COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange First Section

10-Aug.-2017

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Index

Summary

Major facilities construction company
Strengths are its advanced technology and credibility that it has cultivated over its long history

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, installation, maintenance, repair, sale and consultation for office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive inter-disciplinary engineering capabilities across a diverse range of business operations, combined with advanced technology and credibility accumulated over its 90-year history.

1. While each profit item declined in FY3/17, the profit margin maintained its high level and the balance carried forward increased 16.3%

In the FY3/17 results, orders received were ¥185,880mn (up 1.4% year-on-year (YoY)), net sales were ¥168,512mn (down 5.8%), gross profit was ¥22,538mn (down 1.7%), operating income was ¥6,012mn (down 7.6%), ordinary income was ¥6,880mn (down 15.4%), and profit attributable to owners of parent was ¥4,698mn (down 11.8%). Each profit item declined slightly as the results were especially high in the previous fiscal year, but they maintained their previously high levels. The balance carried forward also increased 16.3%, maintaining its high level. The gross profit margin improved, including due to the rigorous cost management and the improvement in operating efficiency, and the gross profit margin rose by 0.6 of a percentage point to 13.4%. Overall, the results can be said to be positive.

2. The balance of construction work carried forward is being maintained at a high level, and increases in net sales and profits are forecast for FY3/18

The forecasts for the FY3/18 results, which is currently underway, are orders received of ¥186,000mn (up 0.1% YoY), net sales of ¥180,000mn (up 6.8%), operating income of ¥7,000mn (up 16.4%), ordinary income of ¥7,500mn (up 9.0%), and profit attributable to owners of parent of ¥5,000mn (up 6.4%). The profit margin is expected to be at around the same level as the previous fiscal year, while the Company is aiming for higher sales and profits from completing the abundance of work in hand, and it seems highly likely that it will achieve these forecasts.

3. The targets for the medium-term management plan, "Century 2025" Phase 1, are net sales of ¥195,000mn and operating income of ¥7,500mn in FY3/19

The Company is approaching the 100th anniversary of its establishment, and so as its 10 year goals, in March 2016 it announced "Century 2025" as its long-term vision. As the final goals in the long-term vision, it intends to be the "The Company of Choice," and as"Century 2025" Phase 1, medium-term management plan, which covers the first three years," it has set quantitative targets for FY3/19 of net sales of ¥195,000mn and operating income of ¥7,500mn. As the first stage of the plan's implementation, the Company announced the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>, and it can be said to be making steady progress in the plan's first year.

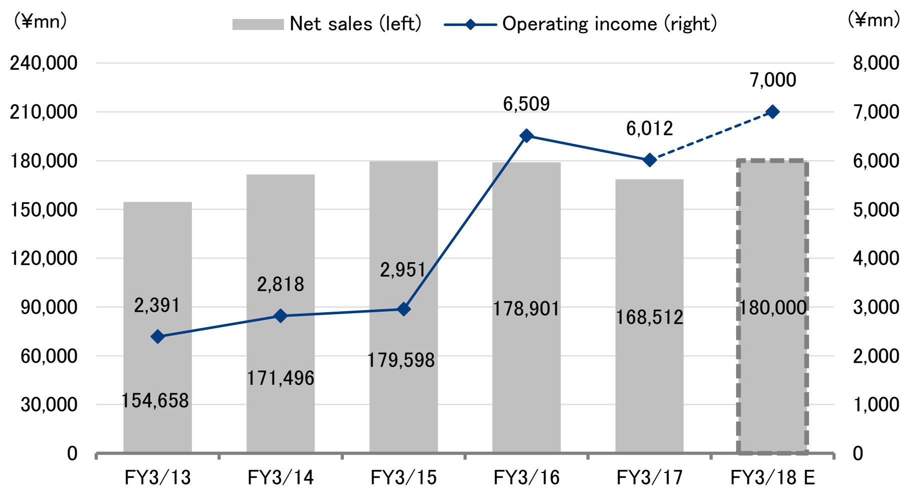
4. Actively returns profits to shareholders, as in addition to the annual dividend of ¥30, it plans to buyback 3 million of its treasury stock (upper limit, ¥4,000mn)

The Company actively returns profits to shareholders, as in addition to stable annual dividends, it buys back its treasury stock. In FY3/17, it paid an annual dividend of ¥30.0 (dividend payout ratio, 40.6%), the same as in FY3/16, which included an extra dividend for the second consecutive year. In this fiscal year, it currently plans to pay an ordinary annual dividend of ¥20.0, but this may increase depending on the level of profits in this period. On May 22, it retired 3 million of the treasury stock it held, and it has also announced that by the end of March 2018, it will newly buy back 3 million stock.

Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Each profit item declined YoY, but the profit margin is being maintained at a high level and higher net sales and profits are forecast in this fiscal year
- Positively returns profits to shareholders, and following on from retiring 3 million shares, it plans to newly buy back 3 million treasury stock

Results trends



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

Company outline

A Mitsui-affiliated, domestically-leading facilities construction company with a long history

1. Company history

Sanki Engineering is a facilities construction company that was established in 1925 as a spin-off of the machinery division of its predecessor, the former Mitsui & Co., Ltd. <8031>. The first large projects for the Company were the Shiga manufacturing plant of Toyo Rayon (currently Toray Industries, Inc. <3402>), and a refrigerated warehouse for Aomori Seihyo. Initially, the Company engaged in heating, plumbing, steel frame construction and the supply of construction materials. It has subsequently branched out into electrical work, developing integrated plant construction planning, design and installation as its main operations.

After World War II, the Company operations expanded due to the demand derived from the Korean War, and in 1958, the Company's capital exceeded ¥1,000mn. In subsequent years, the Company participated in projects undertaken in preparation to host the Tokyo Olympic Games in 1964, and grew in tandem with the expansion of the Japanese economy. The Company diversified from the installation of heating, ventilation, air-conditioning (HVAC), plumbing, electrical, and facility systems into other types of installation, such as transport equipment, conveyance systems, water treatment facilities and waste facilities. Today, it is a leading domestic facilities construction company. The Company's shares were listed on the Tokyo Stock Exchange in 1950.

2. History

The Company is presently a domestically-leading facilities construction company. In April 2015, prior to the 90th anniversary of its establishment in FY3/16, it appointed Mr. Tsutomu Hasegawa as President and Representative Director. At the end of FY3/16, it announced "Century 2025"as its long-term vision toward the 100th anniversary of its establishment in 2025, which adds President Hasegawa's new strategy to the line it has taken up to the present time.

History

1925	Sanki Engineering Co., Ltd. established as a spin-off of the machinery division of its predecessor, the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branch, 6 sub-branch offices, 3 affiliated companies, and around 300 employees
1958	Capital exceeded ¥1,000mn
1963	Completed the Sagami Plant (currently, the Yamato Plant)
1964	Participated in projects relating to the Tokyo Olympic Games, including the Yoyogi National Gymnasium, and the NHK Broadcast Center
1982	Newly established Technical R&D Institute in Yamato City, Kanagawa Prefecture, equipped with facilities for basic research and for large-scale experiments
2000	Opened the Shonan Training Center (Yokosuka City, Kanagawa Prefecture) and strengthened human-resources training
2011	Transferred its head office to its current location in Tsukiji
2015	90th anniversary of its establishment. Announced its long-term vision "Century 2025."

Source: Prepared by FISCO from the Company's website

Business description

4 business segments comprising facilities construction, machinery systems, environmental systems, and real estate

1. Outline of business by segment

The Company's main operations may be divided into four business segments: facilities construction, machinery systems, environmental systems, and real estate. An overview of each segment is set out below.

(1) Facilities Construction Business

The facilities construction business engages in activities including planning, design, installation, maintenance, and repair of facilities including office buildings, schools, hospitals, shopping centers, factories, R&D centers, and other facilities. This scope of activities handled by this business is extensive and may be further subdivided into the following businesses.

a) HVAC and plumbing for buildings

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

b) Industrial HVAC

The industrial HVAC business provides HVAC and plumbing for factories and research facilities of all industries, especially clean room systems for plants requiring high levels of cleanliness, such as semiconductor plants, food processing plants, and pharmaceutical plants; special air-conditioning systems and appurtenances for manufacturers of chemicals and medical systems, and the like; and environmental control systems and so forth to automobile manufacturers.

c) Electrical systems

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

d) Facility systems

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

(2) Machinery Systems Business

The machinery systems business supplies materials handling systems, including various transportation equipment (conveyors, sorting systems, etc.), and conveyance systems for factories and automated warehouses.

(3) Environmental Systems Business

The environmental systems business provides facilities such as water treatment facilities (including facilities to treat drinking water and dispose of sewage, facilities for the disposal of industrial wastewater, and facilities for the treatment or incineration of sludge), facilities for the treatment of waste (including waste incineration facilities, landfill wastewater treatment facilities), and others.

(4) Real Estate Business

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

Sanki Engineering's main business is the provision of the equipment and solutions as described above. The Company obtains about half of its orders directly from facility owner clients and half indirectly through general contractors.

