COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

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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, supervision, installation, sale and consultation of systems and equipments for construction and plant facilities, in office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive 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. In 1H FY3/19, net sales increased 11.3% YoY and operating income rose 130.1% YoY

In 1H FY3/19 results, orders received were ¥103,819mn (up 8.4% year on year (YoY)), net sales were ¥80,723mn (up 11.3%), gross profit was ¥10,771mn (up 15.6%), operating income was ¥1,126mn (up 130.1%), and ordinary income was ¥1,540mn (up 61.7%). Profit attributable to owners of parent was ¥796mn (versus a loss of ¥95mn in the year-earlier period), and the balance carried forward remained at a high level of ¥167,809mn (up 14.1% YoY). The gross profit margin increased by 0.4 percentage points YoY to 13.3%, due to factors including rigorous cost management, progress made in improving operating efficiency continuing on from the previous fiscal period, as well as an increase in relatively highly-profitable industrial HVAC renewal works.

2. FY3/19 full year forecasts revised upwards

For FY3/19, the Company is forecasting orders received of ¥185,000mn (down 3.2% YoY), net sales of ¥199,000mn (up 17.0%), operating income of ¥8,200mn (up 24.4%), ordinary income of ¥8,900mn (up 19.7%), and profit attributable to owners of parent of ¥5,900mn (up 51.0%). These forecasts have been revised upwards from the Company's initial forecasts (net sales = ¥187,000mn; operating income = ¥7,500mn; ordinary income = ¥8,000mn; profit attributable to owners of parent = ¥5,500mn). These upward revisions are based on the fact that there is plentiful construction work at hand as well as the fact that there was an increase in both orders received and sales recorded during the same period, especially for industrial HVAC. Unless very unprofitable projects arise, these targets seem achievable. Further upward revisions are also likely.

3. Achieving the targets in "Century 2025" Phase 1, the medium-term management plan, is in sight

The Company is approaching the 100th anniversary of its establishment. In March 2015, it announced its long-term vision, "Century 2025," as a 10-year goal. 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 medium-term management plan, it has first set quantitative targets for FY3/19 of net sales of ¥195bn and operating income of ¥7.5bn. These targets already look achievable, as the forecasts have been revised upward to net sales of ¥199bn and operating income of ¥8.2bn. As for specific measures, the Company announced the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>, and it is making steady progress. The Sanki Techno Center, which is a comprehensive R&D and training facility that is a major pillar of this project, opened and began operation in October 2018.

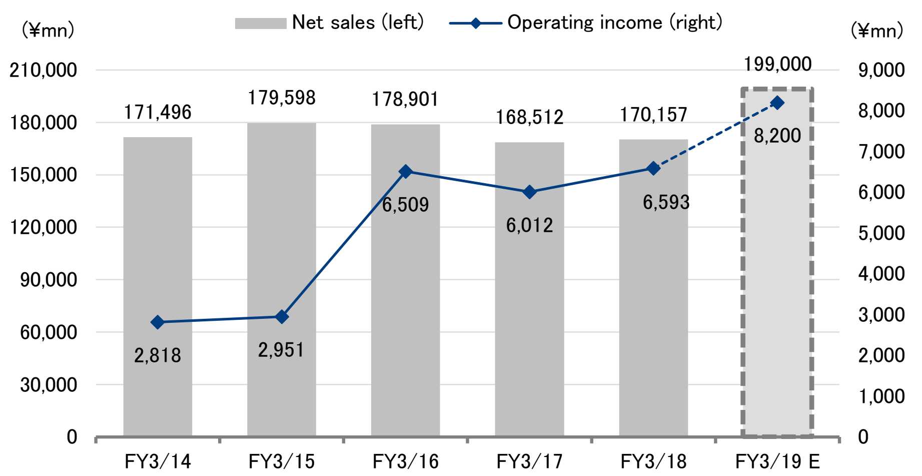
4. The Company has announced that its FY3/19 annual dividend will be ¥40, it retired an additional 1 million treasury shares, and it will buy back 1 million shares

In addition to paying a stable dividend as it has done in the past, and increasing dividends as it has done in recent years, the Company is also proactively returning profits to shareholders through acquiring treasury shares and other methods. In FY3/18, the Company paid an annual dividend of ¥35.0 (dividend payout ratio = 55.5%), and for FY3/19 the Company plans to pay and annual dividend of ¥40.0 (dividend payout ratio = 41.1%). In addition, as part of its measures to further return profits to shareholders, the Company retired 1 million treasury shares it owned (executed in November 2018), and plans to newly acquire up to 1 million additional treasury shares by March 2019. The Company's proactive initiatives to return profits to shareholders are worthy of praise.

Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Upwardly revised forecasts for FY3/19, expecting a 24.4% increase in operating income
- Actively returns profits to shareholders, newly retired 1 million treasury shares and announced a buyback of 1 million treasury shares

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. 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 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

Today, Sanki Engineering is 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. Subsequently, 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 policy it has taken.

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"
2018	Opened Sanki Techno Center, a comprehensive training and research facility (Yamato City, Kanagawa Prefecture)

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

Business description

Four 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. 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. The scope of activities handled by this business is extensive and can be further divided into the following sub-segments.

a) HVAC and plumbing for buildings

The HVAC and plumbing for buildings business provides HVAC, water supply and wastewater systems, plumbing, 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 for factories and research facilities of all industries, especially clean room systems for semiconductor plants and food processing plants, which are areas of strength for the Company, as well as special air-conditioning systems and appurtenances for manufacturers of medical systems, and the like; in addition to environmental control systems and so forth for 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 facilities and solutions covering all phases from planning and design, to installation, maintenance, repair, and replacement, depending on the life cycle of the building. This capability allows its customers to place one-stop shop orders to resolve their problems. By making use of "total engineering" and "life-cycle engineering," which combines a wide variety of businesses horizontally, the Company can provide optimal systems with high added value, and this comprises the Company's strength.

(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 and Tokyo Midtown Hibiya.

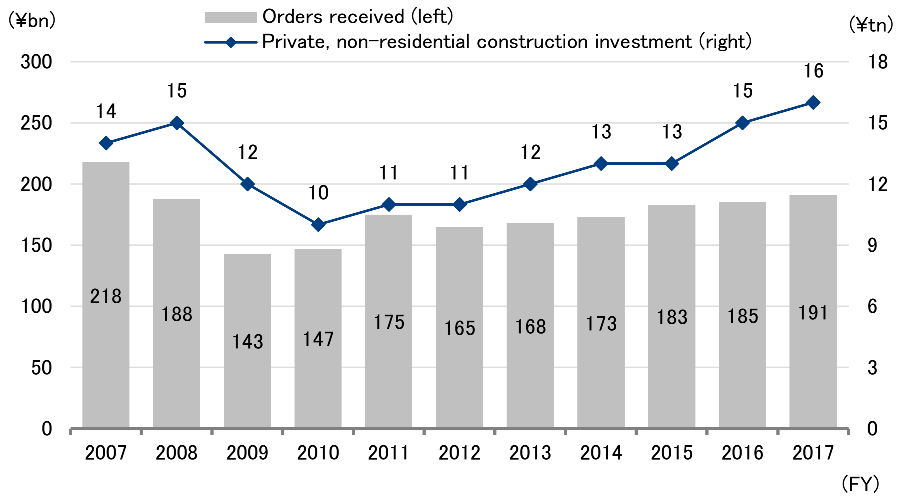
3. Main competitors

Sanki Engineering's competitors vary by project, but its main competitors among the comprehensive facility construction companies 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 strengths lie in its broad business domain and 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 construction investment. The correlation between orders received and private sector, non-residential construction 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

In 1H FY3/19, operating income increased 130.1% YoY Net sales were at a high level, up 11.3% YoY

1. 1H FY3/19 results overview

(1) Earnings

In 1H FY3/19, orders received were ¥103,819mn (up 8.4% YoY), net sales were ¥80,723mn (up 11.3%), gross profit was ¥10,771mn (up 15.6%), operating income was ¥1,126mn (up 130.1%), and ordinary income was ¥1,540mn (up 61.7%). Profit attributable to owners of parent was ¥796mn (versus a loss of ¥95mn in the year-earlier period). The balance carried forward was ¥167,809mn (up 14.1% YoY), remaining at a high level. The gross profit margin increased by 0.4 percentage points YoY to 13.3%, due to factors including rigorous cost management, and progress made in improving operating efficiency continuing on from the previous fiscal period.

