COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange First Section

20-Mar.-2018

FISCO Ltd. Analyst
Noboru Terashima

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

Index

Summary

Major facilities construction company with strengths of advanced technology and credibility cultivated over a long history

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, manufacture, maintenance, installation, sale and consultation of systems and equipments for construction and plant facilities, such as 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 a history of more than 90 years.

1. Recorded operating income of ¥489mn, and the balance carried forward increased 15.8% YoY in 1H FY3/18

In 1H FY3/18 results, orders received were ¥95,775mn (up 5.3% year on year (YoY)), net sales were ¥72,506mn (up 3.1%), gross profit was ¥9,319mn (up 14.4%), operating income was ¥489mn (up 753.5%), and ordinary income was ¥952mn (up 158.2%). The loss attributable to owners of parent was ¥95mn (compared to profit of ¥229mn in the same period in the previous fiscal year) due to the recording of an extraordinary loss, which was mainly a loss on the disposal of noncurrent assets related to the Yamato Site Redevelopment Project. The balance carried forward was maintained at a high level with an increase of 15.8% YoY. Continuing on from the previous fiscal period, profitability improved, including due to rigorous cost management and the progress made in improving operating efficiency, and the gross profit margin rose by 1.3 percentage points YoY to 12.9%.

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 full year, which is currently underway, are for higher sales and profits, of 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%), and there have been no changes to the initial forecasts. Based on the results in 1H and the balance carried forward, we think that the forecasts are at levels that are fully achievable.

3. The targets for the medium-term management plan, "Century 2025" Phase 1, are net sales of ¥195bn and operating income of ¥7.5bn in FY3/19

The Company is approaching the 100th anniversary of its establishment, and so as its 10-year goals, in March 2015 it announced "Century 2025" as its long-term vision. As the final goal in the long-term vision, it intends to be "The Company of Choice," and in "Century 2025" Phase 1, which is the first three years of the new medium-term management plan, it has first set quantitative targets for FY3/19 of net sales of ¥195bn and operating income of ¥7.5bn. As the specific measures for the plan's implementation, the Company announced the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>, and it made steady progress in the previous fiscal year (the first year). The Sanki Techno Center, which is a comprehensive research and training facility that is a major pillar of this plan, is scheduled to open in the fall of 2018.

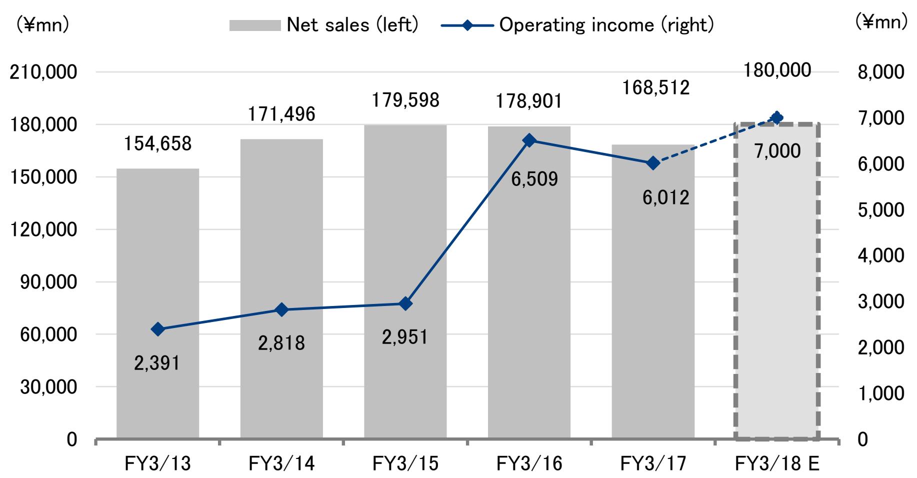
4. Actively returns profits to shareholders, as in addition to the annual dividend of ¥30, implemented a buyback of 3 million treasury shares

Up to the present time, the Company has been actively returning profits to shareholders, such as through buying-back treasury shares, in addition to the stable payment of dividends and the dividend increases of recent years. The FY3/17 annual dividend was ¥30.0 (dividend payout ratio, 40.6%), while for FY3/18, it raised the interim dividend from ¥10 to ¥15, and the forecast for the annual dividend is also an increase from ¥20 to ¥30. Further, as part of its efforts to return profits to shareholders, on May 22, 2017, it retired 3 million treasury shares that it held, and moreover during Q2, it newly acquired 1,955,000 shares (subsequently, by December 11, it has completed the acquisition of the allocation of 3 million shares).

Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Sales and profits increased in 1H FY3/18, and the forecast is also for higher sales and profits for the full fiscal year
- Positively returns profits to shareholders, and following on from retiring 3 million shares, it newly buys 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 outline

Sanki Engineering is a facilities construction company that was established in 1925 as a spin-off of the machinery division of 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 facilities construction business, such as heating, ventilation, air-conditioning (HVAC), plumbing, and electrical systems into other types of facilities, such as transport equipment, conveyance systems, water treatment facilities and waste treatment 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 the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branches, 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 resource development
2011	Relocated its head office to the current location in the Tsukiji area of Tokyo
2015	90th anniversary of its establishment. Announced its long-term vision "Century 2025"

Source: Prepared by FISCO from the Company's website, etc.

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 are divided into four business segments: three facility business segments of facilities construction, machinery systems, environmental systems, and real estate business. 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 facilities 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, facility 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.

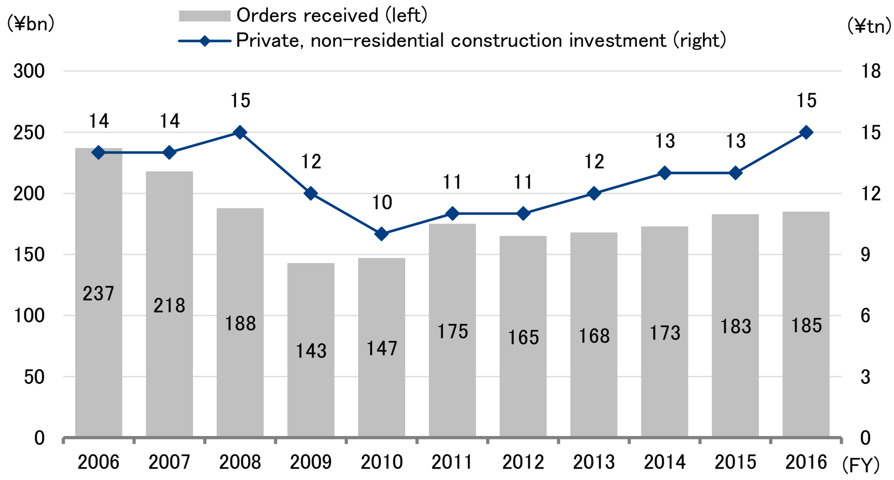
3. Main competitors

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 the Ministry of Land, Infrastructure, Transport and Tourism, etc.

Business trends

Recorded higher operating income YoY, and the balance of construction work also maintained its high level

1. 1H FY3/18 results overview

(1) Profits

In 1H FY3/18 (April to September, 2017) results, orders received were ¥95,775mn (up 5.3% YoY), net sales were ¥72,506mn (up 3.1%), gross profit was ¥9,319mn (up 14.4%), operating income was ¥489mn (up 753.5%), and ordinary income was ¥952mn (up 158.2%), and continuing on from the previous fiscal year, the Company recorded operating income (profit) in the 1H. However, because it recorded an extraordinary loss (mainly from a loss on the disposal of noncurrent assets) related to the Yamato Site Redevelopment Project, the loss attributable to owners of parent was ¥95mn (compared to profit of ¥229mn in the same period in the previous fiscal year).

Orders received trended firmly for industrial HVAC and electrical systems, but they decreased for HVAC and plumbing for buildings, mainly from the effects of receiving orders for large projects in the same period of the previous fiscal year. So for the facilities construction business as a whole, orders received declined 4.2% YoY. Conversely, orders received greatly increased in the plant & machinery systems business (machinery systems and environmental systems), which received orders for a large projects in the current fiscal period, and the total orders amount exceeded the amount in the same period in the previous fiscal year by 5.3%.