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

2. Strengths, distinguishing traits, and competitors

(1) Broad business domain and one-stop shop solutions

It's no exaggeration to say that there are countless companies in Japan providing the same kind of construction and facilities as Sanki Engineering. The Company's strength lies in the wide range of its businesses, which includes HVAC for building, plumbing, industrial HVAC, electrical systems, automated control systems for buildings, transportation systems, and water treatment facilities. The Company can provide services for many types of systems and solutions covering all phases from planning and design, to installation, maintenance, and repair. This capability allows its customers to place one-stop shop orders to resolve their problems. By making optimal use of "total engineering," which combines a wide variety of businesses horizontally, the Company can provide optimal systems with high added value.

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

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

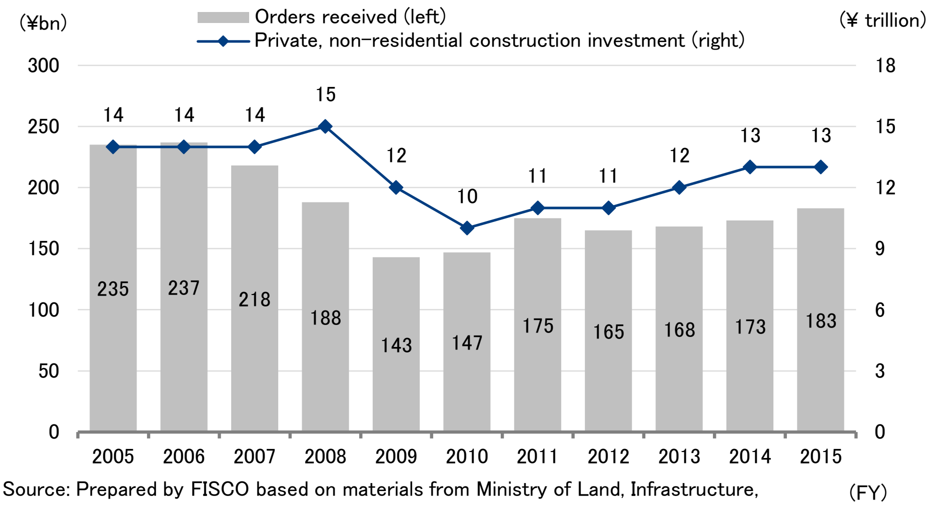
3. Main competitors

Sanki Engineering's competitors vary by project, but its main competitors are other large companies such as Takasago Thermal Engineering Co., Ltd. <1969>, Shinryo Corporation (unlisted), Dai-Dan Co., Ltd. <1980>, and Taikisha Ltd. <1979>. Compared to these competitors, Sanki Engineering's strength is its superiority in industrial HVAC systems, such as clean rooms.

4. Trend in orders received and the economic environment

Given the nature of Sanki Engineering's businesses, orders received are the most important factor affecting the Company's performance. Annual orders received are greatly affected by the overall Japanese market, or the Japanese macro-economy. As the Company's main business is facilities construction, it is influenced by the macro indicator of private sector, non-residential investment. The correlation between orders received and private sector, non-residential investment is arguably very high.

Orders received versus private, non-residential construction investment



Source: Prepared by FISCO based on materials from Ministry of Land, Infrastructure, Transport and Tourism

Business trends

Contents of results were positive, with the gross profit margin improving despite a fall in profits

1. FY3/17 results overview

(1) Profits

In the FY3/17 (April 2016 to March 2017) results, orders received were ¥185,880mn (up 1.4% YoY), net sales were ¥168,512mn (down 5.8%), gross profit was ¥22,538mn (down 1.7%), operating income was ¥6,012mn (down 7.6%), ordinary income was ¥6,880mn (down 15.4%), and profit attributable to owners of parent was ¥4,698mn (down 11.8%).

Orders received increased significantly and surpassed the previous fiscal year due to large-scale orders for facilities construction and environmental systems. Net sales fell YoY, as compared to in the previous fiscal year, the balance of completed large-scale projects declined. But as a result, the balance carried forward increased significantly, up 16.3% on the end of the previous fiscal year. In terms of profits, the gross profit margin improved to 13.4% (12.8% in the previous fiscal year) due to the effects of the measures to improve the profit margin that have been implemented over the past few years. Therefore, while operating income fell below the high level of the previous fiscal year, if compared to the result of two fiscal years ago (¥2,951mn) it still maintained a high level. In ordinary income, there were special factors in the previous fiscal year (including the recording in non-operating income of ¥771mn of equity in earnings of affiliates), and therefore the extent of the decline was greater than that for operating income. So although profits declined YoY, overall the results can still be said to be positive.

