COMPANY RESEARCH AND ANALYSIS REPORT

Sun-Wa Technos Corporation

8137

Tokyo Stock Exchange First Section

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Summary

Possibility of a prolonged phase of upbeat earnings with multiple demand drivers (OLEDs, automobiles, and semiconductors)

Sun-Wa Technos Corporation <8137> (hereinafter, also "the Company") is an independent trading company that specializes in technology products. One of the strengths of the Company is that it has three business divisions of electrical machinery, electronics, and general machinery. Another strength is the Company's two-way trade in which it sells equipment and materials for manufacturers' production lines and then buys and sells the products made by these manufacturers to other companies. By utilizing these strengths, the Company has expanded its businesses.

1. Net sales and net income achieved record highs in 1H at halfway point of FY3/18

The Company reported 1H FY3/18 results with ¥67,348mn in net sales (+34.7% YoY) and ¥1,773mn in operating income (+63.9%). It achieved sharply higher sales and earnings and set all-time highs in net sales and net income for 1H. Key factors contributing to the upbeat results were continuation of vibrant capital investments by Chinese local smartphone manufacturers that picked up in 2H FY3/17, healthy capital investments in semiconductor production lines on heightened demand for semiconductors with advances in IoT, and strong capital investments by the automotive industry led by electric vehicles (EVs), advanced driver-assistance systems (ADAS), and other themes.

2. Raised FY3/18 forecast, expects vibrant business conditions to continue in 2H

The Company has raised the FY3/18 forecast twice thus far and currently projects ¥139,000mn in net sales (+19.2% YoY) and ¥3,500mn in operating income (+16.1%). While some observers believe that investments have been largely exhausted in the smartphone industry, we anticipate ramp-up of OLED investments, which are likely to be increasingly utilized as display devices. Investments in semiconductor and automotive industries should also remain vibrant. We think the updated forecast is still conservative. Even if lower-margin businesses, such as automotive, gain a larger presence, we see a possibility of sales beating the forecast and expect profit contributions from this upside to have an impact exceeding companywide margin.

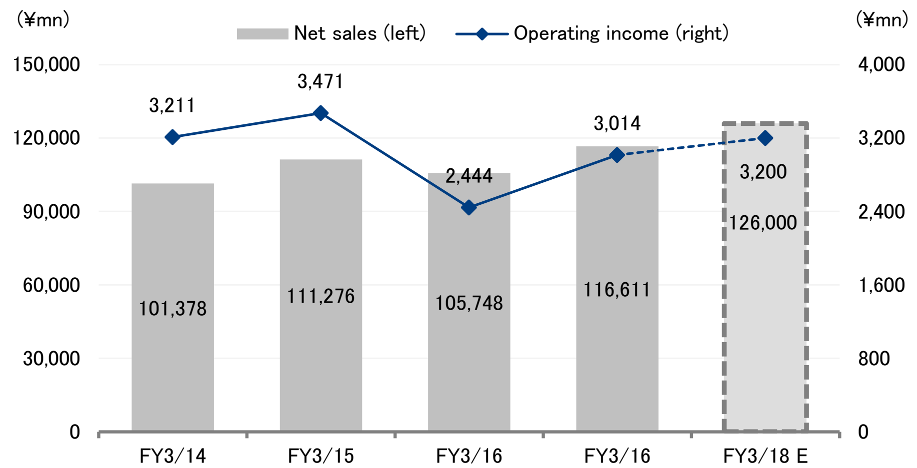
3. Making healthy progress in the Challenge 1500 three-year medium-term management plan, focus on revisions to FY3/19 goals

The Company is currently implementing Challenge 1500, its 9th three-year medium-term management plan, and steady progress with this plan constitutes the Company's longer-term growth strategy. Upward revisions in the FY3/18 forecast have increased the likelihood of revisions to FY3/19 target. The two main growth strategies are expansion of the engineering business and the global SCM solutions business. The Company is broadening the scope of these businesses and approaching its near-term goal of lifting sales above ¥10bn each.

Key Points

- Capital investments are vibrant in a wide range of areas – smartphones, automobiles, semiconductors, and industrial machinery
- Achieving double-digit sales growth in the three divisions; sales are rapidly growing for automobile interior products in the electronics division
- Likely to sustain healthy expansion in the engineering business with labor shortages and personnel cost cutbacks as drivers

Results trends



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

Company profile

Unique trading company handing three different types of products – electrical machinery, electronics, and general machinery

1. Background

The Company traces its roots to a self-run business created by the late Tokuro Yamada in July 1946 that leveraged his experience selling electrical machinery in China since before the war. It was incorporated in November 1949 as YAMADA KOGYO CORPORATION and concluded a distributor contract with YASKAWA Electric Manufacturing Co., Ltd. (currently, YASKAWA Electric Corporation <6506>), marking the full-fledged start of the Company's history. While the Company is a major sales distributor of YASKAWA Electric, it went beyond this relationship to conclude sales distributor contracts with other leading electric equipment and machinery manufacturers as an independent trader of technology products, expanding products that it handled and the customer base, and broadening business scope. The Company established a position as a unique trading company that specializes in technology products, handling three different types of products (electric machinery, electronics, and general machinery) that it continues to hold today.

In overseas activities, the Company rapidly broadened its network of local entities from the 1990s in response to offshore moves by customer firms spurred by yen appreciation, trade friction, and other factors. Following the launch of entity in Singapore in 1995, it proceeded to build an overseas subsidiary network in major Asian countries, Europe, and North America. It recently established local entities in Indonesia, Vietnam, Mexico and the Philippines as countries with strong growth potential.

The Company listed its shares on the OTC market in May 1982, moved to the Second Section of the Tokyo Stock Exchange in April 2003, and advanced to the First Section in March 2005.

