)
Net sales	205,370	203,004	196,238	183,399	88,057	188,000
YoY	12.9%	-1.2%	-3.3%	-6.5%	-1.7%	2.5%
Gross profit	17,947	17,127	18,886	18,384	8,559	-
Gross margin	8.7%	8.4%	9.6%	10.0%	9.7%	-
SG&A expenses	11,407	11,720	12,405	12,048	6,232	-
SG&A expenses ratio	5.6%	5.8%	6.3%	6.6%	7.1%	-
Operating income	6,540	5,406	6,480	6,335	2,326	5,700
YoY	-11.3%	-17.3%	19.9%	-2.2%	-23.7%	-10.0%
Operating margin	3.2%	2.7%	3.3%	3.5%	2.6%	3.0%
Ordinary income	6,538	5,314	6,085	6,188	2,262	5,500
YoY	-7.6%	-18.7%	14.5%	1.7%	-22.7%	-11.1%
Profit attributable to owners of parent	4,794	1,342	4,376	3,364	1,671	3,950
YoY	-6.1%	-72.0%	226.0%	-23.1%	-21.4%	17.4%
EPS after adjustment for stock split (¥)	123.29	32.79	106.88	82.17	40.82	96.47
Dividend per share after adjustment for stock split (¥)	37.5	10	32.5	33	17	39
BPS after adjustment for stock split (¥)	1,085.37	1,087.90	1,173.40	1,222.49	-	-

Note: The FY3/16 financial statements consolidated 15 months for 9 overseas subsidiaries due to changes in the fiscal year. This table presents values on a 12-month basis that adjusts results for all fiscal years to 12 months (though EPS values are shown on a reporting basis). The FY3/17 growth rates (YoY) have also been calculated using the 12-month basis.
Source: Prepared by FISCO from the Company's financial results

Balance sheet summary

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	End of 1H FY3/20
Current assets	74,935	87,662	86,073	90,495	86,962
Cash and deposits	12,551	10,282	25,893	25,714	24,821
Notes and accounts receivable	50,599	66,955	49,673	52,801	50,140
Fixed assets	5,636	5,621	5,761	5,172	5,348
Tangible fixed assets	2,465	2,398	2,363	2,390	2,789
Intangible fixed assets	1,349	1,115	886	691	610
Investments and other assets, etc.	1,821	2,107	2,511	2,090	1,948
Total assets	80,572	93,284	91,835	95,667	92,311
Current liabilities	35,892	48,521	43,597	44,291	41,012
Notes and accounts payable	33,419	42,734	40,829	41,371	37,959
Short-term loans, etc.	466	2,884	53	83	102
Fixed liabilities	238	217	191	1,318	1,217
Shareholders' equity	42,980	43,401	47,061	48,992	49,927
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	38,196	38,618	42,278	44,209	45,143
Treasury shares	-694	-694	-694	-694	-694
Accumulated other comprehensive income	1,462	1,143	984	1,063	154
Net assets	44,442	44,545	48,046	50,056	50,081
Total liabilities and net assets	80,572	93,284	91,835	95,667	92,311

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

Cash flow statement

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	1H FY3/20
Cash flow from operating activities	7,573	-3,309	19,257	1,009	678
Cash flow from investing activities	-1,387	-85	-51	74	-96
Cash flow from financing activities	-2,837	1,504	-3,547	-1,401	-817
Effect of exchange rate change on cash and cash equivalents	-875	-305	-46	138	-658
Net increase (decrease) in cash and cash equivalents	2,473	-2,195	15,611	-179	-893
Cash and cash equivalents at beginning of period	10,004	12,477	10,282	25,893	25,714
Cash and cash equivalents at end of period	12,477	10,282	25,893	25,714	24,821

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

Shareholder return policy

Revised the FY3/20 full year dividend forecast to ¥39 In actuality, the dividend will increase ¥6 YoY

The Company fundamentally utilizes dividends as shareholder return. For the dividend amount, it sets a dividend payout ratio in light of the earnings outlook (short term and medium term), growth investments, and cash flow and pays the dividend based on this ratio. It decided this time to raise the dividend ratio target from "sustaining 30%" previously to "at least 40%" and apply the new level from the FY3/20 interim dividend.

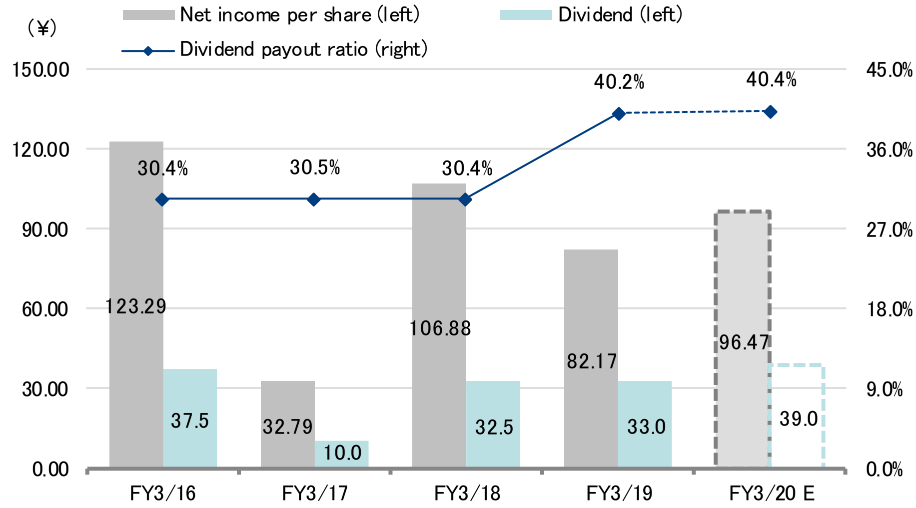
The Company also conducted a stock split along with the dividend payout ratio increase. It intends to conduct a two-for-one stock split effective on June 1, 2019. It seems that the aim of this was to lower the minimum purchase unit price for shares and to increase the number of individual shareholders.

For the FY3/20 dividend, the Company initially announced a dividend forecast of ¥45 (interim dividend of ¥20 and a year-end dividend of ¥25). However, based on the above-described results, it lowered the interim dividend forecast to ¥17 per share, and it also reduced the year-end dividend from the initial forecast of ¥25 to ¥22.

As a result, the FY3/20 annual dividend forecast is ¥39, which is a reduction of ¥6 on the initial forecast. But compared to the previous fiscal year, in which the dividend was ¥33 when adjusted for the stock split, it is actually an increase of ¥6. Based on an EPS of ¥96.47, the dividend payout ratio will be 40.4%.

Shareholder return policy

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



Note: The Company implemented a two-for-one stock split on June 1, 2019.
Source: Prepared by FISCO from the Company's financial results

Disclaimer

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

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

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

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

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

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

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

■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp