

NIHON DENGI CO., LTD.

1723

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Summary

Recovering from COVID-19 impact, redevelopment projects in central Tokyo and plant automation likely to drive longer-term growth

1. Extensive experience and unique engineering technology as strengths

Nihon Dengi Co., Ltd. <1723> (the “Company”) specializes in instrumentation* engineering. Targeting non-residential buildings such as office buildings and hotels, the Company engages in design, installation, and maintenance in the field of air conditioning instrumentation (building automation) for automated control of air conditioning equipment, and engages in design, system development and the installation and maintenance of industrial instrumentation (industrial automation) that automates the production and conveyance lines in factories. Particularly in the air conditioning instrumentation market, which is said to be around ¥166bn in size, the Company has abundant experience and know-how as the largest distributor for Azbil Corporation<6845>, a major manufacturer of automated control equipment, and as a pioneer in the industry. Furthermore, taking advantage of its status as the only engineering specialist company in the industry, the Company has demonstrated its strength.

* Instrumentation: Making various air conditioning and production line equipment and machinery in buildings and factories function organically using measurement, monitoring, and control techniques.

2. Bolstering system development capabilities with establishment of Jupiter Advanced Systems

The mainstay air conditioning instrumentation segment is currently handling high project volume amid a rush of construction projects driven by redevelopment in central Tokyo and other factors. Meanwhile, in the industrial system-related segment (formerly the industrial instrumentation segment), an area the Company is strengthening and expanding as a future core segment, it established subsidiary Jupiter Advanced Systems Co., Ltd., which builds production and management systems for food plants. As an engineering firm, the Company aims to address customer needs in total system development, not just instrumentation, and support automation of food plants that are primarily small and medium-sized companies lacking advances in efficiency. Furthermore, it wants to create technologies for next-generation air conditioning instrumentation “Building IoT” and industrial instrumentation “Industrial IoT” that incorporate cutting-edge AI, IoT, and cloud technologies, beyond simple system development, and provide new high-value-added services as an “instrumentation engineering” company.

3. Raised FY3/21 forecast despite COVID-19

The Company reported FY3/21 1H results* of ¥20,662mn in orders received (+12.7% YoY), ¥12,113mn in net sales (+11.4%), and ¥779mn in operating income (-8.5%). The air conditioning instrumentation segment benefited from increases in office and data center building projects, and the industrial systems-related segment exhibited smooth progress in instrumentation and equipment work for district heating and cooling equipment. While the Company initially expected weak results related to COVID-19, including from the impact of work site closures, the situation did not deteriorate that much, and there has been an upbeat recovery. Due to these conditions, the Company raised its FY3/21 forecasts to ¥32,000mn in net sales (+2.2%) and ¥4,200mn in operating income (-5.1%). Nevertheless, we expect further upward revisions because current forecasts still use conservative 2H assumptions for orders and projects contributing to profits during the period.

* While the Company’s financial results do not include figures and YoY changes for FY3/20 2Q because the discrepancy between consolidated and parent figures is minor, YoY changes on the parent figure for FY3/20 2Q are presented here.

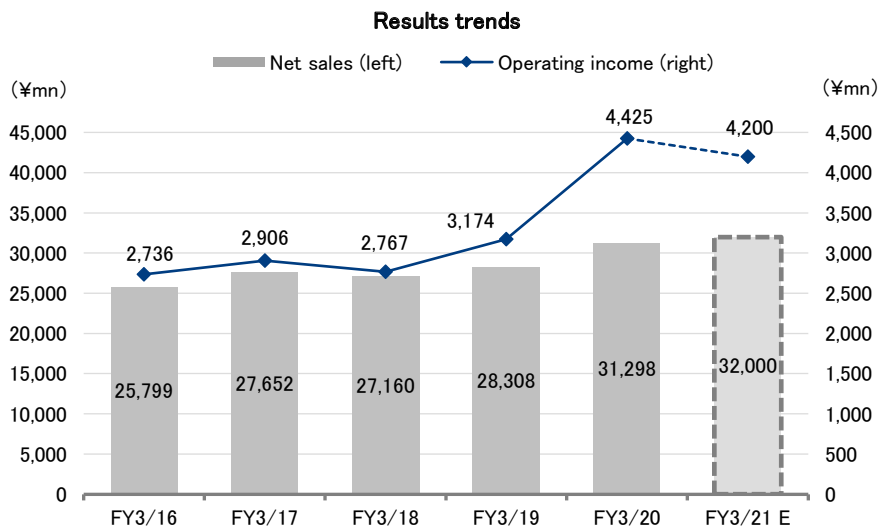
Summary

4. Improved longer-term growth prospects with personnel reinforcement and cultivation of the industrial systems-related segment