1H FY3/18 results

(¥mn, %)

	FY3/17 1H		FY3/18 1H			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	90,912	-	95,775	-	4,862	5.3
Balance carried forward	126,960	-	147,026	-	20,065	15.8
Net sales	70,341	100.0	72,506	100.0	2,165	3.1
Gross profit	8,144	11.6	9,319	12.9	1,174	14.4
SG&A expenses	8,087	11.5	8,829	12.2	742	9.2
Operating income	57	0.1	489	0.7	432	753.5
Ordinary income	368	0.5	952	1.3	583	158.2
Profit attributable to owners of parent	229	0.3	-95	-0.1	-324	-

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

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).

On the other hand, SG&A expenses increased ¥742mn, and the SG&A expenses ratio rose from 11.5% in the same period in the previous fiscal year to 12.2%. However, this was absorbed by the higher gross profit, and operating income increased.

(2) Profits by segment

Consolidated net sales and ordinary income by segment

(¥mn, %)

	FY3/17 1H		FY3/18 1H			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	70,341	100.0	72,506	100.0	2,165	3.1
HVAC and plumbing for buildings	24,001	34.1	27,802	38.3	3,801	15.8
Industrial HVAC	22,082	31.4	20,898	28.8	-1,184	-5.4
Electrical systems	9,065	12.9	8,785	12.1	-279	-3.1
Facility systems	4,587	6.5	3,687	5.1	-900	-19.6
Facilities construction business	59,736	84.9	61,173	84.4	1,437	2.4
Machinery systems	4,384	6.2	4,522	6.2	138	3.2
Environmental systems	5,782	8.2	6,139	8.5	357	6.2
Real estate business	787	1.1	860	1.2	73	9.3
Others	254	0.4	291	0.4	36	14.4
Adjustments	-604	-0.9	-482	-0.7	122	-
Ordinary income	368	0.5	952	1.3	583	158.2
Facilities construction business	-15	-	597	-	612	-
Machinery systems	119	-	6	-	-112	-94.2
Environmental systems	-755	-	-789	-	-33	-
Real estate business	103	-	238	-	134	130.6
Others	20	-	42	-	21	101.0
Adjustments	895	-	856	-	-39	-4.4

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

In the facilities construction business, net sales were ¥61,173mn (up 2.4% YoY). By sub-segment, net sales in HVAC and plumbing for buildings increased 15.8% to ¥27,802mn; in industrial HVAC, they decreased 5.4% to ¥20,898mn; in electrical systems, they declined 3.1% to ¥8,785mn; and in facility systems, they fell 19.6% to ¥3,687mn. So net sales declined YoY in every sub-segment other than in HVAC and plumbing for buildings. But they still rose in the facilities construction business as a whole because of the major increase in HVAC and plumbing for buildings, which had a plentiful balance carried forward from the start of the fiscal period.

Net sales were ¥4,522mn (up 3.2% YoY) in the machinery systems business and ¥6,139mn (up 6.2%) in the environmental systems business. Therefore, total net sales in the plant & machinery systems business increased 4.9% YoY, which was a strong result and basically as forecast.

Also, in ordinary income-loss by segment, the facilities construction business recorded income of ¥597mn (compared to a loss of ¥15mn in the same period in the previous fiscal year), machinery systems posted income of ¥6mn (income of ¥119mn), and environmental systems a loss of ¥789mn (a loss of ¥755mn). As a result, the facilities business as a whole recorded an ordinary loss of ¥184mn (a loss of ¥651mn), which was a major improvement YoY. Also, the real estate business and other businesses recorded ordinary income of ¥238mn (up 130.6%) and ¥42mn (up 101.0%), respectively.