History

	Domestic business development	Overseas business development
November 1949	Established YAMADA KOGYO CORPORATION	
December 1952	Sales agent contract with Osaka Transformer Co., Ltd. (now DAIHEN Corporation)	
November 1960	Sales agent contract with NIPPON GEAR Co., Ltd.	
October 1966	Agent contract with Origin Electric Co., Ltd.	
March 1969	Distributor contract with Toyo Carrier Engineering Co., Ltd (now Toshiba Carrier Corporation)	
July 1970	Exclusive contract with Tateisi Electric Manufacturing Co. (now, OMRON Corporation)	
November 1970	Established Yamada Kucho Co., Ltd. (now SUN-WA-TRINITY CORPORATION)	
September 1971	Sales agent contract with NIKKISO CO., LTD.'s equipment sales division	
June 1974	Started sales of YE DATA INC. products	
November 1977	Established Yamada Kogyo Kenkyusho	
May 1978	Agent contract with Sumitomo 3M Limited	
July 1978	Special agent contract with STANLEY ELECTRIC CO., LTD.	
November 1979	Special agent contract with Nemic-Lambda Co., Ltd. (now TDK-Lambda Corporation)	
May 1981	Sales agent contract with SANKI ENGINEERING CO., LTD.	
May 1982	Listed shares on the OTC market	
June 1990	Established Yamada Butsuryu Co., Ltd. (now SUN-WAN LOGISTICS CO., LTD.)	
April 1993	Changed to the current company name	
May 1995		Established SUN-WA TECHNOS (SINGAPORE) PTE. LTD.
December 1997		Established SUN-WA TECHNOS (HONG KONG) CO., LTD.
April 1998		Established Sun-Wa Technic Europe Co., Ltd. (now SUN-WA TECHNOS EUROPE GmbH; Dusseldorf)
July 1998		Established SUN-WA TECHNOS AMERICA, INC. (Chicago)
November 1998		Established SUN-WA TECHNOS TAIWAN CO., LTD. (joint venture)
April 2000		Established SUN-WA TECHNOS (MALAYSIA) SDN. BHD.
January 2001		Dissolved SUN-WA TECHNOS TAIWAN CO., LTD. (joint venture) and established SUN-WA TECHNOS TAIWAN CO., LTD. (subsidiary)
December 2001		Established SHANGHAI SUN-WA TECHNOS CO., LTD.
September 2002		Opened the Shenzhen Representative Office
April 2003	Listed on the TSE Second Section	
March 2005	Listed on the TSE First Section	
October 2006		Established SUN-WA TECHNOS ASIA (THAILAND) CO., LTD.
January 2009		Established SUN-WA TECHNOS (SHENZHEN) CO., LTD.
August 2013		Opened the Hanoi Representative Office of SUN-WA TECHNOS (HONG KONG) in Vietnam
October 2013		Opened the Hong Kong Logistics Center
March 2014		Opened Taichung Representative Office of SUN-WA TECHNOS TAIWAN
October 2014		Established PT. SUN-WA TECHNOS INDONESIA
September 2015		Established SUN-WA TECHNOS MEXICO S.A. DE C.V. and SUN-WA TECHNOS (PHILIPPINES), INC.
December 2015	Moved the head office to 3-chome Kyobashi, Chuo Ward	
January 2016	Merged the electronics division into the headquarters	Opened the Los Angeles Branch of SUN-WA TECHNOS (AMERICA), INC.
May 2016		Established SUN-WA TECHNOS (VIETNAM) CO.,LTD.
April 2017	Opened the Nagoya Office (upgraded from a branch) and Yokohama Branch (upgraded from a sales site)	

Source: Prepared by FISCO from Company materials

"Broad and deep" coverage of three areas
Capital investments in production lines are the most important demand driver

2. Business overview

The Company is an independent trading company that specializes in technology products and stands out in its coverage of three product fields – electric machinery, electronics, and general machinery. Product information and understanding tends to be broad and superficial when a single company handles three separate fields because of the differences in users and demand drivers. However, the Company derives its strength from pursuit of "broad and deep" interactions. This approach stems from having numerous employees with engineering backgrounds as a technology-oriented trading firm. Another factor is that the Company has accumulated knowledge and experience in each of the three fields through processes carried out over a lengthy period, as it began in general machinery and electrical machinery fields as a sales agent for YASKAWA Electric and DAIHEN <6622> and then added electronic components as "two-way transactions."

The electrical machinery division handles AC servo motors, programmable controllers, linear motors and other motors, inverters, and vacuum chamber robots. The general machinery division covers semiconductor production equipment, industrial robots, clean room robots for conveying liquid crystal displays (LCDs), and medical equipment. The electronics division handles connectors, semiconductors, sensors, LEDs, LCDs, and CPU boards.

List of products handled by Sun-Wa Technos by business division

Electrical machinery	AC servo motors, programmable controllers, linear motors and various other motors, inverters, power conditioners, clean room robots and vacuum chamber robots for semiconductor manufacturing equipment, power substations and other products, and electrical engineering work
General machinery	Semiconductor manufacturing equipment, industrial robots, clean room robots for conveying liquid crystal panels, valve control devices, conveyors, wind- and hydro-power equipment, air conditioners and kitchen equipment, various inspection devices, medical equipment, and other products
Electronics	Power supplies, connectors, semiconductors, sensors, miniature fans, LEDs, LCDs, personal computers for industrial use, circuit boards for central processing units, memory modules, and other products

Source: Prepared by FISCO from Company materials

We can use LCDs as a way of explaining the relationship among the three divisions. LCD plants are equipped with a variety of manufacturing systems. The general machinery division sells these systems (such as glass transport robots) to corporate customers. Meanwhile, the electrical machinery division sells motors that are parts for these systems to the manufacturer of the glass transport robots. The electronics division subsequently sells compact LCD panels produced by the LCD plant to mobile phone manufacturers. In this business model, the Company handles all distribution channels from upstream (production equipment parts/materials) to downstream (end products) for the category of LCD panels due to its coverage of the three fields. The Company also stands out with "two-way transactions." It often procures products (such as LCD panels in the example given above) for trading purposes from customer companies that received its deliveries of manufacturing equipment. The Company calls these "two-way transactions."