FY3/17 results

(¥mn, %)

	FY3/16		FY3/17			
	Amount	Ratio	Amount	Ratio	YoY change %	% change
Orders received	183,270	-	185,880	-	2,609	1.4
Balance carried forward	106,388	-	123,756	-	17,367	16.3
Net Sales	178,901	100.0	168,512	100.0	-10,389	-5.8
Gross profit	22,929	12.8	22,538	13.4	-391	-1.7
SG&A expenses	16,419	9.2	16,526	9.8	106	0.6
Operating income	6,509	3.6	6,012	3.6	-497	-7.6
Ordinary income	8,135	4.5	6,880	4.1	-1,254	-15.4
Profit attributable to owners of parent	5,327	3.0	4,698	2.8	-629	-11.8

Source: prepared by FISCO from the Company's financial results supplementary materials

The Company cited the following points as the factors behind the improvement in the gross profit margin.

a) Rigorous cost management : Higher margins via significant increases in operational efficiency as a result of the measures set out below, in addition to rigorous internal cost management that the Company has hitherto promoted.

b) Reductions in negative margin factors : The environment for orders improved significantly due to an upturn in the operating environment, leading to circumstances where a balance could be struck between costs and quality. Furthermore, delays in construction progress declined as a result of rigorous process control, with profitability (margins) in large-scale projects improving in particular.

c) Establishment of site support structures : The Company has taken various steps to improve support for site engineers, including purchasing operations support through the Procurement Division and work site documentation and other clerical support via the Site-Documentation Support Center newly established in April 2015, designing work support through the Design & Engineering Support Center newly formed in April 2016, and quality supervision via technical experts, and these efforts are paying off (in the form of improved operational efficiency).

Conversely, the actual amount of SG&A expenses increased ¥106mn, and the SG&A expenses ratio rose from 9.2% to 9.8%. But this was due to the decline in net sales and was within the expected range.

(2) Profits by segment

Consolidated net sales & ordinary income by segment

(¥mn, %)

	FY3/16		FY3/17			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	178,901	100.0	168,512	100.0	-10,389	-5.8
HVAC and plumbing for buildings	64,492	36.1	60,376	35.8	-4,116	-6.4
Industrial HVAC	52,084	29.1	49,440	29.3	-2,644	-5.1
Electrical systems	22,958	12.8	21,542	12.8	-1,416	-6.2
Facility systems	10,416	5.8	10,208	6.1	-208	-2.0
Facilities construction business	149,952	83.8	141,567	84.0	-8,384	-5.6
Machinery systems	9,217	5.1	8,192	4.9	-1,024	-11.1
Environmental systems	18,734	10.5	18,271	10.8	-463	-2.5
Real estate business	1,532	0.9	1,592	1.0	59	3.9
Others	542	0.3	499	0.3	-43	-7.9
Adjustments	-1,077	-0.6	-1,611	-1.0	-533	-
Ordinary income	8,135	4.5	6,880	4.1	-1,254	-15.4
Facilities construction business	7,698	-	6,404	-	-1,293	-16.8
Machinery systems	275	-	-138	-	-413	-
Environmental systems	-315	-	671	-	987	-
Real estate business	233	-	189	-	-43	-18.8
Others	52	-	22	-	-30	-57.2
Adjustments	191	-	-270	-	-461	-

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

In the facilities construction business, net sales were ¥141,567mn (down 5.6% YoY). Sales fell in every sub segment: in HVAC and plumbing for buildings, they declined 6.4% to ¥60,376mn; in industrial HVAC, they decreased 5.1% to ¥49,440mn; in electrical systems, they fell 6.2% to ¥21,542mn; and in facility systems, they decreased 2.0% to ¥10,208mn. Sales for HVAC and plumbing for buildings were below the previous fiscal year, mainly for large-scale projects, but the high level of the balance carried forward was maintained at ¥60,013mn. The results in the other sub-segments were also below those of the previous fiscal year, but net sales were secured at the same level as two fiscal years ago (FY3/15).

In the machinery systems business, net sales were ¥8,192mn (down 11.1% YoY), while in the environmental systems business, they were ¥18,271mn (down 2.5%). The reason for the double-digit decline in net sales in the machinery systems business was that net sales in the previous fiscal year, in which there were large-scale projects, were relatively large, and the result was basically as expected. In the real estate business, net sales were ¥1,592mn (up 3.9%), while in other businesses, they were ¥499mn (down 7.9%), which were both basically as forecast.

Also, in ordinary income by segment, in the facilities construction business, it was a profit of ¥6,404mn (down 16.8% YoY); in machinery systems, it was a loss of ¥138mn (compared to profit of ¥275mn in the previous fiscal year) following the completion of a round of large-scale projects; and in environmental systems, it was a profit of ¥671mn (a loss of ¥315mn in the previous fiscal year). As a result, in the facilities business as a whole, ordinary income was ¥6,938mn (down 9.4%). However, the high income level can be said to have been maintained when compared to the result of two fiscal years ago (¥3,073mn). Also, in the real estate business and other businesses, ordinary income was ¥189mn (down 18.8%) and ¥22mn (down 57.2%) respectively, which were also basically as expected.