(3) Order conditions by segment

Orders received by segment

(¥mn, %)

	FY3/17 1H		FY3/18 1H			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	90,912	100.0	95,775	100.0	4,862	5.3
HVAC and plumbing for buildings	33,979	37.4	28,860	30.1	-5,119	-15.1
Industrial HVAC	27,399	30.1	27,060	28.3	-339	-1.2
Electrical systems	8,337	9.2	10,394	10.9	2,057	24.7
Facility systems	5,274	5.8	5,487	5.7	213	4.0
Facilities construction business	74,990	82.5	71,803	75.0	-3,186	-4.2
Machinery systems	3,287	3.6	6,506	6.8	3,218	97.9
Environmental systems	12,451	13.7	16,634	17.4	4,183	33.6
Real estate business	787	0.9	860	0.9	73	9.3
Others	259	0.3	305	0.3	45	17.7
Adjustments	-864	-1.0	-335	-0.3	528	-

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

In the facilities construction business as a whole, orders received were ¥71,803mn (down 4.2% YoY). By sub-segment, in the HVAC and plumbing for buildings, they declined to ¥28,860mn (down 15.1%) due to the effects of having received orders for office-related large projects in the 1H of the previous fiscal year (orders declined). They also fell slightly in industrial HVAC to ¥27,060mn (down 1.2%), but when considering the high level of the previous fiscal year, this segment can be said to be continuing to maintain a high level. Orders trended firmly in electrical systems, at ¥10,394mn (up 24.7%), and in facility systems, at ¥5,487mn (up 4.0%).

In the plant & machinery systems business, orders received for machinery systems increased greatly to ¥6,506mn (up 97.9% YoY), mainly due to the acquisition of a large-scale project in the current fiscal period. They also rose significantly in environmental systems to ¥16,634mn (up 33.6%) following an order for a large-scale DBO* project in the current fiscal period. As a result, in the plant & machinery systems business as a whole, orders received increased greatly YoY to ¥23,141mn (up 47.0%).

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

There were a total of 8 orders for large-scale projects (¥1,000mn or more) worth ¥19,052mn (there were 7 projects in the same period of the previous fiscal year worth ¥17,852mn, and 11 projects 2 fiscal years ago worth ¥19,091mn). So both the number of orders and the monetary amount increased compared to the previous fiscal year, and the average order amount per large-scale project has been trending upward in the last few years.

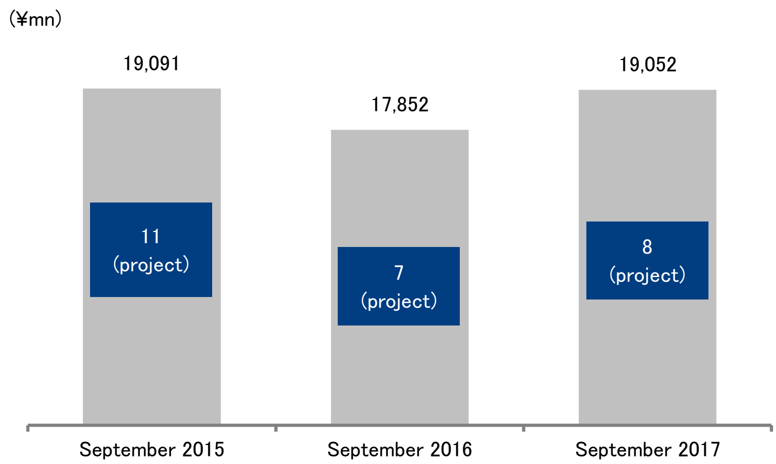
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(project)

	September 2015	September 2016	September 2017
Office	2	3	1
Factory	3	2	2
Hospital	1	-	-
Research institute	1	-	1
Railway and airport facilities	-	-	1
Waste processing facility	3	-	2
Power station, substation	-	1	-
Water and sewage treatment facility	-	1	-
Others	-	-	1
School buildings and lecture halls	1	-	-
Total	11	7	8

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

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



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

From this situation, in 1H FY3/18, total orders received were strong at ¥95,775mn (up 5.3%) and exceeded the net sales growth rate (up 3.1%), while the balance carried forward at the end of the period had risen greatly, to ¥147,026mn (up 15.8%).

2. Financial condition

Looking at the financial condition at the end of 1H FY3/18, current assets were ¥100,231mn (down ¥14,675mn on the end of the previous fiscal year). This was mainly due to falls in cash and deposits of ¥5,827mn and notes and accounts receivable on completed construction contracts of ¥10,672mn. Noncurrent assets were ¥55,378mn (up ¥3,672mn), primarily because of the increase in investments and other assets of ¥3,461mn. As a result, total assets at the end of 1H FY3/18 were ¥155,609mn (down ¥11,002mn).