The general machinery and electronic machinery divisions both rely on capital investments by corporate customers as the demand driver. Trends affecting demand for electronics division products are corporate production activities and consumer spending. Furthermore, while the "electronics division" sounds as if it mainly handles electronic devices, the Company's electronics division actually has extensive sales of raw materials and parts to the automotive industry and FA and industrial machinery industry.

Customers and demand drivers for each business division

	Products handled	Source of demand	Drivers of demand, macroeconomic indicators
Electrical machinery	Electrical components for customers' products	Plants of customer companies	Capital investment by manufacturers, machinery orders, and other measures of industrial expansion
General machinery	Production lines of customer companies		
Electronics	Components produced by customer companies	Manufacture of final products	Consumer spending, industrial production index, etc.

Source: Prepared by FISCO from Company materials

Results trends

Capital investments are vibrant in a wide range of areas – smartphones, automobiles, semiconductors, and industrial machinery

1. 1H FY3/18 results

The Company reported 1H FY3/18 results with ¥67,348mn in net sales (+34.7% YoY), ¥1,773mn in operating income (+63.9%), ¥1,951mn in ordinary income (+76.9%), and ¥1,359mn in net income attributable to owners of the parent (+78.0%). It achieved sharply higher sales and earnings and set all-time highs in net sales and net income for 1H.

While the Company raised 1H targets at the announcement of 1Q results, both sales and earnings exceeded the updated figures. It had upside of 9.5% in sales and 14.4% in operating income compared with the initial outlook.

1H FY3/18 results

(¥mn)

	FY3/17		1H FY3/18				
	1H results	Full-year results	Initial forecasts	Revised forecasts	Results	Growth rate (YoY)	Growth rate versus initial forecasts
Net sales	50,006	116,611	61,500	65,000	67,348	34.7%	9.5%
Operating income	1,082	3,014	1,550	1,550	1,773	63.9%	14.4%
Ordinary income	1,102	3,215	1,700	1,700	1,951	76.9%	14.8%
Net income attributable to owners of the parent	763	1,584	1,050	1,050	1,359	78.0%	29.4%

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

Earnings sharply recovered from 2H FY3/17, including almost ¥40bn in net sales in 4Q for an all-time quarterly high. Continuation of the favorable trend in FY3/18 is a significant factor behind the upbeat results.

Vibrant activity in the industrial electronics and mechatronics industry that is tied to the Company's core businesses provided the direct and main source of strong growth in 1H. Demand drivers in this industry broadly include smartphones, automobiles, semiconductors, industrial machinery, and other areas. The Company steadily harnessed this broad demand expansion to increase its own earnings thanks to involvement in three different fields – electrical machinery, electronics, and general machinery.

The Company used a ¥110/$ forex rate in its FY3/18 forecast. The 1H results included benefits from yen depreciation because the actual 1H rate was ¥112. Specific impacts were about ¥1.6bn on net sales and around ¥70mn on operating income. These levels show that real demand growth primarily fueled the Company's advances in 1H.

Achieved double-digit sales growth in the three divisions Sales are rapidly growing for on-board products in the electronics division

2. Divisional and regional trends

The Company has three business divisions, and trends in these divisions are reviewed below.

In the electrical machinery division, net sales rose 35.9% YoY to ¥12,390mn on increased supply of electrical equipment for capital investments in the industrial machinery industry. Smartphone-related capital investment interest remained strong, particularly in China, as explained above. Demand climbed for electrical equipment used in production systems delivered to these sites.

In the electronics division, net sales expanded 37.1% YoY to ¥50,339mn. This division posted stronger sales of electronic parts to automotive and industrial machinery industries and higher sales of electronic equipment to social infrastructure facilities. We are paying close attention to automotive-related business for the electronics division. The Company launched the automotive sales department in April 2015, and this department's sales grew more than twofold YoY in 2Q FY3/18. While related sales did not actually double because content included some capex-related products, we think the strong result symbolizes rapid growth in demand for ADAS on-board electronic parts and equipment.

In the general machinery division, net sales increased 10.4% YoY to ¥4,619mn on stronger sales of manufacturing equipment to the electronic parts industry and transport equipment to the FPD industry. We attribute slightly weaker sales growth than in the other two divisions to decline in sales of FPD manufacturing equipment related to the capital investment cycle.

Net sales trend by division

(¥mn)

	FY3/16		FY3/17				FY3/18		
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	1H
Electrical machinery	3,880	5,080	3,857	5,258	4,575	7,046	6,056	6,333	12,390
YOY	-25.3%	-28.8%	-17.3%	-3.4%	17.9%	38.7%	57.0%	20.5%	35.9%
Electronics	16,937	20,186	17,128	19,576	20,351	28,764	23,680	26,658	50,339
YOY	-16.7%	-14.8%	-12.7%	-6.2%	20.1%	42.5%	38.2%	36.2%	37.1%
General machinery	1,935	3,269	1,667	2,518	1,875	3,994	1,617	3,001	4,619
YOY	38.8%	19.1%	38.5%	-5.9%	-3.1%	22.2%	-3.0%	19.2%	10.4%
Total net sales	22,754	28,537	22,654	27,352	26,801	39,804	31,355	35,993	67,348
YOY	-15.5%	-15.0%	-11.1%	-5.6%	17.8%	39.5%	38.4%	31.6%	34.7%

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

In regional trends, Japan posted sharply higher sales and profits with net sales at ¥52,385mn (+27.6% YoY) and operating income at ¥935mn (+24.5%). Main drivers were stronger sales of electric equipment for manufacturing systems delivered to the industrial machinery industry and electronic parts used by automotive and industrial machinery industries. Other additions came from manufacturing systems for the electronic parts industry and transport equipment for the FPD industry.