(3) Order conditions by segment

Orders received by segment

(¥mn, %)

	FY3/16		FY3/17			
	Amount	Ratio	Amount	Ratio	YoY change %	% change
Orders received	183,270	100.0	185,880	100.0	2,609	1.4
HVAC and plumbing for buildings	66,172	36.1	65,763	35.4	-409	-0.6
Industrial HVAC	52,522	28.7	49,823	26.8	-2,699	-5.1
Electrical systems	22,667	12.4	21,576	11.6	-1,090	-4.8
Facility systems	11,070	6.0	9,450	5.1	-1,620	-14.6
Facilities construction business	152,432	83.2	146,612	78.9	-5,820	-3.8
Machinery systems	10,309	5.6	8,130	4.3	-2,178	-21.1
Environmental systems	19,610	10.7	30,626	16.5	11,015	56.2
Real estate business	1,532	0.8	1,592	0.9	59	3.9
Others	524	0.3	491	0.3	-33	-6.3
Adjustments	-1,139	-0.6	-1,573	-0.9	-433	-

Source: Prepared by FISCO from the Company materials

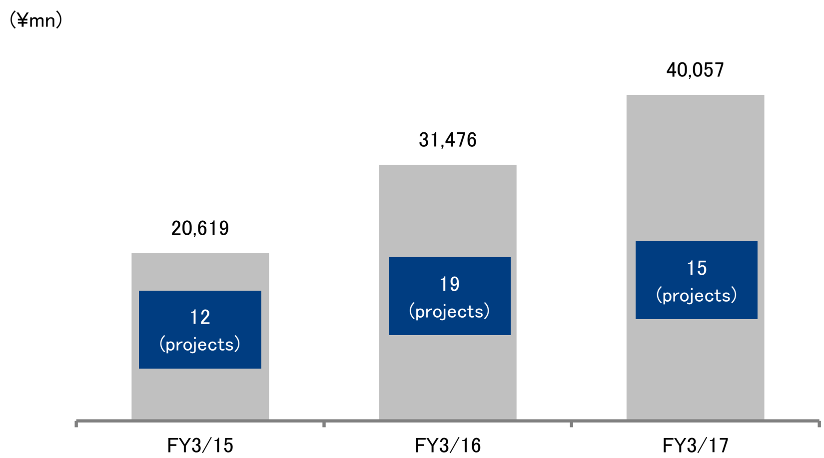
In the facilities construction business, orders received were ¥146,612mn (down 3.8% YoY). HVAC and plumbing for buildings maintained the same level of the previous fiscal year at ¥65,763mn (down 0.6%) as it received some large-scale orders. Industrial HVAC fell to ¥49,823mn (down 5.1%). But when considering the exceptionally high level of the previous fiscal year, this level is not at all a cause for concern, and for example, it exceeded the orders received of two fiscal years ago (¥46,765mn). Electrical systems were ¥21,576mn (down 4.8%), but the same trend of maintaining a high level could be seen and the fact that orders in excess of ¥20,000mn were maintained can be highly evaluated. In facility systems also, orders received were below the result in the previous fiscal year, at ¥9,450mn (down 14.6%), but maintained the level of two fiscal years ago (¥9,272mn).

In the plant & machinery systems business, orders received by machinery systems were ¥8,130mn (down 21.1%), but this was due to the fact that there were large-scale orders in the previous fiscal year. Conversely, in environmental systems, orders received greatly increased, to ¥30,626mn (up 56.2%), as there were orders for large-scale DBO* projects. As a result, in the plant & machinery systems business as a whole, orders received rose significantly YoY to ¥38,756mn (up 29.5%).

* DBO (Design Build Operate) is a method for public-build, private-operations by collectively ordering design, building, and operations and maintenance management from private-sector operators (such as the Company).

There were a total of 15 orders for large-scale projects (¥1,000mn or more) worth ¥40,057mn (there were 19 projects in the previous fiscal year worth ¥31,476mn, and 12 projects in 2 fiscal years ago worth ¥20,619mn). So the number of orders declined compared to the previous fiscal year, but the monetary amount increased, and the average order amount per large-scale project has been trending upward in the last few years.

Large-scale projects with orders exceeding ¥1,000mn



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

Breakdown of large-scale projects with orders exceeding ¥1,000mn

(project)

(project)	FY3/15	FY3/16	FY3/17
Office	2	3	4
Complex building	-	1	-
Commercial facility	1	1	1
Factory	1	5	4
School	-	1	-
Hospital	2	2	1
Research institute	2	1	1
Government office buliding	2	-	-
Waste processing facility	-	3	1
Power station, substation	-	-	1
Water and sewage treatment facility	1	1	2
Others	1	1	-
Total	12	19	15

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

From the above-described conditions, in FY3/17, total orders received increased slightly YoY to ¥185,880mn (up 1.4%). As net sales declined, the balance carried forward at the end of the fiscal period rose significantly, to ¥123,756mn (up 16.3%).

