COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst

Hiroyuki Asakawa

FISCO

FISCO Ltd.

http://www.fisco.co.jp

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Summary

Continuing healthy progress in the final year of the medium-term management plan
Achieving steady growth in the engineering business

SUN-WA TECHNOS CORPORATION <8137> (hereinafter, "the Company") is an independent trading company that specializes in technology products. The Company has steadily expanded its businesses by leveraging coverage of three major areas (electrical machinery, electronics, and general machinery) and two-way trade in which it sells equipment and materials for manufacturers' production lines and then procures the products made by these manufacturers. In recent years, it has been focusing on the engineering business and global SCM solutions.

1. Reported higher sales and profits in 1H FY3/19, limited impact from China risk

The Company reported higher sales and profits in 1H FY3/19 at ¥72,164mn in net sales (+7.2% YoY) and ¥2,312mn in ordinary income (+18.5%). Despite concerns about the impact of trade friction between the US and China and other factors, it increased sales of electronics and other products to the automotive industry and steadily expanded sales to the semiconductor and FPD (flat panel display) industries. Profit met the Company's initial forecast even with setbacks from weaker demand than expected in some industries, such as factory automation and other industrial machinery, due to high smartphone-related demand.

2. Making healthy progress in the final year of the medium-term management plan, expanding the engineering business while raising profitability

This fiscal year (FY3/19) is the final year of Challenge 1500, the current medium-term management plan. The Company already reached the sales goal one year ahead of time and is working toward realization of profit goals in FY3/19. Besides existing business growth, a major theme in this plan is expansion of the engineering business and the global SCM business. The engineering business, in particular, deserves notice. This refers to efforts to pursue added value through having the three existing businesses share and utilize product and technology information they respectively possess and sell things in packages rather than on a standalone basis. The profit margin for the engineering business disclosed this time exceeds the Companywide average as targeted by the Company. This result confirmed healthy growth while raising profitability in the engineering business.

3. Prospect of continued smooth expansion led by the automotive business in 2H FY3/19

For FY3/19, the Company targets ¥150,000mn in net sales (+2.2% YoY) and ¥4,500mn in ordinary income (+3.5%). While it lowered net sales in light of the 1H outcome, it kept ordinary income at the period-start level. The outlook expects the 2H business environment to be roughly similar to 1H with automotive-related demand (particularly safety equipment and other products installed in vehicles) as the main results driver again. Order value and order backlog were at all-time high levels in 1H, and we think this position is likely to support healthy expansion in 2H as well. Some observers expect recovery in Chinese demand to come earlier than anticipated. We advise caution at this point, but forecast a tailwind for the Company's results if it happens.

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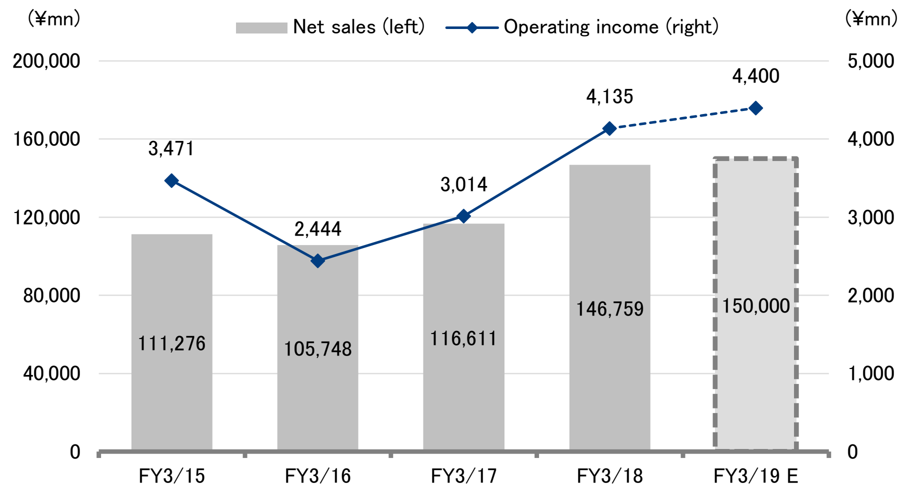
Key Points