The Company targeted ¥3,500mn in operating income in FY3/21 in the medium-term management plan, but achieved this goal a year ahead of time in FY3/20 as a result of upbeat business and has momentum to exceed the goal in FY3/21, despite the COVID-19 situation. However, this also highlights the issue of capacity shortage versus robust demand, and the Company is taking action to reinforce human resources. Given the prospect of additional capacity enabling it to expand acquisition of redevelopment projects in central Tokyo that are likely to increase over the medium term, there is a stronger likelihood that net sales, which had been in the ¥30bn range in the past few years, will expand to about ¥35bn over the medium term. While the air conditioning instrumentation segment should accumulate work on existing facilities, new project business is expected to weaken from a long-term perspective as a result of the aging population. As a strategy, the Company sees a market opportunity in food plants that have the highest number of sites and operating personnel levels in Japan and trail in mechanization. It wants to expand the overall Group by cultivating the industrial systems-related segment through integration of production facilities automation using its instrumentation technology and Jupiter Advanced Systems' production management system and focus on digitalization of the food production business as a longer-term growth business.

Key Points

- Leverages strengths as a specialist in instruments with engineering technology
- Raised FY3/21 forecast despite COVID-19 conditions
- Expecting longer-term growth driven by personnel reinforcement and cultivation of the industrial systems-related segment



Note: Non-consolidated through FY3/20, switched to consolidated from FY3/21
 Source: Prepared by FISCO from financial results and results briefing materials

■ Company profile

“Instrumentation engineering specialist” handling building air conditioning and other equipment

1. Company profile

The Company is an “instrumentation engineering specialist,” and engages in design, construction, and maintenance in the field of air conditioning instrumentation (building automation) for automated control of air conditioning equipment targeting non-residential buildings such as office buildings, hotels, hospitals and factories, and industrial instrumentation (industrial automation) to automate production and conveyance lines in factories. In the mainstay air conditioning instrumentation segment, the Company has abundant experience and know-how as the largest distributor for Azbil, a major manufacturer of automated control equipment, and as a pioneer in the industry. Furthermore, since the Company possesses high-level, industry-leading engineering technology, it is leveraging strength as an “instrumentation engineering specialist” firm. Its business inherently excels from an ESG standpoint because support of building comfort and production efficiency with instrumentation engineering contributes to the global environment via energy savings.

The Company has entered the industrial instrumentation field based on know-how for air conditioning instrumentation and acquired Jupiter Advanced Systems, which builds production management systems for food plants, as a consolidated subsidiary in April 2020 to strengthen and expand this business. It aims to address customer needs through system development, not just instrumentation, and hence changed the segment name from “industrial instrumentation segment” to “industrial systems-related segment” from FY3/21 1Q. It also started preparing quarterly consolidated financial results in FY3/21 1Q and does not show FY3/20 2Q figures or YoY changes in the financial results. However, since Jupiter Advanced Systems’ net sales and operating income are not that large compared to the Company’s figures, we present FY3/20 2Q figures and YoY changes here. At the same time, the Company established ND Tech Co., Ltd., which designs automated control work, and it handles this business as a non-consolidated entity.