For the Facilities Construction Business as a whole, orders received increased 22.9% YoY, and there was also a significant increase in orders received in industrial HVAC, centered on large-scale projects related to electrical machinery and semiconductors. HVAC and plumbing for buildings and electrical systems were also strong. Meanwhile, orders received for Plant & Machinery Systems Business declined 33.8% YoY, mainly due to the 47.2% YoY drop in Environmental Systems for which order volume was high in the previous fiscal year. Orders received for Machinery Systems were roughly flat YoY. The total orders amount, including in Real Estate Business and others, rose 8.4% YoY, and net sales increased 11.3% YoY due to the large increase in industrial HVAC and other factors. At the end of 1H FY3/19, the balance carried forward had increased 14.1% versus the end of 1H FY3/18, and maintained its high level.

1H FY3/19 results

(¥mn, %)

	1H FY3/18		1H FY3/19			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	95,775	-	103,819	-	8,044	8.4
Balance carried forward	147,026	-	167,809	-	20,784	14.1
Net sales	72,506	100.0	80,723	100.0	8,216	11.3
Gross profit	9,319	12.9	10,771	13.3	1,452	15.6
SG&A expenses	8,829	12.2	9,644	11.9	814	9.2
Operating income	489	0.7	1,126	1.4	637	130.1
Ordinary income	952	1.3	1,540	1.9	587	61.7
Profit attributable to owners of parent	-95	-	796	1.0	891	-

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) Factors behind reduced margins: 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 (which ended support operations in April 2018 after handing over these operations to branch offices), both established in April 2015. Designing work support through the Design & Engineering Support Center was formed in April 2016, and quality supervision has been carried out by technical experts. These efforts are paying off (in the form of improved operational efficiency).

On the other hand, the actual amount of SG&A expenses increased ¥814mn, but the SG&A expenses ratio fell from 12.2% in the same period of the previous fiscal year to 11.9%, due to the increase in net sales. The main factors behind the increase were the rise in normal expenses, the rise in costs related to the Yamato site redevelopment, the increase in R&D expenses, the increase in personnel hired, and a rise in personnel costs in conjunction with workstyle reforms, but each was within the expected range. However, these were absorbed by the higher gross profit, and operating income increased significantly YoY.

(2) Earnings by segment

Net sales and ordinary income by segment

(¥mn, %)

	1H FY3/18		1H FY3/19			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	72,506	100.0	80,723	100.0	8,216	11.3
HVAC and plumbing for buildings	27,802	38.3	27,111	33.6	-690	-2.5
Industrial HVAC	20,898	28.8	29,774	36.9	8,875	42.5
Electrical systems	8,785	12.1	8,647	10.7	-138	-1.6
Facility systems	3,687	5.1	4,460	5.5	773	21.0
Facilities Construction Business	61,173	84.4	69,993	86.7	8,819	14.4
Machinery Systems Business	4,522	6.2	4,377	5.4	-145	-3.2
Environmental Systems Business	6,139	8.5	6,132	7.6	-7	-0.1
Real Estate Business	860	1.2	923	1.1	62	7.3
Others	291	0.4	295	0.4	3	1.3
Adjustments	-482	-	-998	-	-516	-
Ordinary income	952	1.3	1,540	1.9	587	61.7
Facilities Construction Business	597	-	1,600	-	1,002	167.6
Machinery Systems Business	6	-	-78	-	-85	-
Environmental Systems Business	-789	-	-758	-	30	-
Real Estate Business	238	-	266	-	28	11.8
Others	42	-	26	-	-15	-35.9
Adjustments	856	-	483	-	-373	-

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

In the Facilities Construction Business, net sales were ¥69,993mn (up 14.4% YoY). By sub-segment, in HVAC and plumbing for buildings, net sales declined 2.5% YoY to ¥27,111mn, but this was not a bad result considering the fact that net sales in the year-earlier period were high. Net sales for industrial HVAC were excellent at ¥29,774mn (up 42.5% YoY), due to solid orders, particularly for the electrical machinery and semiconductor industries. This is an area of strength for the Company, and the increase in the sales ratio in this area contributed to the overall improvement in profitability. Net sales of electrical systems declined 1.6% to ¥8,647mn, but even so annual net sales were still in the ¥20,000mn range, and it was not a poor result. Net sales of facility systems increased 21.0% to ¥4,460mn, which was a strong result. Historically, HVAC and plumbing for buildings has been the largest sub-segment in the Facilities Construction Business, but in 1H FY3/19 the significant increase in industrial HVAC caused it to overtake the building HVAC and plumbing sub-segment.