- Healthy growth in sales to automotive and FPD industries in the Japanese market and industrial machinery industry in the Asian market
- Making smooth progress toward medium-term management plan goals, determined to reach ¥150bn in net sales and ¥4.5bn in ordinary income in FY3/19
- Likely to continue achieving steady expansion while raising profitability for the engineering business, the top priority

Results trends



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

Results trends

Posted higher sales and profits YoY with sales gains and improved gross margin in all three segments
Efficient utilization of SG&A expenses boosted profits too

1. Review of 1H FY3/19 results

The Company reported higher sales and profits in 1H FY3/19 at ¥72,164mn in net sales (+7.2% YoY), ¥2,129mn in operating income (+20.1%), ¥2,312mn in ordinary income (+18.5%), and ¥1,651mn in net income attributable to owners of the parent (+21.4%).

The Company is putting top priority on realizing its target for ordinary income in FY3/19. While 1H sales missed by 8.1% (¥6,336mn), ordinary income reached the initial target. We think this was a passing result.

1H FY3/19 results

(¥mn)

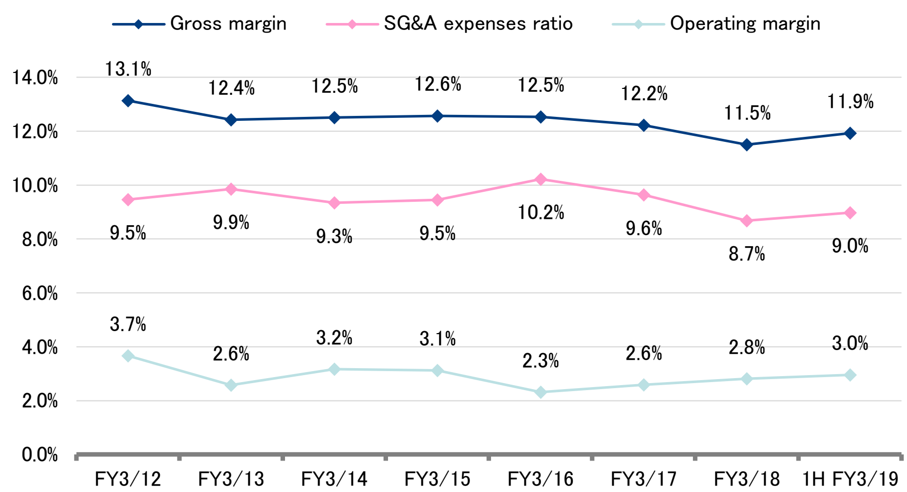
	FY3/18	FY3/19				
	1H	1H forecast	Results	YoY	vs. forecast	Progress rate
Net sales	67,348	78,500	72,164	7.2%	-8.1%	48.1%
Operating income	1,773	2,250	2,129	20.1%	-5.4%	48.4%
Operating margin	2.6%	2.9%	3.0%	-	-	
Ordinary income	1,951	2,300	2,312	18.5%	0.5%	51.4%
Net income attributable to owners of the parent	1,359	1,600	1,651	21.4%	3.2%	52.4%

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

Net sales rose 7.2% YoY with gains in the three major segments (electrical machinery, electronics, and general machinery; details covered below), a generally upbeat trend. The Company also posted higher sales in all regions, including double-digit advances in Japan and Europe/US and 5-6% increases in Asia and others. By demand sector, sales to the automotive industry were upbeat, just as in the previous fiscal year with manufacturing equipment holding at a high level and continued strong growth in the automotive product business. While the semiconductor and industrial machinery industries slowed versus previous momentum and sales undershot expectations in some areas, the Company still achieved sales gains YoY from these industries.

In earnings, gross margin increased by 0.1ppt from 11.8% in the previous year to 11.9%. The SG&A expenses ratio improved too with a 0.2ppt decline from 9.2% to 9.0%. The Company expanded gross margin, despite heavy downward pressure from a product mix change and tougher competition, due to sales efforts and initiatives in the engineering business explained below. In SG&A expenses, while higher logistics costs had been a concern as a factor weighing on profit, stronger sales and rigorous efforts to efficiently utilize spending throughout the Company offset this impact and enabled reduction of the SG&A expenses ratio. Due to these trends, the operating margin climbed by 0.4ppt from 2.6% to 3.0% and operating income increased 20.1% YoY.