Asia also recorded sharply higher sales and profits, similar to Japan, with net sales at ¥17,734mn (+49.7% YoY) and operating income at ¥674mn (+118.3%). Chinese income growth was a major source of Asian gains. Key momentum sources were increased sales of electronic parts and electric equipment to the industrial machinery industry.

US and Europe reported very robust growth with net sales at ¥3,758mn (+98.6% YoY) and operating income at ¥162mn (vs. ¥16mn a year earlier). Income from one-time special demand fueled the very strong growth rates (YoY). Viewed by quarter, special demand occurred in 1Q and business returned to the ordinary pace in 2Q.

Results trends by geographical market

(¥mn)

		FY3/16				FY3/17				FY3/18		
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	1H
Japan	Net sales	18,570	21,523	17,896	22,005	17,931	23,136	21,962	29,183	24,098	28,287	52,385
	YOY	1.7%	0.8%	-5.5%	-5.1%	-3.4%	7.5%	22.7%	32.6%	34.4%	22.3%	27.6%
	Operating income	93	832	34	620	-85	837	260	1,154	154	781	935
	YOY	-54.6%	8.2%	-91.0%	-19.9%	-	0.6%	664.7%	86.1%	-	-6.7%	24.5%
	Operating income margin	0.5%	3.9%	0.2%	2.8%	-0.5%	3.6%	1.2%	4.0%	0.6%	2.8%	1.8%
Asia	Net sales	7,816	8,520	6,384	7,376	5,774	6,068	6,647	11,406	8,110	9,624	17,734
	YOY	32.7%	21.3%	-27.8%	-34.5%	-26.1%	-28.8%	4.1%	54.6%	40.5%	58.6%	49.7%
	Operating income	257	242	142	210	141	167	202	306	338	336	674
	YOY	16.3%	-26.8%	-48.9%	-51.0%	-45.1%	-31.2%	42.3%	45.7%	139.7%	101.0%	118.3%
	Operating income margin	3.3%	2.8%	2.2%	2.8%	2.4%	2.8%	3.0%	2.7%	4.2%	3.5%	3.8%
US and Europe	Net sales	837	888	722	1,236	1,044	847	1,171	3,260	2,306	1,452	3,758
	YOY	8.7%	26.0%	-3.7%	2.6%	24.7%	-4.6%	62.2%	163.8%	120.9%	71.2%	98.6%
	Operating income	22	-14	-7	2	-14	31	1	-3	185	-22	162
	YOY	37.5%	-	-	-94.3%	-	-	-	-	-	-	868.1%
	Operating income margin	2.6%	-1.6%	-1.0%	0.2%	-1.3%	3.7%	0.1%	-0.1%	8.0%	-1.5%	4.3%

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

Overview and progress of the medium-term management plan

Aiming for steady attainment of Challenge 1500 goals in engineering and global SCM solutions businesses

1. Overview of the medium-term management plan

The Company formulates three-year medium-term management plans and strives for longer-term growth through steady implementation of the plan. Longer-term growth strategies hence are essentially equivalent to the medium-term management plan.

The Company is currently implementing Challenge 1500, its 9th three-year plan that covers FY3/17-19. The plan aims to deepen and advance results from the previous JUMP 1200 medium-term plan that ended in FY3/16. The "Challenge 1500" name embodies management's aim to establish a solid foundation for realizing ¥150bn in net sales in FY3/20, the Company's 70th anniversary.

The Company is pursuing three business strategies aimed at achievement of medium-term plan goals - "systems, equipment, and parts/components sales business," "engineering business," and "global SCM solutions business." "Systems, equipment, and parts/components sales business" overlaps with the three existing divisions. The engineering business and global SCM solutions business deserve attention as strategies that are vital to realizing unique growth in the medium-term plan. Details are given below. We understand the engineering business as a catalyst to expand income by organically linking and achieving synergies in the Company's three existing divisions. The global SCM solutions business has a role of cutting across the three existing divisions, similar to the engineering business, and offers an opportunity with its potential to develop into a standalone business division in the future.

Four basic policies and three business strategies in Challenge 1500

Basic policies in Challenge 1500
Contribute to customers' product manufacturing with our core businesses of electrical machinery, electronics, and general machinery
Provide unique high value-added solutions
Provide the latest technology information as a technology trading company
Strengthen group capabilities by enhancing the global network

Three business strategies
Systems, equipment and parts/components sales business
Engineering business
Global SCM solutions business

Source: Prepared by FISCO from Company materials

Likely to update final-year FY3/19 goals in light of healthy progress through FY3/18

2. Medium-term management plan targets

Demand rapidly recovered and expanded in the latter half of FY3/17, the plan's initial fiscal year, overshooting the forecast. FY3/18 is the second year of the medium-term plan. The Company realized very healthy progress through 1H and has already raised the FY3/18 forecast twice. The latest update puts the net sales target at ¥139,000mn, which exceeds the plan's ¥137,000mn goal for FY3/19.

Given these conditions, we think the Company is currently reviewing its plan for the final year of Challenge 1500 and expect disclosure of a revised outlook by the time of the FY3/18 results announcement in May 2018. We see various scenarios for income in the new plan depending on the possibility of continuation of recent robust demand and the sales share of fast-growing automotive industry business. Separately from sales, we are interested in management's outlook for operating margin that has been a focus of improvement efforts for a lengthy period.

