COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange First Section

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Summary

A comprehensive engineering company conducting the Facilities Construction Business and the Plant & Machinery Systems Business 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 equipment 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 nearly 100 years.

1. 1H FY3/21: Orders received increased 2.3% despite 12.0% YoY decrease in net sales

In 1H FY3/21, the Company reported ¥103,236mn in orders received (up 2.3% YoY), ¥80,864mn in net sales (down 12.0%), ¥10,757mn in gross profit (down 18.3%), ¥505mn in operating income (down 84.2%), ¥842mn in ordinary income (down 75.9%), and ¥821mn in profit attributable to owners of parent (down 66.9%). Balance carried forward was ¥158,534mn (down 0.2% from the end of the previous fiscal year), largely unchanged YoY. Gross profit margin decreased 1.0ppt YoY to 13.3%, amid a scenario where it had been particularly high in 1H FY3/20. Nevertheless, thanks to ongoing thorough cost management and reinforcement of site support systems, it held to a level on par with that of 1H FY3/19 when it was also 13.3%. Meanwhile, whereas the COVID-19 pandemic weighed on small and miscellaneous orders received and other aspects of business, it seems to have had a negligible effect on the financial results for 1H FY3/21 overall. The Company made unassuming progress in carrying out Phase 2 of its "Century 2025" medium-term management plan.

2. FY3/21 forecast: Initial operating income forecast projecting 15.7% decrease relative to FY3/20 remains unchanged

The initial forecasts for FY3/21 remain unchanged despite uncertainties regarding effects of COVID-19. Accordingly, the Company forecasts ¥190,000mn in orders received (down 2.1% YoY), ¥200,000mn in net sales (down 3.7%), ¥9,000mn in operating income (down 15.7%), ¥9,500mn in ordinary income (down 15.4%), and ¥6,500mn in profit attributable to owners of parent (down 14.2%). These levels are on track with original plan targets for the second year of "Century 2025" Phase 2. The Company explains that "we intend to steadily promote the "Century 2025" Phase 2 plan despite possible impact on results if COVID-19 impact spreads further and lasts for a longer period than expected."

3. Promoting the targets in "Century 2025" Phase 2, the medium-term management plan

In March 2016, the Company announced "Century 2025" as its long-term version as a10-year goal toward the 100th anniversary of its foundation. It has positioned the first three years of this plan as "Century 2025" Phase 1, and for FY3/19, which is the final fiscal year of Phase 1, the Company have achieved the numerical targets it had set, which was net sales of ¥195bn and operating income of ¥7.5bn, but it has already achieved these targets. Following on from this, it has announced Phase 2, and while the three key initiatives are a continuation of Phase 1, it has added "Disclose financial & capital policies and ESG policies" and "Reinforce Information Transmission." It has also set management targets in addition to financial performance targets in its quantitative targets for FY3/22, including an ordinary profit margin of 5.0% or above, an annual dividend of ¥60 or above, the acquisition of 5mn or more treasury stock (three years from FY3/20), total return ratio of 70% or above, and ROE of 8.0% or above. Despite uncertainty about COVID-19 impact, the Company has not changed the targets at this point and intends to continue moving forward with plan measures.

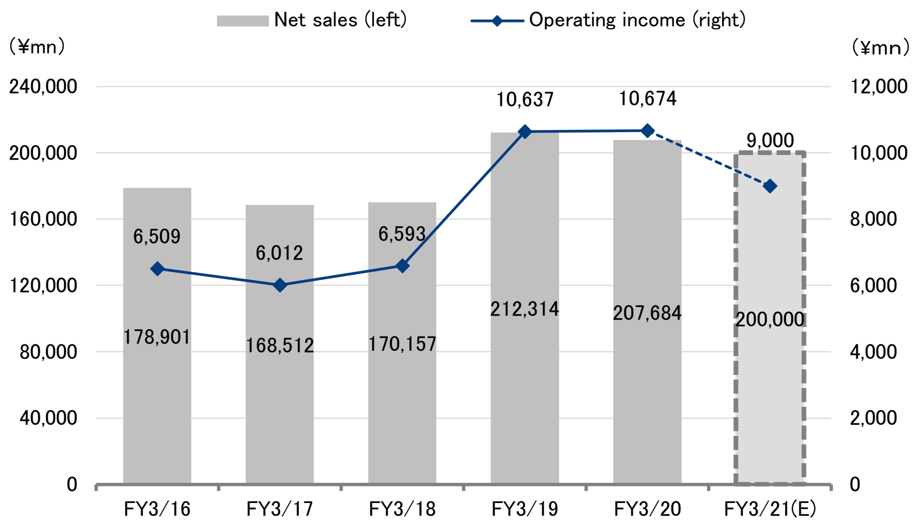
4. Completing acquisition of 1,000,000 treasury stock in FY3/21 while also maintaining a ¥70 annual dividend

The Company has proactively conducted shareholder return with a stable dividend up to now, dividend hikes in recent years, and share buybacks. It paid a ¥60 dividend in FY3/19 and a ¥95 dividend in FY3/20 (including a ¥25 extra dividend) and intends to pay a ¥70 regular dividend again in FY3/21. The Company retired 1,000,000 treasury stock in August 2020, and has furthermore completed acquisition of 1,000,000 treasury stock as of October 31, 2020. As a result, the Company projects a dividend payout ratio of 61.6% and a total return ratio of 79.6%. This puts the Company on track to achieving 83.33% average comprehensive return (weighted average) over the past eight years, including FY3/21. As such, we think the Company is deserving of high marks for its proactive shareholder return policy.