Trends in various margins



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

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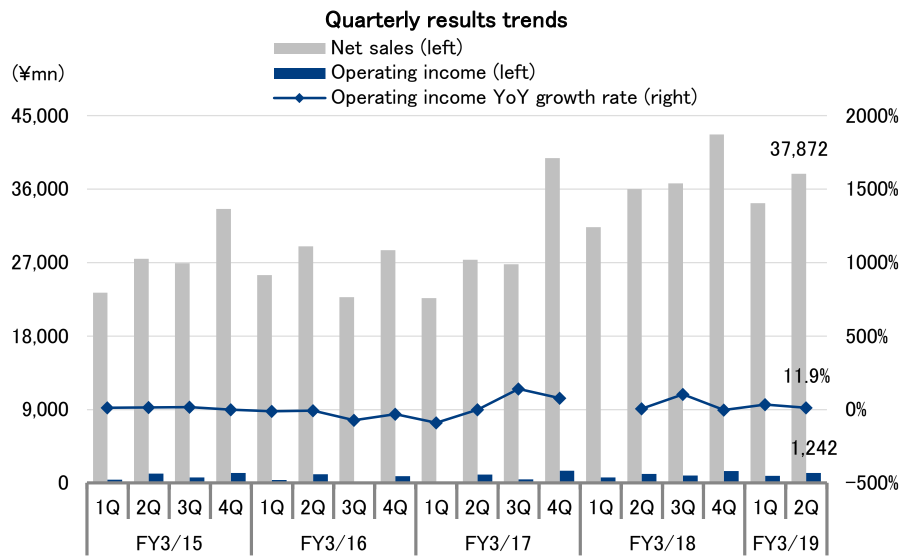
Net sales missed the initial target by 8.1% (¥6,336mn). As explained below, the Company lowered the FY3/19 net sales target by ¥7,500mn with much of the revision coming from a rise in internal eliminations. It removes transactions to avoid double booking of internal transactions that extend across regions and divisions. A larger increase in such transactions than in the initial outlook resulted in downward revision of the sales target. The sales revision has limited impact on earnings because these transactions typically do not involve profits. The Company posted profits on track with the forecast in 1H and maintained FY3/19 profit targets at roughly existing levels.

Looking at quarterly results trends, sales moved above ¥40bn in 4Q FY3/18, but subsequently dropped back to the ¥30bn range again in 1-2Q FY3/19, including seasonality. Sales climbed YoY in both 1Q and 2Q and profits also rose in both quarters.



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

Healthy growth in sales to automotive and FPD industries for the mainstay Japanese market
Sales to the industrial machinery industry in the Asian market, which had been a concern, increased too

2. Segment details

The Company has three business segments (electrical machinery, electronics, and general machinery) as mentioned earlier. Below we review trends for these segments in 1H FY3/19.

(1) Electrical machinery

Sales climbed 7.6% YoY to ¥13,332mn with gains in sales to the FPD industry in Japan and Europe/US and the semiconductor industry in Japan. However, sales to the industrial machinery industry in Asia weakened.

(2) Electronics

Sales increased 6.4% YoY to ¥53,553mn on advances in sales to automotive and FPD industries in Japan and the industrial machinery industry in Asia and Europe/US.

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(3) General machinery

Sales expanded 14.3% YoY to ¥5,278mn with increases to automotive, industrial machinery, and amusement industries in Japan, industrial machinery industry in Asia, and automotive industry in Europe/US.

Net sales trend by segment

(¥mn)

	FY3/18			FY3/19		
	1Q	2Q	1H	1Q	2Q	1H
Electrical machinery	6,056	6,333	12,390	6,271	7,061	13,332
YoY	57.0%	20.5%	35.9%	3.5%	11.5%	7.6%
Electronics	23,680	26,658	50,339	25,662	27,891	53,553
YoY	38.2%	36.2%	37.1%	8.4%	4.6%	6.4%
General machinery	1,617	3,001	4,619	2,357	2,921	5,278
YoY	3.0%	19.2%	10.4%	45.7%	-2.7%	14.3%
Total net sales	31,355	35,993	67,348	34,292	37,872	72,164
YoY	38.4%	31.6%	34.7%	9.4%	5.2%	7.2%

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

3. Results trends by geographical market

Sales and profits improved YoY in the three regional segments of Japan, Asia, and Europe/US.