Looking back at JUMP 1200, the previous medium-term management plan, the Company made healthy progress toward targets through the second year, but missed in the final fiscal year. Management is keenly aware of this outcome and putting considerable emphasis on realization of plan targets in the final fiscal year in the current medium-term plan. While it is obviously important to attain plan targets from the standpoint of laying the groundwork for the next medium-term plan, setting excessively low goals to ensure attainment could wind up disappointing investment and shareholder expectations. We think a key point is determining how to strike a balance between these two aspects.

Challenge 1500 management targets

(¥mn)

	FY3/17		FY3/18			FY3/19 management targets
	Management targets	Results	Management targets	Initial forecasts	Revised forecasts	
Net sales	117,000	116,611	126,000	126,000	139,000	137,000
Operating income	2,800	3,014	3,500	3,200	3,500	4,300
Operating income margin	2.4%	2.6%	2.8%	2.5%	2.5%	3.1%
Ordinary income	3,000	3,215	3,700	3,450	3,800	4,500
Ordinary income margin	2.6%	2.8%	2.9%	2.7%	2.7%	3.3%
Forex assumption (JPY/USD)	117	116.5	117	110	110	117

Source: Prepared by FISCO from Company materials

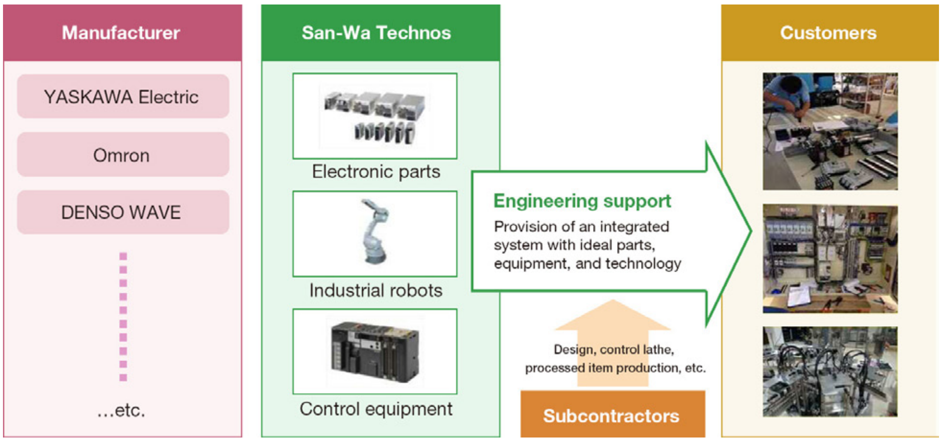
Expecting sustained healthy expansion of engineering business with support from labor shortages and personnel cost reduction

3. Progress of the engineering business

(1) Business overview

The engineering business at the Company is a sales approach for "proposing products from the three divisions of electrical machinery, electronics, and general machinery as system solutions, rather than standalone items." We can use the example of a food supermarket to help explain the positioning of the engineering business. Up to now, the Company had been selling ingredients, such as meat, fish, and vegetables, to customers. The engineering business, meanwhile, involves preparing these individual ingredients for delivery to customers. The extent of pro¬cessing can vary from selling a prepared item to a meal box. The Company does not book sales as the engineering business and related income is allocated to the electrical machinery, electronics, and general machinery divisions.

Engineering business



Source: Company website

Deployment of robots (industrial robots), a strong area, offers a typical case of the engineering business. Robots began with development and deployment in the automotive industry and subsequently spread to the entire industrial community. Although robot deployment is entering a full-fledged adoption stage outside of the automotive industry, these new users often are unable to sufficiently harness robots after installations. In the engineering business, the Company seeks to expand income by helping customers to smoothly deploy robots and realize their benefits with internal engineers to formulate system concepts and external system integrators to build systems.

We have become increasingly confident in the Company's ability to succeed in the engineering business for a number of reasons. Key points are manpower shortages and rising personnel and labor costs. These conditions obviously exist in Japan. The situation in China is getting worse too, and we expect broadening of the trend throughout Asia. Industrial robot deployment offers an effective way of dealing with this challenge. We believe the Company is capable of obtaining major business opportunities in this field if it accumulates experience and enhances service quality in the engineering business.

Additionally, we see room to expand transactions with end users as new trend facilitated by the engineering business. Direct counterparts in the engineering business up to now have been equipment manufacturers. The flow involves equipment manufacturers delivering manufacturing systems to plants and other sites of end users. End-user transactions for the Company, meanwhile, consist of direct delivery of automation equipment and systems to end-user companies. The Company had its first case in FY3/17. While its technology and solution capabilities obviously made this possible, the presence of experts on plant manufacturing lines at the end user was an important factor too. We do not expect immediate expansion of end-user transactions at other customers, but there should be potential for repeat orders with the "existing customer," where success has been achieved, via application to other plants and other facilities.

As this demonstrates, the engineering business might substantially expand business opportunities, in comparison to past standalone sales of existing products. The resulting increase in added value that the Company can deliver to customers is likely to lift profit margin as well.