Key Points

- Mitsui-affiliated, domestically-leading facilities company that is currently implementing measures to improve the profit margin
- Projects 15.7% decline in FY3/21 operating income, though this level is on track with the medium-term plan and in line with expectations
- The Company takes a positive approach to shareholder returns in that it targets a ¥70 annual dividend and anticipates a 79.6% total return ratio inclusive of its acquisition of treasury stock

Results trends



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

Company outline

One of the largest facilities construction company in Japan. As a Mitsui-affiliate, it has a history of nearly 100 years.

1. Company outline

Sanki Engineering is a facilities 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 the war, the Company steadily grew on robust construction demand and surpassed ¥1bn in capital in 1958. 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 company. The Company's shares were listed on the Tokyo Stock Exchange in 1950.

2. History

In April 2015, prior to the 90th anniversary of its establishment in FY3/16, the Company appointed Mr. Tsutomu Hasegawa as President and Representative Director. The Company subsequently announced the “Century 2025” long-term vision headed toward its 100th anniversary in 2025 in March 2016. It completed Phase 1 in FY3/19, the first step, reaching initial targets. Furthermore, since April 2020, it is promoting Phase 2 under Hirokazu Ishida as the new President.

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
2016	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)
2019	Opened the Yamato Product Center, and completed the STeP (Sanki Techno Park) project

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

Business description

4 main segments, with a focus on the Facilities Construction Business

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 provide 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.

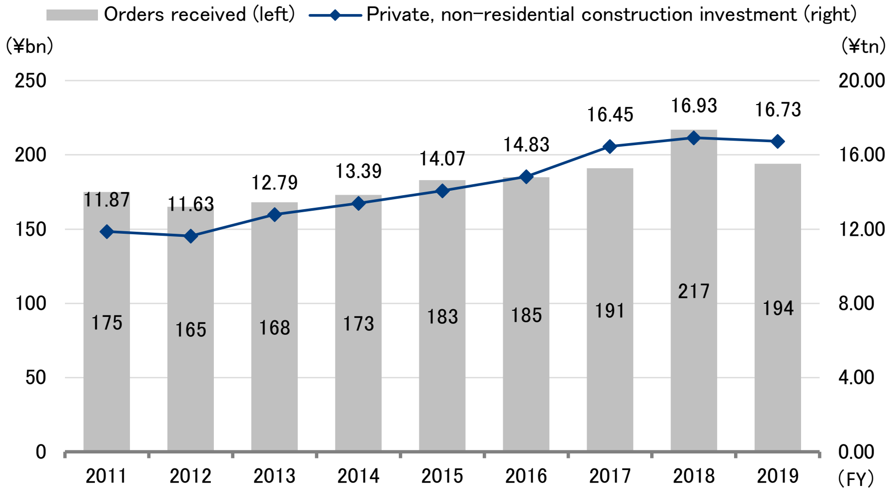
3. Main competitors

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 from the Company's financial results and the "Integrated Statistics on Construction Work," Ministry of Land, Infrastructure, Transport and Tourism

Business trends

Net sales decreased 12.0% YoY despite increase in orders received of 2.3% in 1H FY3/21, and balance carried forward stayed at high level of ¥158.5bn

1. 1H FY3/21 results overview

(1) Earnings

In the 1H FY3/21 results, orders received were ¥103,236mn (up 2.3% year-on-year (YoY)), balance carried forward was ¥158,534mn (down 0.2%), net sales were ¥80,864mn (down 12.0%), gross profit was ¥10,757mn (down 18.3%), operating income was ¥505mn (down 84.2%), ordinary income was ¥842mn (down 75.9%), and profit attributable to owners of parent was ¥821mn (down 66.9%). The downturn in earnings aside, the notion that the Company maintains a substantial balance of projects outstanding is attributable to solid efforts.

Orders received exceeded those of the same period of the previous fiscal year due to orders generated for large projects particularly those involving semiconductors, despite a decrease in small and miscellaneous projects due to the COVID-19 pandemic. Meanwhile, net sales decreased as a result of the Company having completed large projects during its off-season, and also because the COVID-19 pandemic caused a downturn in net sales from small and miscellaneous projects.

In terms of earnings, the gross profit margin was 13.3% as a result of the Company having taken profit improvement measures that largely involved ongoing thorough cost management and reinforcement of site support systems. Although that constitutes a decrease of 1.0ppt YoY, it is safe to say that the gross profit margin has been holding to high levels given that it was unusually high during 1H FY3/20 as a result of the Company having completed profitable large projects during that period. Incidentally, the gross profit margin in 1H FY3/19 was 13.3%. As a result, gross profit was ¥10,757mn (down 18.3% YoY).

Meanwhile, SG&A expenses were ¥10,251mn (up 2.8% or ¥275mn YoY). This is a result of the Company having incurred expenses for addressing COVID-19 and higher personnel costs, and despite lower business trip expenses due to the COVID-19 pandemic. The higher personnel costs are somewhat attributable to a higher headcount, but largely due to the Company having improved employee benefits and working conditions in alignment with work-style reforms. As a result, operating income was ¥505mn (down 84.2%).