(1) Japan

Sales were up 10.1% YoY to ¥57,653mn, and operating income rose 13.9% to ¥1,065mn. The Company boosted sales by leveraging strengths of products in electrical machinery, electronics, and general machinery segments in a wide range of industries, including the main industries of automotive, semiconductor, and industrial machinery.

(2) Asia

Sales advanced 5.1% YoY to ¥18,646mn, and operating income improved 15.5% to ¥778mn. While growth rates were substantially slower than in 1H of the previous year, the Company secured higher sales and profits mainly on increased sales of electronic parts and manufacturing equipment to the industrial machinery industry. Despite the absence of disclosure of data on China, the largest intraregional market, we think business in China stalled and this led to significantly weaker sales growth in light of general global trends and activity at main customers.

(3) Europe/US

Sales were up 11.9% YoY to ¥4,204mn, and operating income climbed 69.2% to ¥275mn. The Company achieved healthy gains in sales to FPD, automotive, and industrial machinery industries. While sales rose sharply by 98.6% in the previous year, they were still up by double digits in FY3/19. This indicates steady expansion in Europe/US. Profit margin was 6.5%, the highest in all segments.

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Results trends by geographical market

(¥mn)

		FY3/18			FY3/19		
		1Q	2Q	1H	1Q	2Q	1H
Japan	Net sales	24,098	28,287	52,385	27,664	29,989	57,653
	YOY	34.4%	22.3%	27.6%	14.8%	6.0%	10.1%
	Operating income	154	781	935	345	720	1,065
	YOY	-	-6.7%	24.5%	123.6%	-7.8%	13.9%
	Operating margin	0.6%	2.8%	1.8%	1.2%	2.4%	1.8%
Asia	Net sales	8,110	9,624	17,734	8,500	10,146	18,646
	YOY	40.5%	58.6%	49.7%	4.8%	5.4%	5.1%
	Operating income	338	336	674	376	402	778
	YOY	138.7%	101.0%	118.3%	11.4%	19.6%	15.5%
	Operating margin	4.2%	3.5%	3.8%	4.4%	4.0%	4.2%
Europe/US	Net sales	2,306	1,452	3,758	2,340	1,864	4,204
	YOY	120.7%	71.2%	98.6%	1.5%	28.4%	11.9%
	Operating income	185	-23	162	171	104	275
	YOY	-	-	868.1%	-7.4%	-552.2%	69.2%
	Operating margin	8.0%	-1.5%	4.3%	7.3%	5.6%	6.5%

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

While simple comparisons of these segment and regional trends by demand industries is not possible because of major differences in core industries and industrial structures by region/country and Japan's overwhelmingly large presence in regional breakdowns, we think having many products and demand industries with sales increases in the main Japanese market indicates the robustness of the Company's profit stability. In changes over time, sales continued rising, just as in FY3/18, to the automotive industry (electronics), semiconductor industry (electrical machinery), and FPD industry (electrical machinery) in Japan, industrial machinery industry (electronics) in Asia, and FPD industry (electrical machinery) in Europe/US.