2. Financial condition

Looking at the financial condition at the end of FY3/17, current assets were ¥114,906mn (down ¥585mn on the end of the previous fiscal year), but this was mainly due to a fall in trade notes and accounts receivable of ¥13,078mn. Non-current assets were ¥51,705mn (down ¥2,225mn), primarily because of the reduction in investments and other assets of ¥2,368mn. As a result, total assets at the end of the fiscal year were ¥166,612mn (down ¥2,810mn).

Current liabilities were ¥66,776mn (down ¥4,087mn), mainly due to the decline in trade notes and accounts payable of ¥3,183mn. Non-current liabilities were ¥11,875mn (down ¥126mn), primarily because of a fall in deferred tax liabilities of ¥555mn. As a result of the above, total liabilities at the end of the fiscal year were ¥80,651mn (down ¥4,214mn). Also, total net assets were ¥85,961mn (up ¥1,403mn) due to an increase in retained earnings of ¥2,727 following the recording of profit attributable to owners of parent.

Balance sheet

(¥mn)

	FY3/16	FY3/17	Difference
Cash and deposits	26,501	34,187	7,685
Notes and accounts receivable on completed construction contracts and other	71,246	58,168	-13,078
Current assets	115,491	114,906	-585
Tangible fixed assets	8,715	8,849	134
Intangible fixed assets	533	542	8
Investments and other assets	44,682	42,314	-2,368
Noncurrent assets	53,931	51,705	-2,225
Total assets	169,423	166,612	-2,810
Notes and accounts payable on construction contracts and other	51,460	48,277	-3,183
Short-term borrowings	5,672	5,654	-17
Payments received for work in progress	3,140	5,728	2,588
Current liabilities	72,863	68,776	-4,087
Obligations for retirement pay	1,834	2,274	439
Deferred tax liabilities	4,742	4,187	-555
Noncurrent liabilities	12,001	11,875	-126
Total liabilities	84,865	80,651	-4,214
Total net assets	84,557	85,961	1,403

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

3. Cash flow conditions

In FY3/17, cash flows from operating activities increased ¥10,845mn, mainly due to the recording of pretax profit of ¥7,004mn and a decrease in trade notes and accounts receivable of ¥8,808mn. Cash flows from investing activities declined ¥1,644mn. Cash flows from financing activities fell ¥2,458mn, although this was mainly due to the payment of dividends of ¥1,970mn.

As a result, the balance of cash and cash equivalents at the end of FY3/17 had increased ¥6,686mn from the end of the previous fiscal year to ¥39,187mn.

Statement of cash flows

(¥mn)

	FY3/16	FY3/17
Cash flows from operating activities	5,220	10,845
Pretax profit	7,834	7,004
Change in trade notes and accounts receivable (- indicates increase)	1,940	8,808
Change in trade notes and accounts payable (- indicates decrease)	-4,666	-3,180
Cash flows from investing activities	5,520	-1,644
Cash flows from financing activities	-1,826	-2,458
Change in cash and cash equivalents	8,833	6,686
Period-end balance of cash and cash equivalents	32,501	39,187

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

Outlook for the future

The outlook is for the gross profit margin to continue to maintain its high level and for higher profits

● **FY3/18 results outlook**

For the FY3/18 results, the Company is forecasting net sales of ¥180,000mn (up 6.8% YoY), operating income of ¥7,000mn (up 16.4%), ordinary income of ¥7,500mn (up 9.0%), and profit attributable to owners of parent of ¥5,000mn (up 6.4%).

In a breakdown of net sales it is expected that facilities construction business will account for ¥148,200mn (up 4.7% YoY). By business line HVAC and plumbing for buildings, as it has ample work carried over at the beginning of the period, will be ¥69,700mn (up 15.4%), industrial HVAC is expected to be ¥46,000mn (down 7.0%), due to a slowdown in orders received. However, given that industrial HVAC has a certain amount of work in hand, there is the potential for it to exceed the forecast. Electrical systems are expected to be ¥23,000 (up 6.8%), as it has a certain amount of work carried forward ; in facility systems they are expected to be 9,500mn (down 6.9%) due to a reaction against high performance in the previous fiscal year. Net sales for plant & machinery systems business are expected to recover, with machinery systems at ¥10,000mn (up 22.1%), and environmental systems at ¥20,000mn (up 9.5%).