1H FY3/20 results

(¥mn)

	1H FY3/20		1H FY3/21			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	100,901	-	103,236	-	2,334	2.3%
Balance carried forward	158,885	-	158,534	-	-351	-0.2%
Net sales	91,845	100.0%	80,864	100.0%	-10,980	-12.0%
Gross profit	13,168	14.3%	10,757	13.3%	-2,410	-18.3%
SG&A expenses	9,976	10.9%	10,251	12.7%	275	2.8%
Operating income	3,191	3.5%	505	0.6%	-2,686	-84.2%
Ordinary income	3,503	3.8%	842	1.0%	-2,660	-75.9%
Profit attributable to owners of parent	2,485	2.7%	821	1.0%	-1,663	-66.9%

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

(2) Earnings by segment

Net sales and gross profit by segment

(¥mn)

	1H FY3/20		1H FY3/21			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	91,845	100.0%	80,864	100.0%	-10,980	-12.0%
Facilities Construction Business	78,237	85.2%	67,807	83.9%	-10,430	-13.3%
HVAC and Plumbing for Buildings	32,580	35.5%	22,614	28.0%	-9,965	-30.6%
Industrial HVAC	30,849	33.6%	29,355	36.3%	-1,494	-4.8%
Electrical Systems	9,845	10.7%	11,440	14.1%	1,595	16.2%
Facility Systems	4,962	5.4%	4,397	5.4%	-565	-11.4%
Machinery Systems Business	5,294	5.8%	4,459	5.5%	-835	-15.8%
Environmental Systems Business	7,413	8.1%	7,610	9.4%	196	2.7%
Real Estate Business	1,050	1.1%	1,179	1.5%	128	12.3%
Others	443	0.5%	366	0.5%	-76	-17.3%
Adjustments	-593	-	-557	-	36	-
Gross profit	13,168	14.3%	10,757	13.3%	-2,410	-18.3%
Facilities Construction Business	11,390	14.6%	9,039	13.3%	-2,350	-20.6%
Building HVAC, Industrial HVAC, Electrical Systems	10,565	14.4%	8,375	13.2%	-2,189	-20.7%
Facility Systems	824	16.6%	663	15.1%	-160	-19.5%
Machinery Systems Business	998	18.9%	707	15.9%	-291	-29.2%
Environmental Systems Business	386	5.2%	655	8.6%	269	69.7%
Real Estate Business	318	30.3%	443	37.6%	125	39.3%
Others	124	28.4%	16	4.4%	-107	-86.6%
Adjustments	-49	-	-105	-	-55	-

Note: From FY3/20, segment profits are disclosed as gross profit
Source: Prepared by FISCO from the Company's Summary of Financial Results

The Facilities Construction Business posted ¥67,807mn in net sales (down 13.3% YoY). In sub-segments, HVAC and plumbing for buildings was down 30.6% to ¥22,614mn. Although results from large projects were in line with expectations, there was a decrease in small and miscellaneous net sales involving establishments such as hotels and department stores due to the COVID-19 pandemic. Sales of industrial HVAC remained relatively high yet decreased slightly by 4.8% YoY to ¥29,355mn. Sales of electrical systems were upbeat, having increased 16.2% YoY to ¥11,440mn. Facility systems was down 11.4% to ¥4,397mn.

Total net sales in the Plant & Machinery Systems Business was down 5.0% YoY to ¥12,069mn. Sales in the Machinery Systems Business decreased to ¥4,459mn (down 15.8%) as a result of the Company not landing conveyor-related projects and other small projects as a result of it having voluntarily curtailed its business activities. Environmental Systems Business had ¥7,610mn (up 2.7%) mainly on progress in a major DBO* project booked as an order previously. Besides these facility business segments, the Real Estate Business recorded ¥1,179mn in net sales (up 12.3%), including the boost from starting rental of a portion of the former Yamato Plant site to Nippon Life Insurance Company, and Others posted ¥366mn in net sales (down 17.3%).

* 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.

The Company discloses gross profit and ordinary income as segment profit values from FY3/20. Our report uses gross profits. In 1H FY3/21, whereas gross profit in the Facilities Construction Business decreased to ¥9,039mn (down 20.6% YoY for a decrease of ¥2,350mn), roughly speaking approximately ¥1,400mn of the downturn was attributable to lower sales and approximately ¥1,000mn of the downturn was attributable to lower profit margins. In the sub-segments, gross profit was ¥8,375mn (down 20.7%) in the HVAC and plumbing for buildings, industrial HVAC, and electrical systems sub-segments, and was ¥663mn (down 19.5%) in the facility systems sub-segment. Gross profit in the Plant & Machinery Systems Business was ¥1,362mn (down 1.6% for a decrease of ¥22mn), which consists of ¥707mn (down 29.2%) in the Machinery Systems Business and ¥655mn (up 69.7%) in the Environmental Systems Business. In the Real Estate Business and Others, gross profits were ¥443mn (up 39.3%) and ¥16mn (down 86.6%), respectively.