Cultivated engineering technology as an instrumentation specialist

2. History

Yamatake Keiki Co., Ltd. (now Azbil) concluded a capital alliance contract with Honeywell (HON), a leading US manufacturer of control equipment, in 1952 and started import sales of air conditioning control equipment in Japan. Due to an almost complete absence of instrumentation work companies to install instrumentation equipment at that time, Shichiryō Shimada and other founding members established the Company based on their confidence in advancement of the air conditioning instrumentation segment and named it “Nihon Dengi” with the intent of “becoming the top Japanese firms in electric technology.” The Company thus started in 1959 as Japan’s first air conditioning instrumentation specialist firm with integrated handling of air conditioning automation control design, installation, adjustment, and maintenance. Since then, collaborating with Azbil, it led the air conditioning instrumentation industry with primary operations in three major metropolitan areas and broadened its business scope to instrumentation fields outside of air conditioning, utilizing the engineering capabilities it cultivated as an instrumentation specialist.

Azbil distributors hold a market share in air conditioning instrumentation of over 70%, industrial instrumentation business still undeveloped

3. Market environment

Building air conditioning is divided into individual air conditioning and central air conditioning. Individual air conditioning is an approach of installing and managing air conditioners by individual rooms, such as multi-tenant buildings. Daikin Industries, Ltd. (6367), Hitachi, Ltd. (6501), and other manufacturers are the main players in this segment. Central air conditioning uses centralized management of air conditioning for an entire building at a designated spot in the building (central monitoring). Since these are large-scale systems, an air conditioning equipment manufacture, system developer, and air conditioning instrumentation firm that controls air conditioning (such as the Company) jointly form the value chain. Individual air conditioning is mainly employed in relatively small buildings and hotels and other buildings with small rooms, while central air conditioning performs well in mid-sized and large buildings, lobbies, and other large spaces. The air conditioning instrumentation market is worth an estimated ¥166bn, and Azbil and Azbil distributors (including the Company) control more than 70%. Azbil equipment hence is effectively the industry standard in air conditioning instrumentation. Furthermore, the Company is the only specialty firm with an engineering division among Azbil distributors and possesses widely recognized high-level technological capabilities.

The air conditioning instrumentation market largely consists of new site installments that post sales at the time of building, plant, and other property construction and existing site work that accumulates annual income from maintenance, renovation, and other work. As a trend in recent years, customers are increasingly requesting installation of air conditioning facilities that meet individual building specifications and applications, and this requires technological capabilities that can be customized to each project. For example, hospital air conditioning instrumentation is very strict and demands proper control of temperature and humidity from the standpoint of air purification and preventing hospital infections. Surgical rooms, in particular, set very strict air conditioning standards. Systems must control air conditioning by utilizing differential air pressure for ventilation to improve air purity. There are many other types of facilities that utilize air conditioning control technology too, such as research facilities, clean rooms, and museums. Profitability is higher for existing site work than on new site installments, and terms are even better for acquisition of projects as the main contractor. Nevertheless, profitability appears to be improving on new site installments thanks to the construction surge related to the Tokyo Olympics and redevelopment projects in central Tokyo.

Industrial instrumentation, which controls automation on plant lines, is positioned as a market in the factory automation industry. Automation is making steady inroads at manufacturing plants to address personnel shortages and cost cutting. Meanwhile, the food, drug, and cosmetic industries have a higher volume of frontline operations that rely on manual tasks, compared to other industries, and offer substantial opportunity for automation as they struggle with worsening personnel shortfalls. In particular, the food production industry has the largest number of employees in the manufacturing industry and a high percentage of activities that depend on manpower. Interest is rising in automation and mechanization as solutions. Many companies with small and medium-sized food production plants that have not made efficiency gains need a supplier of plant automation capabilities. The Company is developing this market and has received consignments for system development since the acquisition of Jupiter Advanced Systems as a subsidiary. The decision to rename this segment as the “industrial system-related segment” reflects the significance of this activity to the Company.