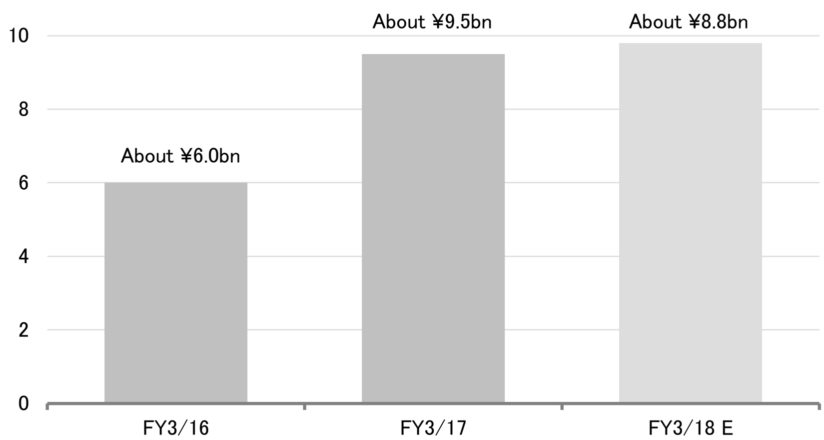
(2) Update on progress

The Company has been making necessary investments to accelerate the engineering business. Using the example cited above, it has been expanding capabilities, including external hires of human resources to handle the role of processing ingredients into prepared items and meals. It restructured in April 2015, establishing the factory automation sales headquarters (now, the FA system sales department), the industrial solutions headquarters (industrial solutions department), and engineering department and accelerating proposals and sales that cut through the three product types.

The Company is also seeking to further strengthen the organization in FY3/18. It merged the mechatronics sales and machinery systems sales departments to create the FA system sales department in April 2017. This reorganization aims to enhance comprehensive capabilities by combining electrical and general machinery. Furthermore, in October 2017, it reorganized the engineering department into the sections of robot promotion, IoT promotion, monitoring and control promotion, automated recognition promotion, electrical equipment technology, and technology services. This framework aims to make internal collaboration more effective through clarification of individual team roles. It should also enable the teams to contribute more actively to engineering business proposals. We think the Company has largely completed efforts to solidify the framework for promotion of the engineering business and arrived at the stage of just accumulating results.

Investments in the engineering business over the past few years have been steadily producing results. The Company started disclosure of the procurement amount from 2Q to serve as an indicator of the scale of its engineering business. Net sales in the engineering business work out to this amount plus a certain amount of profit. The procurement amount steadily increased from about ¥6bn in FY3/16 to roughly ¥9.5bn in FY3/17 and is likely to be about ¥8.8bn in FY3/18. The anticipated YoY decline in the FY3/18 value stems from the existence of an extraordinary major deal in FY3/17. This business appears to be growing at a healthy pace in terms of the number of deals. The Company is pursuing a ¥10bn sales goal for the engineering business and has moved within reach of attaining the goal in the current medium-term management plan.

Trend in engineering business procurement amount



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

The engineering business is contributing to profits as well. It generates margin from the added value of the "solution" in contrast to selling agent business as a trading company. This aspect supports expectations for realization of higher margin. We think the Company is making steady progress toward achieving its initial goal in earnings thus far. The Company has already raised the FY3/18 forecast twice versus the period-start view, as noted earlier, and is pointing to profits from the engineering business as an important source.

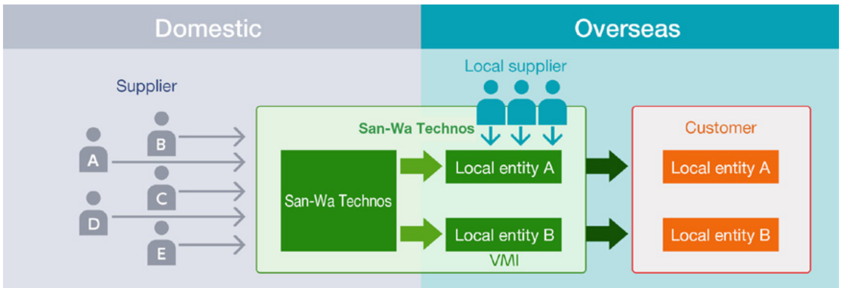
Within reach of ¥10bn in net sales thanks to the tailwind of increased customer outsourcing needs

4. Progress on the global SCM solutions business

The Company prepared for global SCM solutions during JUMP 1200, the previous medium-term management plan, and officially started this business in the current medium-term plan period. Going back further, however, the Company had already been offering procurement agent, logistics agent, and delivery management services for some time. The global SCM solutions business is an advanced version of these past services that leverages the Company's overseas network (13 overseas local entities and 25 global sites) to create a profitable business.

We think the global SCM solutions business can be implemented in a variety of ways. One example is described here. The Company delivers other items required by the customer at the same time, regardless of whether they are the Company's catalog products or not, in addition to the ordered product when delivering products based on an order from the customer. It intends to operate this service as a profitable business, obtaining margin on each of the products.

Conceptual image of global SCM solutions business



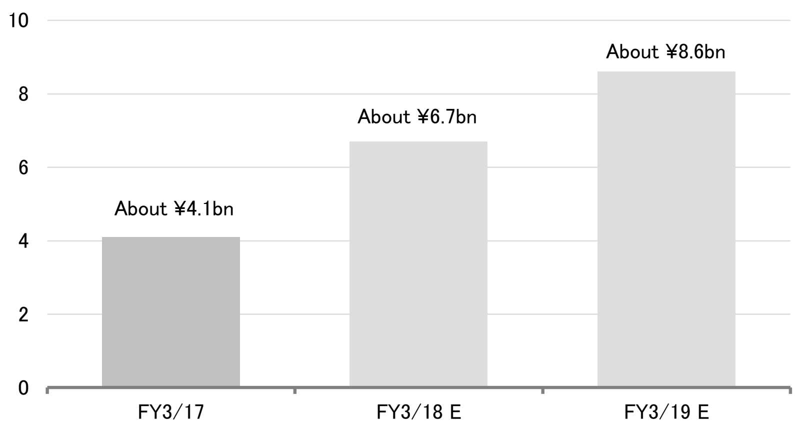
Source: Company website

The Company is making healthy progress in expansion of the global SCM solutions business, similar to engineering. Net sales totaled about ¥4.1bn in FY3/17, the FY3/18 outlook is around ¥6.7bn, and this business is expected to grow further to about ¥8.6bn in FY3/19. The Company is aiming for ¥10bn in sales for the global SCM solutions business too as a goal and already has an outlook for reaching this level.