Total net sales in Plant & Machinery Systems Business declined 1.4% YoY. In the Machinery Systems Business, net sales were ¥4,377mn (down 3.2%), while net sales in the Environmental Systems Business were ¥6,132mn (down 0.1%), so net sales were generally flat YoY. Other than facilities work segments, net sales in the Real Estate Business increased 7.3% YoY to ¥923mn, due to factors including the start of leasing part of the former Yamato Plant site to Nippon Life Insurance Company.

In ordinary income and loss by segment, the Facilities Construction Business recorded ordinary income of ¥1,600mn (up 167.6% YoY), Machinery Systems posted an ordinary loss of ¥78mn (versus a profit of ¥6mn in the year-earlier period), and Environmental Systems recorded an ordinary loss of ¥758mn (loss of ¥789mn in the year-earlier period). Also, the Real Estate Business and other businesses recorded ordinary income of ¥266mn (up 11.8%) and ¥26mn (down 35.9%), respectively.

(3) Orders by segment

Orders received by segment

(¥mn, %)

	1H FY3/18		1H FY3/19			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	95,775	100.0	103,819	100.0	8,044	8.4
HVAC and plumbing for buildings	28,860	30.1	32,385	31.2	3,524	12.2
Industrial HVAC	27,060	28.3	38,495	37.1	11,434	42.3
Electrical systems	10,394	10.9	12,013	11.6	1,618	15.6
Facility systems	5,487	5.7	5,350	5.2	-137	-2.5
Facilities Construction Business	71,803	75.0	88,244	85.0	16,440	22.9
Machinery Systems Business	6,506	6.8	6,536	6.3	30	0.5
Environmental Systems Business	16,634	17.4	8,776	8.5	-7,857	-47.2
Real Estate Business	860	0.9	923	0.9	62	7.3
Others	305	0.3	320	0.3	15	5.1
Adjustments	-335	-	-982	-	-647	-

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

In the Facilities Construction Business as a whole, orders received were ¥88,244mn (up 22.9% YoY). By sub-segment, in HVAC and plumbing for buildings, orders received were solid, and increased to ¥32,385mn (up 12.2%). In industrial HVAC, orders were ¥38,495mn (up 42.3%), and the large increase was due to factors including orders for large-scale projects related to electrical machinery and semiconductors industries. In electrical systems, orders received were a solid ¥12,013mn (up 15.6%). In facility systems, orders were ¥5,350mn (down 2.5%), a small YoY decline but still a solid level.

In the Plant & Machinery Systems Business, orders received for Machinery Systems were flat YoY at ¥6,536mn (up 0.5%), but this was a good result considering the fact that large-scale orders were received in the year-earlier period (orders received in 1H FY3/17 totaled ¥3,287mn). On the other hand, for Environmental Systems, orders declined significantly by 47.2% to ¥8,776mn, but this was not a bad result considering the fact that orders received in the year-earlier period were abnormally high due to a large-scale DBO* project. As a result, in the Plant & Machinery Systems Business as a whole, orders received were ¥15,313mn (down 33.8%), and combined with Facilities Construction Business, in facilities work segments as a whole, orders were ¥103,557mn (up 9.1%).

* DBO (Design Build Operate) is a method for publicly-built, privately-operated projects with a collective order made to private companies (such as the Company) for design, building, and operations and maintenance management.

In areas other than facilities work segments, orders received in Real Estate Business totaled ¥923mn (up 7.3%), and orders received in Others totaled ¥320mn (up 5.1%). Total orders received in 1H FY3/19 (including adjusted amounts) was ¥103,819mn (up 8.4%), and a high level was maintained. As a result, the balance carried forward at the end of the fiscal period was ¥167,809mn (up 14.1% versus the end of the year-earlier period), staying at a high level.

There were a total of 9 orders for large-scale projects (¥1,000mn or more) worth ¥15,873mn (in the year-earlier period there were 8 orders worth ¥19,052mn, while in 1H FY3/17 there were 7 orders worth ¥17,852mn). On a YoY basis, there was an increase in the number of orders received and a decline in value, but if you take away the fact that there was a large DBO project in the year-earlier period, the average value per order is increasing.