(3) Orders received by segment

Orders received by segment

(¥mn)

	1H FY3/20		1H FY3/21			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	100,901	100.0%	103,236	100.0%	2,334	2.3%
HVAC and Plumbing for Buildings	32,810	32.5%	33,153	32.1%	342	1.0%
Industrial HVAC	28,741	28.5%	34,553	33.5%	5,811	20.2%
Electrical Systems	12,198	12.1%	9,802	9.5%	-2,395	-19.6%
Facility Systems	5,905	5.9%	5,393	5.2%	-512	-8.7%
Facilities Construction Business	79,656	78.9%	82,902	80.3%	3,246	4.1%
Machinery Systems Business	5,479	5.4%	4,268	4.1%	-1,211	-22.1%
Environmental Systems Business	14,933	14.8%	15,049	14.6%	115	0.8%
Real Estate Business	1,050	1.0%	1,179	1.1%	128	12.3%
Others	324	0.3%	274	0.3%	-50	-15.5%
Adjustments	-543	-	-438	-	104	-

Source: Prepared by FISCO from the Company's Summary of Financial Results

The Facilities Construction Business booked ¥82,902mn in orders received (up 4.1% YoY). As such, the amount of orders received in 1H gives rise to the likelihood of the amount exceeding ¥100bn for a third consecutive fiscal year. By sub-segment, orders received were ¥33,153mn (up 1.0%) in HVAC and plumbing for buildings and ¥34,553mn (up 20.2%) in industrial HVAC, culminating in YoY in both sub-segments. The industrial HVAC sub-segment achieved particularly favorable results in terms of orders received from semiconductor-related, 5G-related, and R&D-related business. Whereas orders received in the electrical systems sub-segment decreased to ¥9,802mn (down 19.6%), the lower amount does not seem to pose cause for concern given that the sub-segment continues to generate orders of around ¥10bn. Orders received in facility systems were ¥5,393mn (down 8.7%), which seems relatively strong given that the amount is at the same level as that achieved in FY3/19.

As for the Plant & Machinery Systems Business, orders received in the Machinery Systems Business decreased to ¥4,268mn (down 22.1% YoY) largely resulting from a loss of small orders due to the COVID-19 pandemic. Meanwhile, orders received in the Environmental Systems Business were ¥15,049mn (up 0.8%), thereby holding to high levels on par with the previous fiscal year. As a result, orders received in the Plant & Machinery Systems Business totaled ¥19,318mn (down 5.4%), and together with the Facilities Construction Business, orders received for the facilities work segments overall reached ¥102,221mn (up 2.1%).

In areas other than facilities work segments, orders received in the Real Estate Business totaled ¥1,179mn (up 12.3%), and in Others totaled ¥274mn (down 15.5%). Total orders received in 1H FY3/21 (including adjusted amounts) was ¥103,236mn (up 2.3%). Balance carried forward at the end of 1H FY3/21 hence worked out to ¥158,534mn (down 0.2%).

Orders for large-scale projects (orders exceeding ¥1,000mn) totaled ¥26,427mn with 14 projects. Orders received increased in terms of both quantity and monetary value relative to the same period of the previous fiscal year, yet the average monetary value per single order fell below that of the previous fiscal year to ¥1,887mn (relative to ¥2,707mn in the same period of the previous fiscal year).

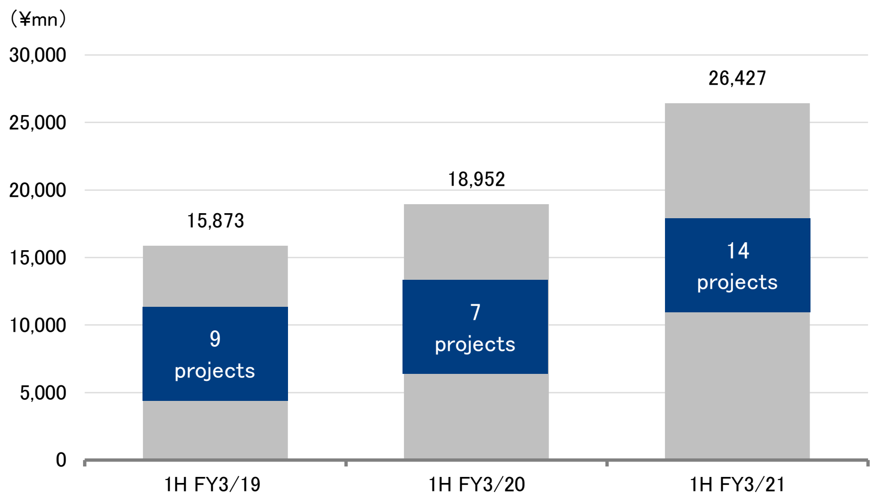
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(projects)

	1H FY3/19	1H FY3/20	1H FY3/21
Office	1	-	3
Hotel	1	-	-
Factory	5	2	3
Research institute	-	-	3
Logistics Center	1	-	-
Hospital and Clinics	1	1	1
Other building interiors	-	2	1
Railway, Airport	-	-	1
Waste processing facility	-	1	1
Water treatment plants and sewage plants	-	1	1
Total	9	7	14
Total (¥mn)	15,873	18,952	26,427

Source: Prepared by FISCO from the Company's Summary of Financial Results

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



Source: Prepared by FISCO from the Company's Summary of Financial Results

2. Financial condition

In financial conditions at the end of 1H FY3/21, current assets totaled ¥97,739mn (down ¥33,025mn YoY) with main changes of a ¥14,567mn decrease in cash and deposits and a ¥23,422mn decline in notes and accounts receivable on completed construction contracts and other. Noncurrent assets were ¥51,948mn (up ¥1,908mn), which was primarily because of an increase in investments and other assets of ¥1,807mn. As a result, total assets at the end of 1H FY3/21 were ¥149,688mn (down ¥31,117mn).