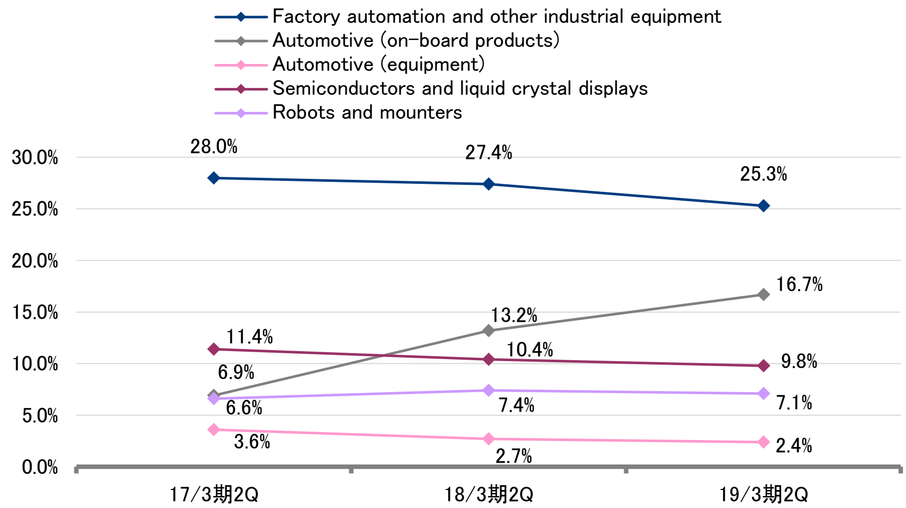
Segment and regional trends

	Japan			Asia			Europe/US		
	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery
Automotive industry		○	○						○
Semiconductor industry	○								
Industrial machinery industry			○	×	○	○		○	
FPD industry	○	○					○		
Smartphone industry									
Amusement industry		○							

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

While factory automation and other industrial equipment is still the largest sales source by industry, its ratio has been trending lower over the past few years. Conversely, the automotive (on-board products) area is sharply raising its presence. This reflects sales to various on-board product industries within the automotive application. We think the electronics segment delivers materials and electronic parts. The five major industries that stably hold top-level ratios have exhibited YoY growth rates that are positive or flat. The automotive (on-board products) area's ability to rapidly increase its ratio in this environment attests to strong growth.

Trends in sales ratios by industry (five major industries)



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

Overview and progress of the medium-term management plan

Determined to reach ¥150bn in net sales and ¥4.5bn in ordinary income in FY3/19 driven by three business strategies for engineering business and other areas

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. The Company is implementing Challenge 1500, the ninth three-year medium-term management plan, with FY3/19 as the final fiscal year.

Challenge 1500 aims to deepen and advance results from the previous JUMP 1200 medium-term management 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. As explained later in detail, the Company already reached the sales goal ahead of time in FY3/18 and is working toward realization of profit goals in FY3/19, the plan’s final year, as the top priority.

The medium-term management plan calls for growth and expansion in three strategic areas – “systems, equipment, and parts/components sales business,” “engineering business,” and “global SCM solutions business.” Some attention should be given to correlation among these three businesses.

The "systems, equipment, and parts/components sales business" could be viewed as a renaming of the Company's existing three business segments (electrical machinery, electronics, and general machinery). We think it is natural for the Company to pursue expansion of this business.

The "engineering business" expresses a sales methodology and strategy for expansion of the "systems, equipment, and parts/components sales business," rather than being an independent business. While the Company has a wide range of products that extend across the three business segments, this area promotes sales by combining multiple products as a system and proposing solutions to customers, instead of standalone sales of these items.

The "global SCM solutions business" has functionality and characteristics of procurement on behalf of customers and resembles the engineering business in terms of cutting across the three business segments. The Company positions it as an income-generating business, rather than a "customer service" to lift sales in the three business segments, and is thinking about developing it into an independent 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 the Company's materials

Looking at Challenge 1500 business goals and actual results thus far, just as in the first fiscal year, the Company reported results in FY3/18, the plan's second year, substantially exceeding goals after three upward revisions. Sales surpassed the final-year goal of ¥137,000mn and ordinary income was close to the final-year goal as well.

In light of this outcome, the Company set its period-start targets for FY3/19, the plan's final year, at ¥157,500mn in net sales and ¥4,500mn in ordinary income. As explained above, while it lowered the full-year sales target to ¥150,000mn due to a rise in internal eliminations at the 1H announcement, it is steadily progressing toward the profit target on track with the initial plan. The Company places emphasis on both sales and ordinary income as indicators in the medium-term management plan and kept the ordinary income target at the period-start level of ¥4,500mn.