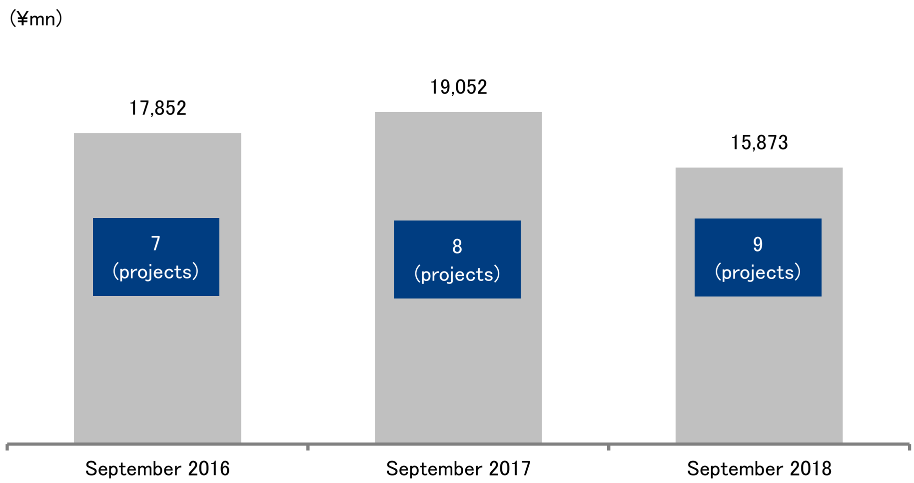
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(projects)

	September 2016	September 2017	September 2018
Offices	3	1	1
Hotels/inns	-	-	1
Factories	2	2	5
Research institutes	-	1	-
Logistics Center	-	-	1
Hospitals/convalescence institutions	-	-	1
Others	-	1	-
Railway and airport facilities	-	1	-
Power stations, substations	1	-	-
Waste processing facilities	-	2	-
Water and sewage treatment facilities	1	-	-
Total	7	8	9
Total (¥mn)	17,852	19,052	15,873

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

2. Financial condition

The financial condition at the end of 1H FY3/19 was that current assets were ¥111,664mn (down ¥11,236mn YoY), which was due to factors including a ¥9,690mn decline in notes and accounts receivable on completed construction contracts and others. Noncurrent assets were ¥58,446mn (up ¥4,333mn), which was primarily because of an increase in tangible noncurrent assets of ¥3,611mn on the fully-fledged redevelopment of the Yamato site, a ¥737mn increase in investments and other assets, and other factors. As a result, total assets at the end of 1H FY3/19 were ¥170,110mn (down ¥6,903mn).

Current liabilities were ¥65,731mn (down ¥8,055mn), mainly due to a ¥6,453mn decline in notes and accounts payable on construction contracts and others. Noncurrent liabilities were ¥17,414mn (up ¥378mn), with the main factors including a ¥788mn increase in deferred tax liabilities. As a result, total liabilities at the end of 1H FY3/19 were ¥83,145mn (down ¥7,677mn). Total net assets were ¥86,965mn (up ¥773mn). This was mainly due to factors including a ¥877mn increase in the valuation difference on other securities.

Condensed balance sheet

(¥mn)

	As of March 31, 2018	As of September 30, 2018	Change
Cash and deposits	43,866	37,195	-6,671
Notes and accounts receivable on completed construction contracts and others	64,458	54,767	-9,690
Current assets	122,901	111,664	-11,236
Tangible noncurrent assets	10,662	14,274	3,611
Intangible noncurrent assets	813	797	-15
Investments and other assets	42,636	43,374	737
Noncurrent assets	54,112	58,446	4,333
Total assets	177,014	170,110	-6,903
Notes and accounts payable on construction contracts and others	49,854	43,401	-6,453
Short-term loans	6,894	6,875	-18
Payments received for work in progress	3,439	5,679	2,240
Current liabilities	73,787	65,731	-8,055
Long-term loans	6,610	5,915	-695
Liability for retirement benefits	2,884	3,022	137
Deferred tax liabilities	2,187	2,976	788
Noncurrent liabilities	17,035	17,414	378
Total liabilities	90,822	83,145	-7,677
Total net assets	86,191	86,965	773

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

3. Cash flow conditions

In 1H FY3/19, cash flows from operating activities increased ¥1,434mn, mainly due to the fact that the ¥10,409mn collection in trade notes and accounts receivable exceeded the ¥6,014mn decline in trade notes and accounts payable. Cash flows from investing activities declined ¥2,051mn, which was primarily due to the ¥2,002mn decline by to acquisition of tangible noncurrent assets. Cash flows from financing activities declined ¥2,007mn, mainly due to the repayment of long-term loans of ¥695mn and ¥1,211mn in dividend payments.

As a result, the balance of cash and cash equivalents at the end of 1H FY3/19 had decreased ¥2,671mn from the end of the previous fiscal year to ¥42,195mn.