Orders received are expected to be ¥152,200mn (up 3.8% YoY) in the core facilities construction business. By business line, HVAC and plumbing for buildings are expected to recover to ¥71,700mn (up 9.0%), and industrial HVAC orders are expected to stay at roughly prior-year levels of ¥49,000mn (down 1.7%). The Company projects orders for electrical systems and facility systems to ¥22,000mn (up 2.0%) and ¥9,500mn (up 0.5%), respectively, basically in line with the previous period. In the plant & machinery systems business, the Company expects a significant increase in machinery systems orders to ¥12,000mn (up 47.6%) as large orders are anticipated, but a decrease in environmental systems to ¥20,000mn (down 34.7%) as a reaction against large-scale orders received in the previous period. Based on these forecasts, total orders received are expected to remain basically unchanged YoY at ¥186,000mn (up 0.1%), while the balance of construction work carried forward is forecast to continue to maintain its high level.

FY3/18 forecast

(¥mn, %)

	FY3/17		FY3/17 E			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	185,880	100.0	186,000	100.0	120	0.1
HVAC and plumbing for buildings	65,763	35.4	71,700	38.6	5,937	9.0
Industrial HVAC	49,823	26.8	49,000	26.3	-823	-1.7
Electrical systems	21,576	11.6	22,000	11.8	424	2.0
Facility systems	9,450	5.1	9,500	5.1	50	0.5
Facilities construction business	146,612	78.9	152,200	81.8	5,588	3.8
Machinery systems	8,130	4.3	12,000	6.4	3,870	47.6
Environmental systems	30,626	16.5	20,000	10.8	-10,626	-34.7
Real estate business	1,592	0.9	1,800	1.0	208	13.1
Others	491	0.3	500	0.3	9	1.8
Adjustments	-1,573	-0.9	-500	-0.3	1,073	-
Net sales	168,512	100.0	180,000	100.0	11,488	6.8
HVAC and plumbing for buildings	60,376	35.8	69,700	38.7	9,324	15.4
Industrial HVAC	49,440	29.3	46,000	25.5	-3,440	-7.0
Electrical systems	21,542	12.8	23,000	12.8	1,458	6.8
Facility systems	10,208	6.1	9,500	5.3	-708	-6.9
Facilities construction business	141,567	84.0	148,200	82.3	6,633	4.7
Machinery systems	8,192	4.9	10,000	5.6	1,808	22.1
Environmental systems	18,271	10.8	20,000	11.1	1,729	9.5
Real estate business	1,592	1.0	1,800	1.0	208	13.1
Others	499	0.3	500	0.3	1	0.2
Adjustments	-1,611	-1.0	-500	-0.3	1,111	-
Gross profit	22,538	13.4	24,000	13.3	1,462	6.5
SG&A expenses	16,526	9.8	17,000	9.4	474	2.9
Operating income	6,012	3.6	7,000	3.9	988	16.4
Ordinary income	6,880	4.1	7,500	4.2	620	9.0
Profit attributable to owners of parent	4,698	2.8	5,000	2.8	302	6.4

Source: prepared by FISCO from the Company's financial results supplementary materials

Overall, given that currently there is ample work in hand, we feel there is every likelihood that the Company will achieve the above targets. Going forward, the point to pay attention to is avoiding unexpectedly unprofitable projects by rigorous progress management. In respect of orders also, the environment surrounding the construction and HVAC industries is one of flow, and given that there is expected to be an ample volume of works, it is felt that it is possible for the Company to secure their target for orders received.

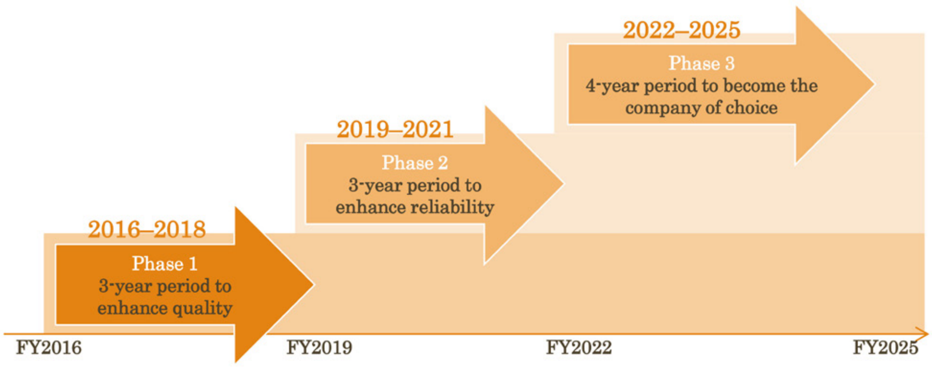
The gross profit margin in the previous fiscal year was at a high level (13.4%), but the Company plans to maintain it at the same high level (13.3%) in this fiscal year through continuing to implement measures to improve profits, including establishing on-site support systems, strengthening negotiating capabilities for the procurement of materials, and supporting on-site purchasing operations through ongoing integrated management by the Procurement Division. From this, if the net sales result is as targeted, the gross profit amount is forecast to be ¥24,000mn.