Challenge 1500 management targets

(¥mn)

	FY3/17		FY3/18		FY3/19	
	Management targets	Results	Management targets	Results	Management targets	Revised forecast
Net sales	117,000	116,611	126,000	146,759	137,000	150,000
Operating income	2,800	3,014	3,500	4,135	4,300	4,400
Operating margin	2.4%	2.6%	2.8%	2.8%	3.1%	2.9%
Ordinary income	3,000	3,215	3,700	4,349	4,500	4,500
Ordinary margin	2.6%	2.8%	2.9%	3.0%	3.3%	3.0%

Source: Prepared by FISCO from the Company's materials

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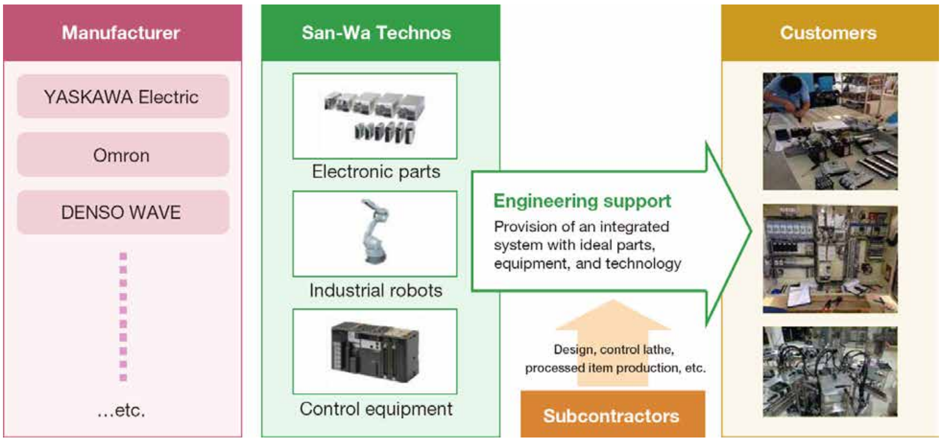
Continuing steady expansion while improving profitability in top-priority engineering business

2. Progress of the engineering business

(1) Business overview

The engineering business at the Company is a sales approach for "proposing products from the three segments 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 processing can vary from selling a prepared item to a side dish or 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 segments.

Engineering business



Source: Company website

We explained the engineering business as a sales methodology, but it offers potential to make actual contributions to earnings, primarily by improving profit margin. As in the example described above, effort expended to prepare a meal box or side dishes constitutes added value and thereby significantly increases profitability. While the margin improvement effect is limited at this point because of the fairly small absolute value of added-value portion, profitability in the engineering business clearly exceeds the overall average as explained below. We think increasing the added-value portion is likely to be an issue in the next stage considering steady ramp-up of the engineering business as a sales methodology. Expansion of the engineering business helps in obtaining upkeep and maintenance demand too. It increases the possibility of securing repeat orders as well. We see such related demand and a positive spillover effect as important benefits from the engineering business.

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(2) Update on progress

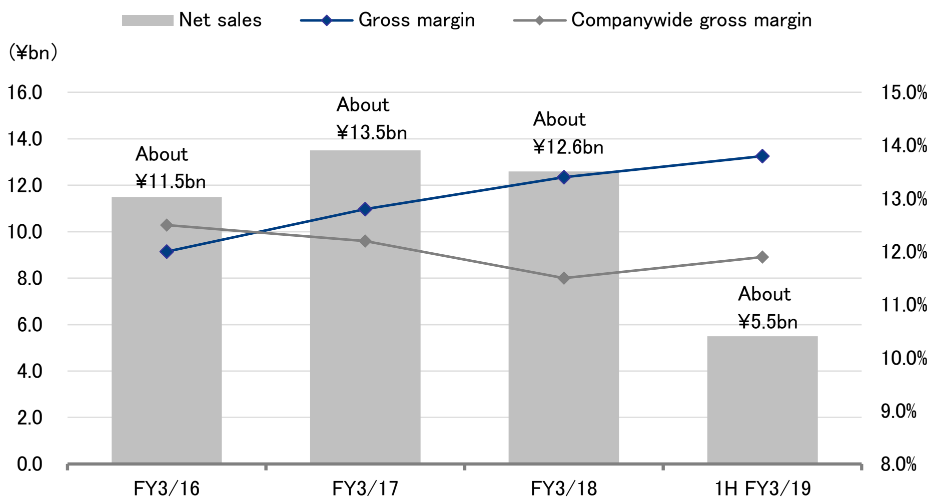
The Company implemented various initiatives aimed at accelerating growth in the engineering business from its previous medium-term management plan period. These include hiring external human resources and carrying out multiple reorganizations. A recent example was revamping the engineering organization in October 2017 into the following sections - robotics promotion, IoT promotion, monitoring and control promotion, automated recognition promotion, electrical equipment technology, and technology services. The Company also started referring internally to the electrical machinery and general machinery segments, which have similar customers and demand structures, out of its three business segments as the “machinery and electrical division” in order to bolster collaboration awareness and operations.