Condensed statement of cash flows

(¥mn)

	1H FY3/18	1H FY3/19
Cash flows from operating activities	1,556	1,434
Pretax profit	-182	1,389
Change in trade notes and accounts receivable (- indicates increase)	13,242	10,409
Change in trade notes and accounts payable (- indicates decrease)	-7,278	-6,014
Cash flows from investment activities	-2,599	-2,051
Cash flows from financing activities	-3,813	-2,007
Repayment of long-term loans	-170	-695
Purchase of treasury stock	-2,290	-0
Dividend payments	-1,271	-1,211
Change in cash and cash equivalents (- indicates decrease)	-4,827	-2,671
Cash and cash equivalents at end of period	34,359	42,195

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

● **FY3/19 outlook**

For FY3/19, the Company forecasts net sales of ¥199,000mn (up 17.0% YoY), operating income of ¥8,200mn (up 24.4%), ordinary income of ¥8,900mn (up 19.7%), and profit attributable to owners of parent of ¥5,900mn (up 51.0%). Based on the strong 1H results, these forecasts have been upwardly revised from the forecasts made at the start of the fiscal year. (The initial forecasts were net sales of ¥187,000mn, operating income of ¥7,500mn, ordinary income of ¥8,000mn, and profit attributable to owners of parent of ¥5,500mn.) Orders received are expected to be ¥185,000mn (down 3.2%), and the balance carried forward is expected to be ¥130,712mn (down 9.7%).

Breaking down net sales, in the Facilities Construction Business, they are forecast to be ¥163,200mn (up 16.8% YoY). By sub-segment, in HVAC and plumbing for buildings, sales are expected to be ¥63,300mn (down 0.8%), which is around the same as the previous fiscal year and maintaining the high level, partly because the previous year's level was high. In industrial HVAC, the forecast is for sales of ¥70,000mn (up 50.4%), as orders are strong. Sales of electrical systems are forecast to be basically unchanged YoY at ¥20,000mn (down 3.2%), and those of facility systems to increase to ¥9,900mn (up 13.9%). In the Plant & Machinery Systems Business, net sales are forecast to remain high at ¥12,000mn (up 29.7%) for Machinery Systems and to ¥22,000mn (up 10.5%) for Environmental Systems.

In the mainstay Facilities Construction business, orders received are forecast to be ¥152,200mn (down 0.8%), roughly flat YoY. By sub-segment, in HVAC and plumbing for buildings, orders are expected to be ¥58,400mn (down 6.2%), in industrial HVAC, ¥63,000mn (up 6.9%), in electrical systems, ¥21,000mn (down 7.4%), and in facility systems, ¥9,800mn (up 2.2%). In the Plant & Machinery Systems Business, the forecast for Machinery Systems is for orders of ¥12,000mn (down 0.8%), which is basically unchanged YoY, while in Environmental Systems orders are expected to be ¥19,000mn (down 21.6%), partly because orders were at high levels in the previous two fiscal years. As a result, as a whole, orders received are forecast to decrease 3.2% to ¥185,000mn.

FY3/19 forecast

(¥mn, %)

	FY3/18		FY3/19 E			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	191,113	100.0	185,000	100.0	-6,113	-3.2
HVAC and plumbing for buildings	62,274	32.6	58,400	31.6	-3,874	-6.2
Industrial HVAC	58,907	30.8	63,000	34.1	4,093	6.9
Electrical systems	22,675	11.9	21,000	11.4	-1,675	-7.4
Facility systems	9,585	5.0	9,800	5.3	215	2.2
Facilities Construction Business	153,443	80.3	152,200	82.3	-1,243	-0.8
Machinery Systems Business	12,100	6.3	12,000	6.5	-100	-0.8
Environmental Systems Business	24,247	12.7	19,000	10.3	-5,247	-21.6
Real Estate Business	1,755	0.9	1,800	1.0	45	2.6
Others	587	0.3	500	0.3	-87	-14.8
Adjustments	-1,020	-0.5	-500	-0.3	520	-
Net sales	170,157	100.0	199,000	100.0	28,843	17.0
HVAC and plumbing for buildings	63,782	37.5	63,300	31.8	-482	-0.8
Industrial HVAC	46,556	27.4	70,000	35.2	23,444	50.4
Electrical systems	20,653	12.1	20,000	10.1	-653	-3.2
Facility systems	8,695	5.1	9,900	5.0	1,205	13.9
Facilities Construction Business	139,688	82.1	163,200	82.0	23,512	16.8
Machinery Systems Business	9,254	5.4	12,000	6.0	2,746	29.7
Environmental Systems Business	19,909	11.7	22,000	11.1	2,091	10.5
Real Estate Business	1,755	1.0	1,800	0.9	45	2.6
Others	578	0.3	500	0.3	-78	-13.5
Adjustments	-1,030	-	-500	-	530	-
Gross profit	25,060	14.7	28,600	14.4	3,540	14.1
SG&A expenses	18,466	10.9	20,400	10.3	1,934	10.5
Operating income	6,593	3.9	8,200	4.1	1,607	24.4
Ordinary income	7,434	4.4	8,900	4.5	1,466	19.7
Profit attributable to owners of parent	3,906	2.3	5,900	3.0	1,994	51.0