Current liabilities were ¥52,395mn (down ¥27,309mn), mainly due to a ¥20,044mn decrease in notes and accounts payable on construction contracts and other. Noncurrent liabilities were ¥11,129mn (down ¥2,605mn), with the main factors including a decrease of ¥525mn in long-term loans payable and a decrease of ¥2,322mn in liability for retirement benefits. As a result, total liabilities at the end of 1H FY3/21 were ¥63,525mn (down ¥29,915mn). Total net assets totaled ¥86,163mn (down ¥1,201mn), mainly due to a ¥4,060mn decrease in retained earnings from payment of dividends, a ¥1,367mn decrease in retirement of treasury stock, and a ¥1,286mn increase in unrealized gains on available-for-sale securities.

Condensed balance sheet

(¥mn)

	FY3/20	1H FY3/21	YoY change
Cash and deposits	44,946	30,378	-14,567
Notes and accounts receivable on completed construction contracts and other	71,739	48,317	-23,422
Current assets	130,765	97,739	-33,025
Tangible noncurrent assets	13,957	14,035	77
Intangible noncurrent assets	679	703	24
Investments and other assets	35,403	37,210	1,807
Noncurrent assets	50,040	51,948	1,908
Total assets	180,805	149,688	-31,117
Notes and accounts payable on construction contracts and other	52,489	32,444	-20,044
Short-term loans payable	6,869	6,699	-169
Advances received on uncompleted construction contract	7,493	7,147	-345
Current liabilities	79,705	52,395	-27,309
Long-term loans payable	3,850	3,325	-525
Liability for retirement benefits	3,465	1,143	-2,321
Noncurrent liabilities	13,735	11,129	-2,605
Total liabilities	93,440	63,525	-29,915
Total net assets	87,364	86,163	-1,201

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

3. Cash flow conditions

In 1H FY3/21, net cash used in operating activities was ¥7,258mn. The main inflows were ¥517mn in profit before income taxes, ¥825mn in depreciation and amortization, and a decrease of ¥22,686mn in notes and accounts receivable on completed construction contracts and other. The main outflows were a decrease of ¥20,035mn in notes and accounts payable on construction contracts and other, a decrease of ¥2,099mn in liability for retirement benefits (contributions to benefit trust assets), and a decrease of ¥4,065mn in other current liabilities. Net cash used in investment activities was ¥897mn. The main outflows were ¥852mn in purchase of property, plant and equipment. Net cash used in financing activities was ¥4,390mn. The main outflows were a net decrease of ¥695mn in short- and long-term loans payable, ¥133mn in purchase of treasury stock and ¥3,458mn in cash dividends paid.

Cash and cash equivalents hence decreased ¥12,568mn in 1H FY3/21 to a period-end balance of ¥33,378mn.

Condensed statement of cash flows

(¥mn)

	1H FY3/20	1H FY3/21
Cash flows from operating activities	5,369	-7,258
Profit before income taxes	3,613	517
Change in notes and accounts receivable on completed construction contracts and other (- indicates increase)	29,496	22,686
Change in notes and accounts payable on construction contracts and other (- indicates decrease)	-23,810	-20,035
Cash flows from investment activities	-584	-897
Purchase of property, plant and equipment	-1,375	-852
Cash flows from financing activities	-3,184	-4,390
Change in short- and long-term loans payable (- indicates decrease)	-695	-695
Cash dividends paid	-2,383	-3,458
Change in cash and cash equivalents (- indicates decrease)	1,554	-12,568
Cash and cash equivalents at end of period	44,865	33,378

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

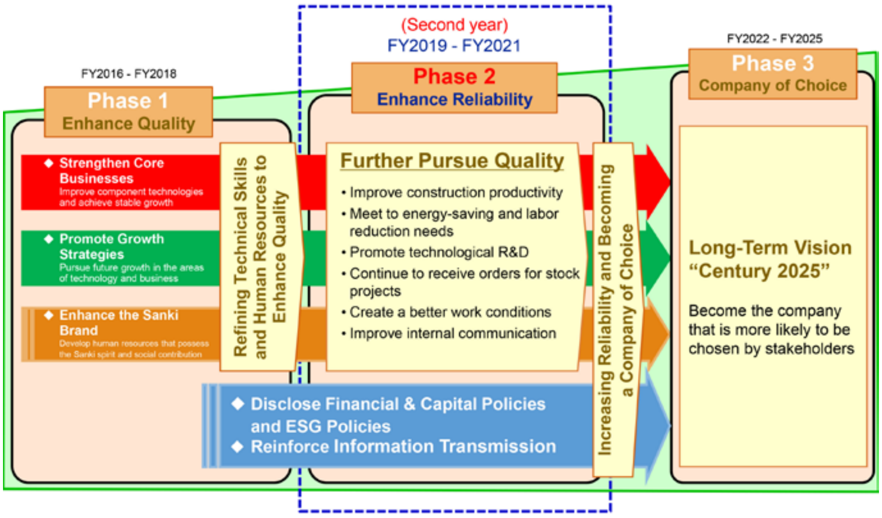
Medium-term management plan

Promoting “Century 2025” Phase2

1. What is the “Century 2025” long-term vision?

The Company has announced a 10-year long-term vision “Century 2025” that covers from FY3/17 to FY3/26, 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.