Medium-Term Management Plan

STeP Project to start in earnest

1. The Long –Term Vision “Century 2025”

The Company has a 10-year long-term vision “Century 2025” that covers from FY3/17 to FY3/26, ahead of the 100th anniversary of its establishment. The ultimate goal of this long-term vision is to be “The Company of Choice.” The Company has divided the 10 years into three phases described below in order to achieve this goal and the Company’s policy is to implement business strategies promoted in each phase of medium-term management plan.



Phase 1: We will enhance quality by refining our skills and wisdom and developing our human resources as a foundation for responding to change.
Phase 2: Superior quality generates customer satisfaction, and customer satisfaction and confidence leads to reliability.
Phase 3: Increased reliability will encourage more customers to choose our company.

2. Overview of the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>

One of the priority measures in the medium-term management plan, “Century 2025” Phase 1, is the “Redevelopment of the Yamato Site.” The Company announced the overview of this redevelopment project, which it has named the “STeP (Sanki Techno Park) Project.” First, it divided the project into three plans: 1) building the Sanki Techno Center, 2) reorganizing manufacturing plants in the machinery systems business, and 3) making effective use of existing assets. The progress made in each plan and the schedule for the future are described below.

(1) Building the Sanki Techno Center

One of the targets in “Century 2025” Phase 1 is “Improving the quality of technologies and human resources,” and the Company has already announced that it plans to build the “Sanki Techno Center” to achieve this target. In this plan, it will renovate the former A-block in the Sanki Yamato Buildings that it owns and will utilize it for the “Sanki Techno Center” (6 above-ground floors and 1 below-ground floor, with a total area of approximately 45,000 square meters). It already completed the design work for this in the previous fiscal year (FY3/17) and has started the preparatory construction work. Going forward, it will start the renovation work during the current fiscal year (FY3/18) and plans to open the Center in the fall of 2018. It has also already begun leasing one of the Sanki Yamato Buildings (the former B-block) to external tenants, while it has not yet decided on how it will utilize the former C-block.

(2) Reorganizing manufacturing plants in the machinery systems business

For the second pillar of the STeP Project, "Reorganizing manufacturing plants in the machinery systems business," the Company has announced that in order to consolidate the current, aging manufacturing plants, it will rebuild them as a new machinery systems manufacturing plant (a site area of approximately 11,000 square meters, and a building area of around 5,500 square meters). It will conduct the design work in the current fiscal year (FY3/18), start the construction work from FY3/19, and aim for the plant to start operations in the summer of 2019.

(3) Making effective use of existing assets

For the third pillar, "Making effective use of existing assets," the Company has announced that it will utilize as rental real estate the land space created from the above-described consolidation of manufacturing bases into the new machinery systems manufacturing plant. The plan is to conduct soil surveys during the current fiscal year (FY3/18) and also to carry out the demolition work in parallel with this, and then to start leasing the sites in the period from the end of this fiscal year to the start of the next fiscal year. It officially announced this plan on June 21 after announcing its results, and as a consequence, net sales and profits in the real estate business are expected to further increase from the next fiscal year (FY3/19) onwards.

Shareholder return policy

Actively returns profits to shareholders through buying back and retiring shares and increasing the dividend

The Company actively returns profits to shareholders. As one of its shareholder-return policies up to the present time, it has actively purchased its shares on the stock mark and retired them. Recently also, on May 22, 2017, it retired 3,000,000 of the shares it held. Moreover, it has announced that it will newly acquire 3,000,000 of treasury stock (upper limit, ¥4,000mn) between May 15, 2017, and March 31, 2018.

Further, regarding dividends, the Company has to date continued to pay a stable annual dividend of ¥15, however, (with 90th anniversary commemorative dividend of ¥5) also paid in FY3/15 an annual dividend of ¥20. In FY3/16, in addition to raising the annual regular dividend to ¥18, due to sound results performance the Company paid an extra dividend of ¥12, and as a result paid a total annual dividend of ¥30 (dividend payout ratio of 35.8%). Furthermore, in the previous fiscal year (FY3/17), in addition to raising the annual regular dividend to ¥20, for the second consecutive year it paid an extra dividend of ¥10, and as a result paid a total annual dividend of ¥30 (dividend payout ratio, 40.6%). At the present time, the forecast for the annual dividend for this fiscal year (FY3/18) is only for an regular dividend of ¥20. But if it maintains the dividend payout ratio on the same level as the previous two fiscal years, the annual dividend would be approximately ¥30, so it may increase the dividends depending on results going forward.

We feel that his positive attitude towards shareholder returns should be regarded highly.

Disclaimer