Increasing the efficiency of plant production lines with “instrumentation engineering”

4. “Instrumentation engineering” strength

“Instrumentation” involves making the various equipment and machinery in office buildings and factories, such as for air conditioning and production lines, work together and function organically through measurement, monitoring, and control techniques. For example, office building air conditioning instrumentation is positioned as a technology that provides a comfortable environment with the least amount of energy. Specifically, it involves measuring temperature, humidity, pressure and other variables, and monitoring the measured data, then controlling the entire system while controlling individual machines, in order to maintain a certain environment, thereby achieving comfort and saving energy. In recent years, instrumentation technology has attracted attention and continued to evolve as an essential technology for saving energy, including the development of measurement and monitoring systems utilizing the latest IT technology, and being used as the core technology for district heating and cooling. Meanwhile, “engineering” refers to the technological ability of users to optimize entire systems of equipment and utilities that tend to be only partially optimized. Few companies have both “instrumentation” and “engineering” capabilities, thus the Company’s strength is its technological capability of “instrumentation engineering.” While leading firms have already solidified their market positions in air conditioning instrumentation to some extent, as explained above, industrial instrumentation often takes place under the manufacturer who delivers production line automated control equipment to the plant and lacks efficiency from the standpoint of total optimization. The Company is expanding business by leveraging its strength in “instrumentation engineering” technology, targeting production lines at small and medium-sized plants in the food industry that widely confronts these issues.

Business overview

Both air conditioning instrumentation and industrial systems as driving forces

1. Business description

The Company’s business includes the air conditioning instrumentation segment and industrial systems-related segment, which accounted for 83% and 17% of net sales in FY3/21 1H, respectively. The air conditioning instrumentation segment is broadly divided into new site installments that handle air conditioning instrumentation projects for building construction and existing site work for maintenance and renovation at existing sites. While new site installment business largely receives orders from general contractors and subcontractors*, existing site business typically involves a direct contract with a building owner or others in which the Company itself is the main contractor. The industrial systems-related segment, meanwhile, has widened its scope from instrumentation that connects production and conveyance lines at plants to control of industrial robots and other systems. Through collaboration with Jupiter Advanced Systems, the Company has bolstered system development capabilities in industrial instrumentation beyond just air conditioning instrumentation. It also steadily deploys AI, IoT, cloud services, and other cutting-edge technologies in instrumentation. The Company thereby aims to create technologies for next-generation air conditioning instrumentation “Building IoT” and industrial instrumentation “Industrial IoT” and provide new high-value-added services as an “instrumentation engineering” company.

* Subcontractors: Companies that specialize in a certain type of work, such as air conditioning, electrical, or sanitation-related equipment, and receive work orders from general contractors that manage overall construction projects for large buildings.

Complete production of automated control of building air conditioning facilities

2. Air conditioning instrumentation segment

Air conditioning instrumentation involves comprehensively managing an automated control system for a building through, among other things, heat source control, air conditioning control, power control, and central monitoring equipment. By realizing a comfortable building space with an optimal automated control system, and by proposing equipment/machine upgrades, assisting with building energy management, and proposing ways to save energy, among other services, the Company helps customers preserve their building assets and reduce lifecycle costs. The Company's air conditioning instrumentation segment is divided into the building systems business and the solutions business. The building systems business is the Company's mainstay business, and provides system design, installation management, prehandover test operations and adjustments, and usage guidance at the time of handover for the air conditioning and plumbing equipment, etc. installed during building construction. Even after the building has been completed, by being involved in the maintenance of the delivered equipment/machinery, the Company manages and analyzes energy usage, proposes repairs and upgrades to save energy, and otherwise provides ongoing support. The solutions business seeks to resolve issues, such as energy savings, using instrumentation technology through direct transactions and contracts with facility owners and end users in the air conditioning instrumentation segment (at existing sites).

“Instrumentation engineering” company with trusted system development services

3. Industrial system-related segment

In the industrial systems-related segment, industrial instrumentation automates control of production processes, transport, and overall plant operations, and provides systems related to automated control for plants ranging from small to large. These systems aim to enhance the customer's value chain with product control, quality retention, productivity improvement, cost savings, and environmental consideration. The Company is known within the industrial instrumentation industry for its total production ability underpinned by “instrumentation engineering” that extends from control system design to control console manufacturing, installation, and maintenance. Specifically, it helps in ensuring safety, raising the precision of sorting work, and boosting efficiency, mainly at food and drug production sites, through electrical instrumentation work, design and installation of utility equipment (cold/hot water, steam, compressed air, etc.) that meets special specifications, and other activities. Furthermore, by effectively utilizing waste hot water and waste heat that are no longer needed by plants, it supports reducing environmental load, saving energy at plants, and cutting operating costs. Additionally, the Company addresses a variety of issues, such as boosting productivity, eliminating manpower shortages, and ensuring safety (food defense) without human intervention, by deploying picking robots and other equipment in box filling, inspection, assembly, and handling processes that involve manpower.