Long-term vision “Century 2025”



Source: Company’s Status of Business Progress in the Medium-Term Management Plan

2. Progress achieved under major initiatives

(1) Strengthen core businesses

a) Facilities Construction

Improved construction quality: The Company has made progress in carrying out initiatives that include: 1) establishing the Quality Control Center, 2) Streamlining operations through use of autonomous airflow measurement robots, and 3) streamlining construction management operations by drawing on digital information that includes building information modeling (BIM).

Established a construction framework that includes partner companies: The Company overhauled terms and conditions of payment for partner companies, thereby requiring that any partner company with paid-in capital amounting to less than ¥40mn make payment in cash with respect to all business operations of such partner company.

b) Facility Systems

Providing new consulting services: The Company newly established the Consulting Promotion Section. The Company also designed work styles aligned with the needs of different companies (work-style consulting services).

c) Machinery Systems

Expanded hybrid system products and services to cater to labor reduction and automation needs: The Company has been achieving steady growth with respect to order received and sales of hybrid equipment.

d) Environmental Systems

Expanded energy conservation and energy generation business fields: The Company received orders for the Kitatama Water Reclamation Center No. 1 Sludge Incineration Systems Reconstruction Project (Tokyo). Having installed its first supercharged fluidized bed incinerator equipped with a binary power generation system, the Company has achieved substantial energy savings while reducing carbon dioxide emissions and creating energy by generating power.

(2) Growth strategy: Promotion of stock-based business for the future

a) Clean Hill Tenzan

The energy recovery-type waste treatment facility Clean Hill Tenzan was completed in March 2020. It was the Group's first new construction project involving a design-build-operate (DBO) order. It constituted a large life-cycle engineering (LCE) project with respect to which the Company maintains responsibility for construction and Sanki Kako Kensetsu Co., Ltd. maintains responsibility for its operation over a period of 20 years.

b) Other: Orders to be completed in the future (¥1,000mn or more)

This consists of 14 projects including new construction and expansion.

Orders to be completed in the future (¥1,000mn or more)

Property name	Category of project	Type of project
Kurita Water Industries Ltd. New Research and Development Facility Construction Project (provisional name)	HVAC systems	New construction
KANAE Tochigi Factory No. 3 Building	HVAC and plumbing systems	New construction
Kawanishi City General Medical Center Development Project (provisional name)	Plumbing systems	New construction
Toyota Technical Center Shimoyama Plumbing and Electrical Systems Project	Plumbing and electrical systems	New construction
Kitatama Water Reclamation Center No. 1 Sludge Incineration Systems Reconstruction Project	Water and sewage treatment systems	Expansion
		9 other projects

Source: Prepared by FISCO from the Company's Status of Business Progress in the Medium-Term Management Plan

(3) Initiatives to enhance the Sanki Brand

a) Improved technology

The Company has been working to improve its technology, which has mainly involved the three initiatives as follows.

- Conducted special joint safety patrols in the summer of FY2020
- Held online presentation and awards ceremony for president's awards consisting of the Superior Employee Award, the Yano Technology Award, and the Construction Method and Business Improvement Award
- Held in-house video presentations profiling development outcomes of the R&D Center

b) Initiatives for improving communication

The Company has been turning to online means of recruitment and training amid COVID-19 and associated susceptibility to miscommunication.

- Conducted online new employee induction training for FY2020
- Held online gatherings with prospective employees

(4) Social contributions

The Company welcomed the 10-year anniversary of its “SANKI YOU Eco Contribution Points” system. The eco-points scheme serves as a sustainability initiative that helps subsidize environmental conservation activities. It involves converting achieved reductions in carbon dioxide emission volume into Eco Contribution Points (¥100 per ton) when a customer adopts a proposed solution for saving energy that helps reduce carbon dioxide emissions. Results of the eco-points scheme include an approximately 45,000-ton reduction in carbon dioxide emissions on a consolidated basis for FY2019, approximately 17,000 trees planted up through FY2019, and “SANKI YOU Eco Contribution Points” financial contributions amounting to ¥21.2mn up through FY2019. To mark its 10-year anniversary, the Company created Kansha-no-Mori forest, performed commemorative tree planting, and added special website content profiling its “SANKI YOU Eco Contribution Points” scheme.

(5) Strengthen the ability to communicate information

The Company has also been strengthening its ability to communicate information, which has involved reaching out to communities that are home to its respective branch offices and stores by enlisting its new advertising campaign featuring “Kaiteki wo Katachi ni (Making Your Comfort a Reality)” television commercials and posters using Aurora Vision, digital signage, and other such means.