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.

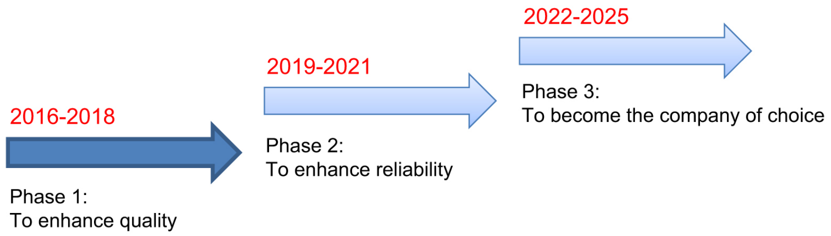
The gross profit margin in the previous fiscal year was at a high level (14.7%), but the Company plans to ensure a slightly lower level (14.4%) this fiscal year. It will do so by continuing to implement measures to improve profits, including establishing and enhancing on-site support systems, particularly by strengthening negotiating capabilities for the procurement of materials, and supporting on-site purchasing operations through ongoing integrated management by the Procurement Division. As a result of the above, if net sales are as expected, gross profit of ¥28,600mn (up 14.1% YoY) is expected. Meanwhile, SG&A expenses are expected to increase by 10.5% YoY to ¥20,400mn, partly due to the leveling off of higher-than-normal expense increases. As a result, the Company is expecting operating income of ¥8,200mn (up 24.4%).

Medium-term management plan

STeP Project starts in earnest

1. The Long-Term Vision "Century 2025"

The Company has announced a 10-year long-term vision "Century 2025" that covers from fiscal 2016 to fiscal 2025, 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.

Source: Prepared by FISCO from the Company's materials

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) Start of operations for entire Sanki Techno Center

The biggest goal in "Century 2025" Phase 1 is "improving the quality of technologies and human resources," and one of major pillars for initiatives to achieve this goal is the plan to construct the Sanki Techno Center. In this plan, it renovated the former A-block of the Sanki Yamato Buildings, turning it into the Sanki Techno Center (six above-ground floors and one underground floor, with a total area of approximately 45,000 square meters) as a comprehensive research and training facility. The new Technical Research & Development Institute (renamed the "R&D Center" from December 2018) started operations in March 2018, and the entire complex commenced full operation in October 2018.

(2) Reorganizing manufacturing plants in the Machinery Systems Business

Toward "reorganizing manufacturing plants in the Machinery Systems Business," the Company has announced it will build 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, the machinery systems plant has been temporarily relocated to the Shonan area, and the new plant started construction in May 2018 and is scheduled to commence operations around August 2019.

(3) The completion of the dismantling of the Yamato Plant facilities

The Company progressed the dismantling of the various facilities in the Yamato Plant, which was comprised of the above-described machinery systems manufacturing plant, the former Technical Research & Development Institute, and other buildings, and it completed the dismantling work in April 2018. The costs of this dismantling work and the loss on the disposal of noncurrent assets had already been recorded in the FY3/18 results. Following the completion of this dismantling work, the plan is to construct the above described new machinery systems plant on one part of this land, while the Company decided 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 was leased to Nippon Life in June 2018, so going forward, sales and profits in the Real Estate Business can be expected to further accumulate.

(4) Quantitative target of ¥7,500mn in operating income is completely within reach

Also, as a quantitative target for “Century 2025” Phase 1, the Company has set a target of operating income of ¥7,500mn in FY3/19, the final fiscal year of Phase 1. It appears that this goal is completely within reach, given the fact that the forecast for this fiscal year (FY3/19) was upwardly revised to ¥8,200mn.