Results trends

Healthy recovery from COVID-19 impact

1. FY3/21 1H results trends

The Company reported FY3/21 1H results of ¥20,662mn in orders received (+12.7% YoY), ¥12,113mn in net sales (+11.4%), ¥779mn in operating income (-8.5%), ¥834mn in ordinary income (-6.5%), and ¥564mn in net profit attributable to owners of the parent (-7.2%). Profits fell on higher sales. While the Company initially expected weak results because of the COVID-19 outbreak from February 2020, actual progress was relatively upbeat. The Company's results exhibit seasonality in which 4Q sales are much higher than 1–3Q as completion and delivery of projects is concentrated in 4Q. Earnings progress through 2Q hence is fairly low at only about 20%.

FY3/21 1H results

	FY3/20 1H			FY3/21 1H			
	Results	% of sales	Progress rate	Results	% of sales	Change rate	Progress rate
Net sales	10,873	100.0	34.7	12,113	100.0	11.4	37.9
Gross profit	3,560	32.7	32.7	3,499	28.9	-1.7	-
SG&A expenses	2,709	24.9	42.0	2,720	22.5	0.4	-
Operating income	851	7.8	19.2	779	6.4	-8.5	18.5
Ordinary income	892	8.2	20.0	834	6.9	-6.5	19.6
Net profit attributable to owners of the parent	608	5.6	19.1	564	4.7	-7.2	19.2

Note: Non-consolidated through FY3/20, changed to consolidated from FY3/21

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

By business segment, the air conditioning instrumentation segment booked ¥18,180mn in orders (+13.2% YoY) and ¥10,044mn in net sales (+5.0%) and the industrial systems-related segment posted ¥2,482mn in orders (+9.2%) and ¥2,068mn in net sales (+57.7%). In the air conditioning instrumentation segment, while orders received rose for research facilities, offices, and lodging facilities under new installments, it dropped for plant projects under existing site work. Completed work value increased for offices and data centers under new installments and declined for research facilities under existing site work. In the industrial systems-related segment, orders received was healthy in work related to industrial robots and energy savings, and the value of completed work related to instrumentation and equipment for district heating and cooling equipment performed well. Due to COVID-19, restrictions on entry to work sites in the spring interfered with sales activities mainly in 1Q, and we therefore initially expected weak sales and profits. Nevertheless, the Company made healthy progress with a double-digit increase in sales thanks to steady business build-up and considering numerous large-scale projects that generally have low profit margins on finished work and moderately challenging work due to Azbil's release of new products for the first time in a while. It is also possible to conclude that COVID-19 did not have as much impact as anticipated because of the existence of multiple unrelated factors that weighed on profit margins, such as large projects with favorable profits and very strong demand that enabled the Company to be highly selective when accepting orders in the previous year.

Results trends

Project performance in FY3/21 1H

Segment / Project name	Project content	Location	Date
Air conditioning instrumentation segment / Building systems business			
Chiba Cancer Center	Air conditioning automated control	Chiba Prefecture	July 2020
msb Tamachi	Air conditioning automated control	Tokyo	July 2020
Yokohama City's new City Hall building	Air conditioning automated control	Kanagawa Prefecture	May 2020
Denso Corporation's Anjo Plant	Air conditioning automated control	Aichi Prefecture	May 2020
MUNI KYOTO	Air conditioning automated control	Kyoto Prefecture	May 2020
Air conditioning instrumentation segment / Solutions business			
LaLaport TOKYO-BAY	Replacement project for central monitoring facilities	Chiba Prefecture	August 2020
Japan Tobacco Inc.'s Sumida Building	Replacement project for central monitoring facilities	Tokyo	July 2020
Akihabara Daibiru Building	Replacement project for central monitoring facilities	Tokyo	August 2020
Yokohama Information & Culture Center	Replacement project for central monitoring facilities	Kanagawa Prefecture	May 2020
National Sanitorium Oku-Komyoen	Automated control project	Okayama Prefecture	July 2020
Industrial systems-related segment			
Takanashi Milk Products Co., Ltd.'s Gunma Plant	Replacement project for central monitoring facilities	Gunma Prefecture	June 2020
YOSHINOYA HOLDINGS CO., LTD.'s Tokyo Plant	Machinery facilities installation work	Saitama Prefecture	May 2020
Tokyo Netsu Kyokyu Co., Ltd.'s Takeshiba Management Office No. 2 Plant	Automated control work	Tokyo	May 2020
Toyota Motor Corporation's Headquarters Plant	Electrical instrumentation work	Aichi Prefecture	August 2020
Social medical corporation Yuaikai's Tomigusuku Central Hospital	Automated control work	Okinawa Prefecture	June 2020