Current liabilities were ¥58,349mn (down ¥10,426mn), mainly due to a decline of ¥7,271mn in notes and accounts payable on construction contracts and others. Noncurrent liabilities were ¥12,790mn (up ¥915mn), primarily due to increases in deferred tax liabilities of ¥650mn and in liability for retirement benefits of ¥250mn. As a result, total liabilities at the end of the fiscal period were ¥71,139mn (down ¥9,511mn). Also, although the Company recorded profit attributable to owners of parent, it also retired 3 million treasury shares, so retained earnings declined ¥3,546mn, and total net assets became ¥84,469mn (down ¥1,491mn).

Balance sheet

(¥mn)

	FY3/17	1H FY3/18	Difference
Cash and deposits	34,187	28,360	-5,827
Notes and accounts receivable on completed construction contracts and other	58,168	47,495	-10,672
Current assets	114,906	100,231	-14,675
Tangible noncurrent assets	8,849	9,038	189
Intangible noncurrent assets	542	563	21
Investments and other assets	42,314	45,776	3,461
Noncurrent assets	51,705	55,378	3,672
Total assets	166,612	155,609	-11,002
Notes and accounts payable on construction contracts and other	48,277	41,005	-7,271
Short-term borrowings	5,654	5,483	-171
Payments received for work in progress	5,728	5,502	-225
Current liabilities	68,776	58,349	-10,426
Deferred tax liabilities	4,187	4,838	650
Liability for retirement benefits	2,274	2,524	250
Noncurrent liabilities	11,875	12,790	915
Total liabilities	80,651	71,139	-9,511
Total net assets	85,961	84,469	-1,491

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

3. Cash flow conditions

In 1H FY3/18, cash flows from operating activities increased ¥1,556mn, mainly due to the collection of trade notes and accounts receivable of ¥13,242mn. Cash flows from investing activities declined ¥2,599mn. Cash flows from financing activities fell ¥3,813mn, primarily because of the acquisition of treasury shares of ¥2,290mn and dividend payments of ¥1,271mn.

As a result, the balance of cash and cash equivalents at the end of 1H FY3/18 had decreased ¥4,827mn from the end of the previous fiscal year to ¥34,359mn.

Statement of cash flows

(¥mn)

	1H FY3/17	1H FY3/18
Cash flows from operating activities	3,502	1,556
Pretax profit (- indicates loss)	336	-182
Change in trade notes and accounts receivable	23,772	13,242
Change in trade notes and accounts payable (- indicates decrease)	-16,799	-7,278
Cash flows from investing activities	-397	-2,599
Cash flows from financing activities	-1,573	-3,813
Expenditure to acquire treasury shares	-	-2,290
Dividends-payment amount	-1,334	-1,271
Change in cash and cash equivalents (- indicates a decrease)	1,432	-4,827
Cash and cash equivalents at end of period	33,933	34,359

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

Outlook

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 retained its initial forecast for 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. 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%), due to orders received of large-scale projects.

Orders received are expected to be ¥148,200mn (up 1.1% YoY) in the core facilities construction business. By business line, HVAC and plumbing for buildings are expected to be basically in line with the previous period to ¥65,700mn (down 0.1%), and industrial HVAC orders are expected to recover to ¥51,000mn (up 2.4%). 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-scale orders are anticipated, but a decrease in environmental systems to ¥24,000mn (down 21.6%) 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		FY3/18 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	65,700	35.3	-63	-0.1
Industrial HVAC	49,823	26.8	51,000	27.4	1,177	2.4
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	148,200	79.7	1,588	1.1
Machinery systems	8,130	4.4	12,000	6.5	3,870	47.6
Environmental systems	30,626	16.5	24,000	12.9	-6,626	-21.6
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	-0.8	-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	25.6	-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	0.9	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	24,500	13.6	1,962	8.7
SG&A expenses	16,526	9.8	17,500	9.7	974	5.9
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 good, 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.