Upbeat conditions in the global SCM solutions business reflect the lengthy history and accumulated knowhow in this area mentioned above as well as the reality of manpower shortages in global logistics, inventory management, materials procurement, and other areas, even at large manufacturers (some observers might say even more so at large manufacturers) because past reorganization reforms and restructuring processes targeted these areas. Meanwhile, large companies are more likely to frequently move businesses across countries in pursuit of efficient production operations. We think the overall environment is moving in a direction that increases demand for the Company's global SCM solutions business.

Expansion of the global SCM solutions business is clearly positive for the Company. An important point is that it reliably generates profit because of accumulated knowhow over many years amid rising demand for these services. Nevertheless, profit margin appears to be lower than in the Company's other businesses and rapid growth in related sales is likely to reduce overall profitability. The Company listed improved profitability as an important goal in the current medium-term management plan. We will be closely watching how it strikes a balance between expansion of business scale and securing profitability.

Trends in global SCM solutions business sales



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

Business outlook

Raised FY3/18 forecast but still has upside room

The Company forecasts ¥139,000mn in net sales (up 19.2% YoY), ¥3,500mn in operating income (up 16.1%), ¥3,800mn in ordinary income (up 18.2%), and ¥2,650mn in net income attributable to owners of the parent (up 67.3%) in FY3/18. The Company raised the FY3/18 forecast at 1Q and 2Q announcements in reaching current targets.

Overview of FY3/18 forecasts

(¥mn)

	FY3/17	FY3/18						
	Full year	1H	2H		Full year			
	Results	Results	Forecasts	Growth rate (YoY)	Initial forecast	Growth rate (YoY)	Updated forecast	Growth rate (YoY)
Net sales	116,611	67,348	71,652	7.6%	126,000	8.1%	139,000	19.2%
Operating income	3,014	1,773	1,727	-10.6%	3,200	6.2%	3,500	16.1%
Ordinary income	3,215	1,951	1,849	-12.5%	3,450	7.3%	3,800	18.2%
Net income attributable to owners of the parent	1,584	1,359	1,291	57.2%	2,150	35.7%	2,650	67.3%

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

To attain the updated target, the Company needs ¥71,652mn in net sales (+7.6% YoY), ¥1,727mn in operating income (-10.6%), and 2.4% operating margin in 2H. While it appears that these levels could be realized without difficulty in 2H based on related growth rates (YoY) and operating margin thus far, the Company is adhering to a cautious stance.

We think one reason for the caution is a tough sales hurdle from 2H FY3/17. In particular, 4Q sales totaled ¥39,804mn, an all-time high on the verge of ¥40bn. While setting a new record is well within reach if recent momentum continues, the Company has taken a stance of avoiding easy optimism even toward the relatively near future.

The Company is also taking a cautious approach to earnings and does not see a 10.6% YoY decline in 2H operating margin as conservative. This view factors in growth in automotive-related (facilities and on-board electronic parts) sales. Margin is often very low in automotive businesses, as is widely known, and this is true at the Company as well. Management finds the current 2H outlook reasonable because of concern about decline in margin from less attractive product mix related to growth in automotive sales.

We advise a favorable view of the Company's cautious stance described above and are convinced by management's explanation. Nevertheless, we also believe the current 2H outlook is overly conservative.

We apply the following logic. The Company's outlook takes a realistic view of low margin in automotive-related business. It is difficult to imagine a scenario in which margin exceeds expectations and operating income and following figures beat the forecast. Sales upside, meanwhile, is very possible. This reflects our view that robust demand for the Company's products is likely to continue from 2H FY3/17 and 1H FY3/18 during 2H. Smartphones remain an important final product, but automobiles and semiconductors are also contributing in this cycle. The Company benefited from these industries on multiple occasions in the past, though content has considerably changed.

In the automotive business, demand for on-board parts related to ADAS and EVs has grown into a major area, besides capital investment activity, and the Company is effectively tapping into this wave as explained above. In semiconductors, the Company's involvement is capital investments, and this business is receiving support from two major structural trends of the shift from HDDs to SSDs and the emergence of China's semiconductor industry. With these conditions, we expect a healthy business environment for the Company to continue in 2H, even with some temporary fluctuations. We thus think the Company has a good chance of beating its ¥139,000mn target for FY3/18 net sales.

Sales upside works out to about ¥2,000mn at a double-digit sales growth rate in 2H FY3/18. We estimate operating income upside of ¥50mn using a 2.5% operating margin in this case. In fact, however, margin on excess sales (¥2,000mn in this case) often greatly exceeds the Company average and comes close to incremental margin (gross margin in the Company's case as a trading company). Operating income upside might reach about ¥200mn from this perspective. We believe this amount is enough to trigger a positive surprise.