Note: Property names are the names used internally by the Company, and may differ from official building names
 Source: Prepared by FISCO from the Company's materials

Raised forecast, though 2H appears to be using conservative assumptions

2. FY3/21 outlook

The Company forecasts FY3/21 results of ¥30,500mn in orders received (-1.0% YoY), ¥32,000mn in net sales (+2.2%), ¥4,200mn in operating income (-5.1%), ¥4,250mn in ordinary income (-4.8%), and ¥2,930mn in net profit attributable to owners of the parent (-8.0%). Factoring in healthier progress in 1H results than initially expected, it lifted full-year targets by ¥650mn in operating income, ¥650mn in ordinary income, and ¥470mn in net profit attributable to owners of the parent.

Results trends

FY3/21 outlook

(¥mn, %)

	FY3/20		FY3/21 E			
	Results	% of sales	Revised forecast	Change rate	Initial target	Revision rate
Net sales	31,298	100.0	32,000	2.2	32,000	0.0
Gross profit	10,874	34.7	-	-	-	-
SG&A expenses	6,448	20.6	-	-	-	-
Operating income	4,425	14.1	4,200	-5.1	3,550	18.3
Ordinary income	4,464	14.3	4,250	-4.8	3,600	18.1
Net profit attributable to owners of the parent	3,184	10.2	2,930	-8.0	2,460	19.1

Note: Non-consolidated through FY3/20, changed to consolidated from FY3/21

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

Initial forecasts for FY3/21 results assumed a slight rise in net sales based on non-recurrence of plant closures in the second and third waves of COVID-19 and steady completion of projects in order backlog. A steep decline in profits was expected, despite the prospect of booking sales from order backlog, because of concerns about an anticipated decline in capital investments accompanying economic downturn eroding earnings. Actual progress, however, showed less impact by COVID-19 than expected, and the Company raised its forecast. For sales, it retained its initial target, even with postponement of some existing site work in the first wave of COVID-19, because there were almost no plant closures. In earnings, however, since COVID-19 had less of an impact than expected, the Company appears to have modestly eased assumptions that had been extremely conservative. Nevertheless, it still holds a conservative stance regarding FY3/21 forecasts because of its typical cautious view toward orders and sales for plant projects, which have relatively short delivery schedules and high profitability.

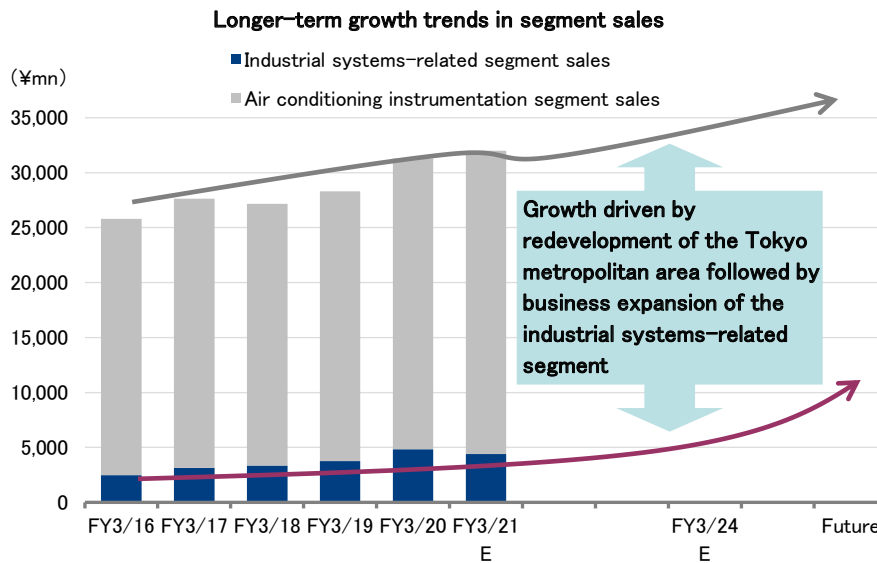
Expectations for growth strategy in the next medium-term management plan