Initiatives of the Company to strengthen its ability to communicate information

Source: Company’s Status of Business Progress in the Medium-Term Management Plan

(6) Financial & capital policies involving return of profits to stakeholders: Implementation in progress

Return of profits to stakeholders

Phase 2 Management targets	
Dividends	Annual dividends per share of ¥60 and higher
Acquisition of treasury stock	Approx. 5 million shares
Total return ratio	70% or higher

Source: Prepared by FISCO from the Company's Status of Business Progress in the Medium-Term Management Plan

With respect to its share buybacks, the Company has already completed treasury stock acquisitions of 1,958,000 shares during FY3/20 and 1,000,000 shares during FY3/21. The Company intends to purchase around 2,042,000 additional shares. As for the annual dividend, the Company is targeting a dividend of ¥70 per share for FY3/21 and a total return ratio of 79.6%.

Acquisition of Sanki Engineering treasury stock

Year conducted	Number of shares acquired (thousand shares)
Fiscal 2019	1,958 thousand shares
Fiscal 2020 (complete)	1,000 thousand shares
Shares scheduled to be acquired during Phase 2	Approx. 5,000 thousand shares
Planned shares remaining	Approx. 2,042 thousand shares

Source: Company's Status of Business Progress in the Medium-Term Management Plan

(7) Initiatives of the Company from an ESG perspective

Implement initiatives to create sustainable social value.

Initiatives of the Company from an ESG perspective

Item	Measure details
E (Environment)	• Active promotion of energy conservation and energy generation (Received order for Kitatama Water Reclamation Center No. 1 Sludge Incineration Systems Reconstruction Project) • Newly created Kansha-no-Mori and conducted tree planting activities to commemorate the 10th anniversary of SANKI YOU Eco Contribution Point system
S (Society)	• Introduced a flextime system for all employees to promote work-styles that leverage diversity • Shortened work hours for work-life balance • Commenced Smile Plans through four groups, in order to further promote Smile Project work-style reforms • Reviewed payment conditions to reform financing of partner companies
G (Governance)	• Selected external director as chairman of the Board of Directors • Conducted interviews through a third-party institution in order to evaluate the effectiveness of the Board of Directors • Advisory Committee on Nomination and Remuneration comprised of only external directors • Ensured independence of legal affairs section as organization reporting directly to the president

Source: Company's Status of Business Progress in the Medium-Term Management Plan

Outlook

Initial forecast for FY3/21 unchanged amid projected 15.7% decrease in operating income relative to that of FY3/20

For FY3/21, the Company forecasts ¥200,000mn (down 3.7% YoY) in net sales, ¥9,000mn (down 15.7%) in operating income, ¥9,500mn (down 15.4%) in ordinary income, and ¥6,500mn (down 14.2%) in profit attributable to owners of parent. It also projects ¥190,000mn (down 2.1%) in orders received and ¥126,163mn in balance carried forward. These are targets originally set for the second year of the Phase 2 plan, but also factor in COVID-19 impact that can be envisioned at this point. However, the Company might revise targets if COVID-19 impact worsens.

Breaking down net sales, in the Facilities Construction Business, they are forecast to be ¥163,000mn (down 5.0%). By sub-segment, in HVAC and plumbing for buildings net sales are expected to decrease by 15.2% YOY to ¥60,000mn. In industrial HVAC they are expected to decrease by 1.1% to ¥67,000mn. In electrical systems they are expected to increase by 14.2% to ¥25,000mn. In facility systems they are expected to decrease by 1.1% to ¥11,000mn. With respect to the Plant & Machinery Systems Business, net sales for the Machinery Systems Business are forecast to decrease by 10.5% to ¥10,000mn amid an anticipated decrease in small and miscellaneous projects, while net sales for the Environmental Systems Business are expected to increase by 7.5% to ¥25,000mn.

For orders received, the Company forecasts ¥155,000mn (down 1.7%) in the mainstay Facilities Construction Business, roughly on par with the previous fiscal year. By sub-segment, in HVAC and plumbing for buildings orders are expected to decrease by 5.0% YOY to ¥59,000mn. In industrial HVAC they are expected to increase by 7.9% to ¥63,000mn due to upbeat performance of semiconductor and 5G-related business. In electrical systems they are expected to decrease by 12.0% to ¥22,000mn. In facility systems they are expected to decrease by 9.6% to ¥11,000mn. With respect to the Plant & Machinery Systems Business, orders for the Machinery Systems Business are expected to decrease by 3.4% to ¥10,000mn, while orders for the Environmental Systems Business are expected to decrease by 5.1% to ¥23,000mn. As a result, overall orders received including the Real Estate Business and Others are forecast to be ¥190,000mn (down 2.1%).

FY3/21 forecast

(¥mn)