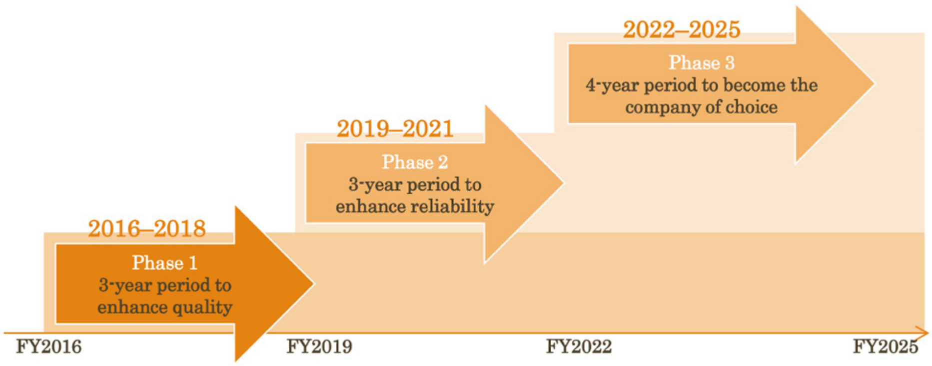
The gross profit margin in the previous fiscal year was at a high level (13.4%), but the Company plans to slightly raise the level (13.6%) this fiscal year. It will do so by continuing to implement measures to improve profits, including establishing and enhancing on-site support systems, particularly by 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 ¥24,500mn. Details are described below.

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. Progress 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) Commencement of full-scale construction of 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 and 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) as a comprehensive research and training facility. Fully fledged renovation work has already been started in the 1H of the current fiscal year, and the Center is scheduled to commence operation around October 2018.

Also, as one part of the building work for the "Sanki Techno Center," the Company has announced it will additionally install a new Technical Research & Development Institute within the Center. On the dismantling of the existing Technical Research & Development Institute, during the 1H of the current fiscal year it has been temporarily relocated to the Sanki Yamato Building. Going forward, the plan is to start operations of the new Technical Research & Development Institute within the Sanki Techno Center around April 2018, in advance of the subsequent full opening of the Center.

(2) Reorganizing manufacturing plants in the machinery systems business

Toward "reorganizing manufacturing plants in the machinery systems business," the Company has announced it will rebuild 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) on the site of the former standard products manufacturing plant. For this rebuilding, in the 1H of the current fiscal year, the machinery systems plant has been temporarily relocated to the Shonan area, and the new plant is scheduled to commence operations around August 2019.

(3) The Yamato Plant facilities are currently being dismantled

The Company is currently dismantling the various facilities of the Yamato Plant, which is comprised of the above-described machinery systems manufacturing plant, the Technical Research & Debelopment Institute, and other buildings. The cost of this dismantling work has already been recorded as an extraordinary loss in 1H FY3/18, while one part of it is also scheduled to be recorded in the 2H. After the completion of this dismantling work, the plan is to construct from the next fiscal year the above described new machinery systems plant on one part of this land. In the 1H of the current fiscal year, the Company announced that the remaining land will be prepared and maintained as rental real estate from the perspective of effectively utilizing assets owned. About 41,000 square meters of this land is scheduled to be leased from the spring of 2018, so from FY3/19 onwards, sales and profits in the real estate business can be expected to further accumulate.

3. The progress made in the various measures

The above-described Yamato Site Redevelopment Project is one of the priority measures in "Century 2025" Phase 1. But other than this, the Company is also implementing various other qualitative measures, and the progress made in these measures is described below.

(1) Enhancing the on-site support organizations

a) The Procurement Division: from April 2017, started operations at all branches of the Procurement Web System that digitizes ordering works.

b) Site-Documentation Support Center: Expanded the scope of operations, including introducing green site requirements to our main-contractor worksites, and starting support for labor safety management. No. of cases handled = 942 cases (up 91 YoY)

c) Design & Engineering Support Center: integrated the Design and Engineering Support Center into the Engineering Management Office, and supported design operations at all branches. 59 cases handled (up 29 YoY)

(2) ICT investment toward improving productivity

a) Effectively utilizing tablet devices: introduced 1,200 tablet devices throughout the Group as a whole, mainly at construction sites. Continued to improve operational efficiency.

b) Development of a technical documents search system: currently constructing a mechanism that will allow cross searches by Group employees from anywhere of the technical documents spread across the Group.