3. Medium-term growth

The Company had set FY3/21 goals of ¥31,000mn in orders received (¥26,000mn in the air conditioning instrumentation segment and ¥5,000mn in the industrial systems-related segment), ¥30,000mn in net sales (¥26,000mn in the air conditioning instrumentation segment and ¥4,000mn in the industrial systems-related segment), and ¥3,500mn in operating income. Thanks to upbeat momentum, it realized the goals a year early in FY3/20 and is likely to exceed them in FY3/21, even with COVID-19. The main reason for quick realization of medium-term management plan goals was steadfast implementation of the five priority strategies: 1) pursuing business with an emphasis on efficiency, 2) promoting stronger relationships with customers, 3) rigorously adhering to strategic orders acceptance, 4) bolstering technological capabilities to meet needs and broadening scope, and 5) responding to workstyle reforms. While the Company is likely to continue these priority strategies considering their success, capacity shortage to address demand is an issue. Personnel shortages had also become a bottleneck for acquiring orders as people needed to be allocated to projects. However, the Company has already taken measures and is moving forward with staffing reinforcement. Despite the training period, it should be capable of leveraging these resources to increase air conditioning instrumentation orders over the medium term amid the anticipated boost in redevelopment projects, mainly in central Tokyo. The Company hence should be capable of targeting net sales, which had been in the ¥30bn range in the past few years, of about ¥35bn.

Results trends

Over the long term, even with prospective accumulation of existing site work, the Company is likely to encounter a slowdown in new building construction due to the aging population and declining birthrate. If that is the case, it may face overcapacity in personnel. However, the small size and steady growth of the industrial systems-related segment and the broad scope of the food plants it targets provide extensive room for growth. The Company thus should be capable of benefiting simultaneously from stable income in air conditioning instrumentation and earnings growth in industrial systems by shifting personnel from the air conditioning instrumentation segment to the industrial systems-related segment. The broad scope of industrial instrumentation also means that the Company has opportunities in system development and other instrumentation-related businesses, with synergies already emerging in system development and partner recruitment in industrial instrumentation from the addition of Jupiter Advanced Systems as a Group member. If the Company achieves vertical integration by bringing a machinery manufacturer into the Group at some point, it would be capable of receiving consignments for plant automation as a one-stop provider of instrumentation, systems, and machinery. This approach is likely to strengthen order acquisition and in-house production will boost profitability. While hoping for COVID-19 impact to settle down in the near term, as explained above, the Company foresees positive business environments in the near, medium, and long terms. Looking ahead based on these prospects, the outlook for longer-term growth naturally improves. If conditions remain healthy, the next medium-term management plan slated for release in spring 2021 should be interesting.



Source: Prepared by FISCO from the Company's materials

■ Shareholder return policy

Plans to raise the FY3/21 dividend along with the upward revision to forecasts

With regard to the distribution of profits to shareholders, as long as there are no events or new capital investment plans that significantly impact business results, the Company's policy is to maintain a consistent payout ratio aimed at 30% and return profits to shareholders through dividends commensurate with profit growth. In addition to the policy described above, the Company raised its period-end dividend forecast from ¥82 to ¥100, accompanying the upward revision to its FY3/21 forecasts. This puts the full-year dividend at ¥110, reflecting the ¥10 interim dividend and the forecast period-end dividend.



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