Summary income statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	
				1H	Full year E
Net sales	111,276	105,748	116,611	67,348	139,000
YoY	9.8%	-5.0%	10.3%	34.7%	19.2%
Gross profit	13,988	13,256	14,255	7,945	-
Gross profit margin	12.6%	12.5%	12.2%	11.8%	-
SG&A expenses	10,516	10,812	11,240	6,172	-
YoY	11.1%	2.8%	4.0%	17.6%	-
Ratio of SG&A expenses to sales	9.5%	10.2%	9.6%	9.2%	-
Operating income	3,471	2,444	3,014	1,773	3,500
YoY	8.1%	-29.6%	23.3%	63.9%	16.1%
Ratio of SG&A expenses to sales	3.1%	2.3%	2.6%	2.6%	2.5%
Ordinary income	3,761	2,645	3,215	1,951	3,800
YoY	9.4%	-29.7%	21.6%	76.9%	18.2%
Net income attributable to owners of the parent	2,466	1,690	1,584	1,359	2,650
YoY	13.8%	-31.5%	-6.3%	78.0%	67.3%
EPS (¥)	171.83	117.76	113.64	98.11	191.22
Dividend (¥)	26.00	28.00	28.00	14.00	28.00

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

Summary balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	2Q FY3/18
Current assets	45,329	49,239	46,857	55,507	59,948
Cash and deposits	6,937	7,584	6,359	6,759	7,510
Notes and accounts receivable	33,075	34,419	33,006	34,141	34,810
Non-current assets	8,369	9,509	8,581	9,309	10,857
Tangible fixed assets	4,038	3,879	3,788	3,056	3,132
Intangible fixed assets	76	243	240	222	195
Investments and other assets	4,254	5,386	4,553	6,030	7,528
Total assets	53,698	58,748	55,439	64,816	70,805
Current liabilities	30,735	32,370	28,691	36,596	37,528
Notes and accounts payable – trade	25,917	27,496	24,732	31,182	32,305
Short-term loans payable, etc.	2,528	2,782	2,317	2,489	2,488
Non-current liabilities	4,309	4,426	4,484	4,581	7,539
Long-term loans payable	2,205	2,100	2,400	2,300	4,700
Shareholders' equity	16,807	18,929	20,217	21,034	22,199
Capital stock	2,553	2,553	2,553	2,553	2,553
Capital surplus	1,958	1,958	1,958	1,958	1,958
Retained earnings	12,350	14,472	15,761	16,950	18,116
Treasury shares	-53	-54	-54	-427	-427
Net assets	18,654	21,951	22,263	23,637	25,737
Total liabilities and net assets	53,698	58,748	55,439	64,816	70,805

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

Cash flow statement

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18 2Q
Cash flow from operating activities	-1,374	1,353	-60	1,679	-1,301
Cash flow from investing activities	-127	-444	-384	-235	-66
Cash flow from financing activities	769	-470	-654	-818	2,144
Cash and cash equivalent conversion difference	236	208	-127	-226	-26
Cash and cash equivalent change	-496	647	-1,225	400	750
Cash and cash equivalent period-start balance	6,949	6,453	7,100	5,875	6,275
Cash and cash equivalent period-end balance	6,453	7,100	5,875	6,275	7,026

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

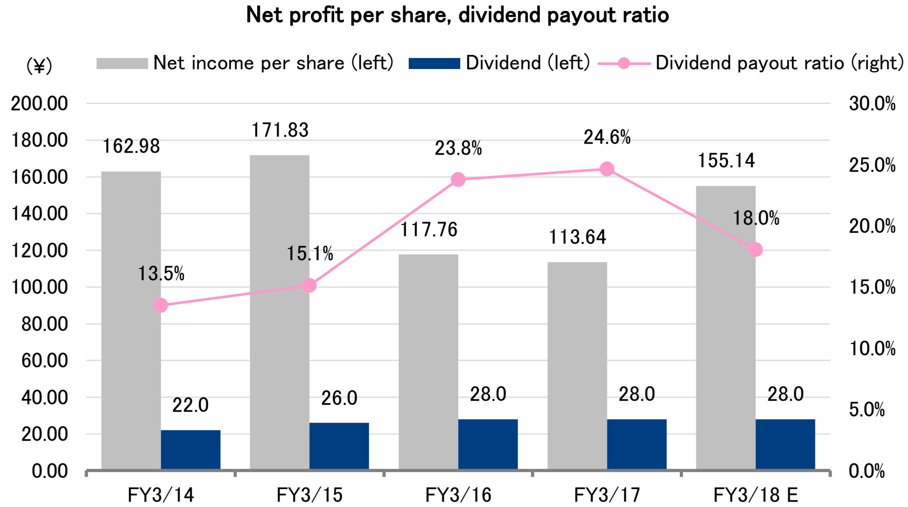
Shareholder return policy

Possible dividend revision, though expecting priority on stable increases

The Company's basic policy is to provide returns to shareholders in the form of dividends. Management prioritizes providing stable, continuous dividends, as demonstrated in its track record to date. While remaining very aware of the need for stable dividends, the Company has also increased them in keeping with earnings growth.

The Company disclosed a FY3/18 dividend target of ¥28 (with an interim dividend of ¥14 and a period-end dividend of ¥14), which is flat YoY, and decided to pay a ¥14 interim dividend in line with the period-start outlook. It raised the FY3/18 outlook and currently expects ¥191.22 in net income per share. The estimated dividend payout ratio at this point has dropped to 14.6% due to maintaining the dividend target at the period-start level of ¥28 for the full year.

We see a reasonable chance of the Company raising the dividend target in light of the past. However, its stance on the dividend gives priority to stable increases and does not alter the dividend based on profit fluctuation using a fixed dividend payout ratio. We expect the Company to cautiously approach changes to the dividend outlook in light of business conditions in not only FY3/18, but also from FY3/19 and advice investors to avoid overly simplistic build-up of dividend hike expectations.



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

Information security

Utilizes a wide range of measures to manage customer information

As a listed company, the Company is keenly aware of the need for information security to combat cyber-terrorism and other threats. It adopts a wide range of measures that leverage strong IT-related knowledge as a technology-centric trading company. We think losses and leaks of private information and credit card numbers are the primary risks in information security in the minds of investors. From this perspective, the Company's risk exposure related to information security is relatively low because it does not operate B-to-C business.

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