(3) Entering the third year of the "Smile Project" to reform the work style

The Company is advancing measures for the project it launched in October 2015, prior to the society, to reform the work style, with the President as its leader.

a) Disseminating messages from top management: promoting "willingness to take leave, the creation of an environment to enable leave, and the determination to allow leave"

b) Reduction of long working hours: setting targets for overtime hours for each department.

c) Precise time management: introducing a new overtime management tool in addition to duty rosters.

d) Making work easier: return to work, working from home (test operations), review of dormitory accomodations, etc.

(4) Measures to improve communication

In the previous fiscal year (FY3/17), the President visited all of the divisions and branches, and directly exchanged opinions with approximately 300 employees. In this fiscal year, these forums will be made by every division cheif and branch head mamager, and the plan is to carry them out a total of 55 times, starting from the 2H. Also, continuing on from the previous fiscal year, the 2nd round of "Sanki Ladies' Roundtable Forum," which is an exchange meeting for female employees, is scheduled to be held in the 2H.

(5) From the perspective of ESG

The Company is also implementing the following measures from the viewpoint of ESG.

a) Environment (E)

1) Implemented "SANKI YOU Eco Contribution Points" donations for FY2016 2H

2) An order received for the DBO style of energy-recovery type waste disposal facilities including new construction work

3) Constracted of a wood biomass gasification power generation facility (related to renewable energy)

4) Jointly with NEDO and others, construction of advanced energy-saving facility in Shanghai, China

5) Registration in the "ZEB Planner" that is a license system newly instituted by the Ministry of Economy, Trade, and Industry in FY2017

b) Society (S)

1) Entered the third year of the "Smile Project", the Company's unique reforms to work style

2) Launch of the "Smile Site Plan" as an expert subcommittee for the above-mentioned project that specializes in work-site managers

3) New establishment of the "Women's Hotline", a consultation service exclusively for women

c) Governance (G)

1) Supplementing the content for the assessment of the Board of Directors
2) Participation in the platform for the digital implementation of voting rights
3) Holding of meetings for the exchanges of opinions between executives specifically on corporate governance
4) Began revising the standards for submitting proposals to the Board of Directors
5) Enhancing the dialogue with shareholders (strengthening of systems and increasing the number of opportunities for dialogue, holding briefings sessions for individual investors)

Shareholder return policy

Actively returns profits to shareholders by increasing the dividend and acquiring and retiring treasury shares

The Company actively returns profits to shareholders. Previously, its basic approach was to pay a stable annual dividend of ¥15, but in FY3/15, it added ¥5 as a commemorative dividend to mark the 90th anniversary of its foundation, for an annual dividend of ¥20. Furthermore, in FY3/16, it increased the annual regular dividend to ¥18 and additionally paid an extra dividend of ¥12 at the end of the fiscal year because of the sound results, and therefore it paid a total annual dividend of ¥30 (for a dividend payout ratio of 35.8%). Moreover, in the previous fiscal year (FY3/17), it again increased the annual regular dividend to ¥20 and also paid an extra dividend of ¥10, for an annual dividend of ¥30 (dividend payout ratio, 40.6%). For the annual dividend for the current fiscal year (FY3/18), it had initially planned annual regular dividend of ¥20, but based on the results in the 1H, it has announced that it will pay an extra dividend of ¥5 additionally, and it increased the interim dividend to ¥15.0 (¥10.0 in the previous fiscal year), while also raising the end-of-period dividend at ¥15.0. Therefore, it plans to increase the annual dividend to ¥30.0.

In addition, as part of its shareholder-return policies, up to the present time it has actively bought-back its treasury shares on the stock markets and retired these shares. Recently, on May 22, 2017, it retired 3 million of the treasury shares it held, and the number of outstanding shares became 63,661,156. Further, it announced that it planned to newly acquire 3 million of treasury shares (upper limit, ¥4,000mn) between May 15, 2017, and March 31, 2018, and by December 2017, it had already acquired the framework of 3 million shares.

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

Disclaimer