	FY3/20		FY3/21 (E)			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	194,018	100.0%	190,000	100.0%	-4,018	-2.1%
HVAC and Plumbing for Buildings	62,095	32.0%	59,000	31.1%	-3,095	-5.0%
Industrial HVAC	58,391	30.1%	63,000	33.2%	4,609	7.9%
Electrical Systems	25,000	12.9%	22,000	11.6%	-3,000	-12.0%
Facility Systems	12,171	6.3%	11,000	5.8%	-1,171	-9.6%
Facilities Construction Business	157,659	81.3%	155,000	81.6%	-2,659	-1.7%
Machinery Systems Business	10,351	5.3%	10,000	5.3%	-351	-3.4%
Environmental Systems Business	24,247	12.5%	23,000	12.1%	-1,247	-5.1%
Real Estate Business	2,210	1.1%	2,000	1.1%	-210	-9.5%
Others	917	0.5%	1,000	0.5%	83	9.1%
Adjustments	-1,367	-	-1,000	-	367	-
Net sales	207,684	100.0%	200,000	100.0%	-7,684	-3.7%
HVAC and Plumbing for Buildings	70,756	34.1%	60,000	30.0%	-10,756	-15.2%
Industrial HVAC	67,736	32.6%	67,000	33.5%	-736	-1.1%
Electrical Systems	21,889	10.5%	25,000	12.5%	3,111	14.2%
Facility Systems	11,119	5.4%	11,000	5.5%	-119	-1.1%
Facilities Construction Business	171,501	82.6%	163,000	81.5%	-8,501	-5.0%
Machinery Systems Business	11,169	5.4%	10,000	5.0%	-1,169	-10.5%
Environmental Systems Business	23,261	11.2%	25,000	12.5%	1,739	7.5%
Real Estate Business	2,210	1.1%	2,000	1.0%	-210	-9.5%
Others	931	0.4%	1,000	0.5%	69	7.4%
Adjustments	-1,389	-	-1,000	-	389	-
Gross profit	32,110	15.5%	31,000	15.5%	-1,110	-3.5%
Operating income	10,674	5.1%	9,000	4.5%	-1,674	-15.7%
Ordinary income	11,224	5.4%	9,500	4.8%	-1,724	-15.4%
Profit attributable to owners of parent	7,576	3.6%	6,500	3.3%	-1,076	-14.2%

Note: The amounts listed as "adjustments" serve to eliminate inter-segment transactions included in each segment.
Source: Prepared by FISCO from the Company's Summary of Financial Results

Going forward, we should keep an eye on effects of the COVID-19 pandemic and should also continue paying attention to whether or not the Company is rigorously managing progress so as to avoid possibilities of projects that might incur unexpected losses. With respect to orders, the environment surrounding the construction and HVAC industries encompassing the Company is such that it is likely to encounter ample work volume involving follow-up services. As such, we deem that the Company is apt to achieve its target for orders received, even upon having accounted for effects of the COVID-19 pandemic.

Whereas the gross profit margin was high (15.5%) in FY3/20, the Company intends to engage in measures to increase profits further. This will involve establishing and reinforcing various site support systems on an ongoing basis, enhancing the ability of the Procurement Division in particular to engage in materials procurement negotiations, and providing ongoing support for site purchasing operations through integrated management. Given the Company's target of achieving a 15.5% gross profit margin, on par with the previous fiscal year, the Company forecasts gross profit of ¥31,000mn and operating income of ¥9,000mn.

Shareholder return policy

Proactive stance toward shareholder return with dividend hikes and share buybacks/retirement, positive approach to other stakeholders too

The Company actively returns profits to shareholders. While its basic annual dividend was ¥15 through FY3/14, a change in profit structure prompted a dividend increase beginning in FY3/15. Due to strong results in FY3/19, the Company implemented an extra year-end dividend of ¥20 in addition to the normal ¥40 dividend, for a total annual dividend of ¥60 (a dividend payout ratio of 40.0%). In FY3/20, the Company had an initial annual dividend target of at least ¥60 and raised the dividend to ¥95 (¥35 interim, ¥60 year-end) including a ¥25 extra dividend to reflect robust earnings. In FY3/21, it currently plans to sustain the regular dividend at ¥70.

The Company actively purchases its own shares in the market and retires them as part of the shareholder return policy. It acquired 1,958,000 shares and retired 2,000,000 treasury stock during FY3/20. Meanwhile, thus far in FY3/21 the Company has already retired 1,000,000 shares and has purchased another 1,000,000treasury stock. Also, the Company's sum total return ratio (weighted average) amounts to 83.33%, given a ¥34,397mn sum total of its share buybacks and dividend payments made from FY3/14 to FY3/21, relative to a ¥41,277mn sum total (incl. projected amounts) in profit attributable to owners of parent during that period. This level of returns is extremely high relative to many listed companies. Going forward, we should keep an eye on developments with respect to the Company's dividend policies and share buybacks, particularly given that the Phase 2 plan has stated that the Company is targeting a total return ratio of at least 70% over the three years from FY3/20, in conjunction with purchases of roughly 5,000,000 shares (2,958,000 shares already acquired) and dividends.

The Company also has a positive approach toward other stakeholders besides shareholders. Specifically, it revised payment terms for partner companies with full cash payments to those with less than ¥40mn in capital. It intends to conclude a commitment-line contract that readies it to address changes in societal conditions, including COVID-19 impact, secures funds to assist partner companies, and prepares it for temporary working capital demand. We think the Company should be favorably assessed for its positive stance in shareholder return and relationships with various stakeholders.

Shareholder returns

	Share buybacks		Dividend amount (B)	Amount of shareholder returns (C) = (A) + (B)	Profit attributable to owners of parent
	No. of shares	Amount (¥mn) (A)			
FY3/21 (E)	1,000,000	1,171	4,106	5,277	6,500
FY3/20	1,958,000	2,899	5,543	8,442	7,576
FY3/19	1,000,000	1,191	3,595	4,786	9,046
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	34,397	41,277
			Total return ratio (weighted average)		83.33%

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

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