The forecasts for “Century 2025” Phase 2, the subsequent medium-term management plan, are expected to be announced in the spring of 2019. We are looking forward to seeing what level of profit the Company is targeting.

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 in this fiscal year is described below.

(1) Development of new technology

a) Development of energy-saving HVAC system (DOUP™) for clean rooms
b) Development of Heat Stroke Monitoring System using IoT sensor network to protect workers at construction sites
c) Market rollout of aluminum refrigerant piping method “Aluminger”
d) Market rollout of one of the world’s fastest conveyor and sorting devices (Cross-Belt Sorter)

(2) Work-style reforms

a) Entered the fourth year of the Company’s unique work-style reform “Smile Project”
b) Continuing the “Smile Site Plan” committee, which is focusing on workstyle reforms at construction sites
c) Office reform, which includes work-style reforms (NEW OFFICE Project)

(3) Social contributions

a) Donations and tree-planting through “SANKI YOU Eco Contribution Points”
b) Tree-planting and conservation activities at events at the Sanki Forest and others
c) Participation in the Water sprinkling event held by the Bureau of Environment of the Tokyo Metropolitan Government
d) Supporting 7-man rugby for persons with hearing disabilities
e) Continuing earthquake disaster reconstruction project

(4) From the perspective of ESG

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

a) Environment (E)

1) Continuing donations of "SANKI YOU Eco Contribution Points"
2) "DOUP™" energy-saving HVAC system for clean rooms

b) Society (S)

1) Entered the fourth year of the Company's unique work-style reform "Smile Project"
2) Office reform, which includes work-style reforms (NEW OFFICE Project)
3) "Heat Stroke Monitoring System" to protect workers on construction sites
4) Inculcation of SDGs in company (corporate ethics training, integrated reports)

c) Governance (G)

1) Changed the Board of Directors composition
   Added 2 directors to create an organization of 5 non-executing directors (2 internal, 3 external)
   Added 1 auditor to create a system of 5 auditors (2 internal, 3 external)
2) Continued to conduct meetings for directors with expertise in the corporate governance code to exchange opinions
3) Dialogue with shareholders (increased the number of opportunities for dialogue, and, held briefing sessions for individual investors)
4) Considering of capital policy in light of capital costs
5) Continuous revision of strategically held shares

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. Its basic policy had been to pay an annual, ordinary dividend of ¥20, but as the FY3/17 results were strong, it also paid an extra period-end dividend of ¥10 for an annual dividend of ¥30 (dividend payout ratio, 40.6%). Further, in FY3/18, in addition to the regular dividend (¥20), it paid an interim extra dividend of ¥5 and period-end extra dividend of ¥10, meaning the annual dividend increased by ¥5 YoY to ¥35 (dividend payout ratio, 55.5%). For the FY3/19 annual dividend, the Company has already paid an interim dividend of ¥20 (interim dividend in FY3/18 was ¥15), and right now the Company plans to pay a ¥20 year-end dividend, which would make the annual dividend ¥40. However, these are the plans for the regular dividend (annual dividend of ¥40), so the Company may further increase the dividend depending on future operating results and progress on achieving the goals of "Century 2025" Phase 1.

Also, as part of its measures to return profits to shareholders, the Company has actively acquired its treasury shares on the stock market and retired them. On November 16, 2018, the Company retired 1 million of the treasury shares it held, and announced that it will newly acquire 1 million treasury shares (up to a maximum of ¥1,400mn).

A table of the share buybacks and dividend payments that the Company made (or plans to make) from FY3/14 through FY3/19 shows the total amount to be ¥19,838mn. During this period, the total return ratio (weighted average), which is the ratio of the total return to the total profit attributable to owners of parent (use the forecast for FY3/19), has been 82.5%. We feel that the Company's proactive stance on shareholder returns should be highly praised.

Shareholder returns

	Share buybacks		Dividend amount	Amount of shareholder returns	Profit attributable to owners of parent
	No. of shares	Amount (¥mn)			
FY3/19 E	1,000,000	1,400	2,546	3,946	5,900
FY3/18	3,000,000	3,679	2,136	5,815	3,906
FY3/17	0	0	1,906	1,906	4,698
FY3/16	0	0	1,906	1,906	5,327
FY3/15	2,000,000	1,604	1,270	2,874	2,461
FY3/14	4,000,000	2,408	983	3,391	1,763
			Total	19,838	24,055
			Total return ratio (weighted average)		82.5%

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

Disclaimer