The Company worked on redefining the “engineering business” again in 1H FY3/19. This is a very important first step in assessing the engineering business scale and results with consistency. The updated approach defined it as “sales from bundled selling of two or more types of items rather than standalone product sales.” It is estimated that the new definition raises sales value by about ¥5bn compared to the previous calculation method. The key point is consistency and continuity. We think this definition should facilitate more precise analysis over time.

The engineering business amounted to about ¥5.5bn in 1H FY3/19, or about 44% of the roughly ¥12.6bn in FY3/18 results. Progress appears to be trailing the previous fiscal year, but this is not that important in our view because the engineering business often consists of large equipment deals and these results in significant sales volatility. We focus on profitability (margin) trends and think this is most important. The Company’s definition of the engineering business implies that the added-value portion should lift profits compared to standalone sales. We thus believe a key indicator is whether the business is reliably generating profits and profit margin exceeds the overall average.

The Company disclosed profit margin for the first time in its latest results. According to these values, the engineering business gross margin rose to about 14% in 1H FY3/19, beating the overall average of 11.9% by roughly 3ppt. We have a favorable view of healthy advances as intended. However, it should be noted that profit margin is often low on large-scale deals. Since these deals are likely to be placed under the engineering business, such cases might cause a nominal decline in engineering profitability. We think profitability needs to be confirmed on a basis excluding such projects too in cases with large-deal exceptions.

Trend in engineering business sales



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

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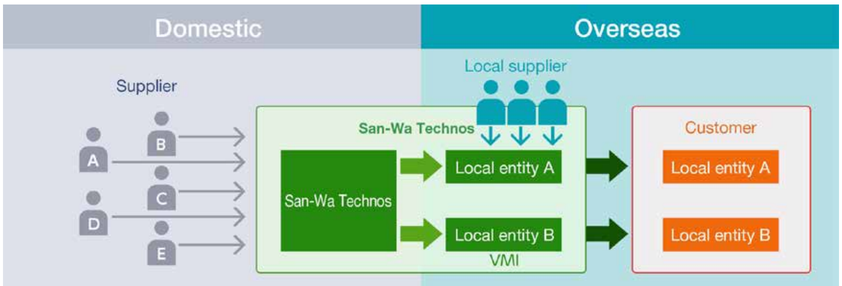
Incorporating outsourcing needs using the overseas network and international logistics knowhow, within reach of the ¥10bn sales threshold in FY3/19

3. Progress on the global SCM solutions business

(1) Business overview

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 management 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 26 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's motivation and aim in promotion of the global SCM solutions business stem from the lack of global logistics, inventory management, and materials procurement manpower, even at large manufacturers, following sustained targeting of these areas in business reorganization reforms and other restructuring. Outsourcing needs exist in these areas due to the reality of pursuit of greater efficiency in manufacturing and frequent business transfers that extend across countries, particularly at large companies. The Company wants to incorporate this demand using its knowhow accumulated over many years and overseas network. We think there is very large potential demand for the global SCM solutions business.

(2) Update on progress

The global SCM solutions business has been growing at a healthy pace, similar to the engineering business. Sales totaled about ¥4.1bn in FY3/17 and rose to roughly ¥7.2bn in FY3/18. The initial FY3/19 budget targets ¥9.8bn, and the Company reported that this business proceeded in line with the plan through 1H and did not alter the full-year outlook. The Company is aiming for ¥10bn in sales as a near-term goal for the global SCM solutions business and appears to be on track to achieving this level in FY3/19.

Deal opportunities from 1H FY3/19 include 1) supplying parts and materials for customized power sources used in business phones from Japan to Thailand, 2) supplying touch panels for airplane audiovisual systems from Taiwan to Japan, and 3) supplying mobile robot production items from the US to Japan.

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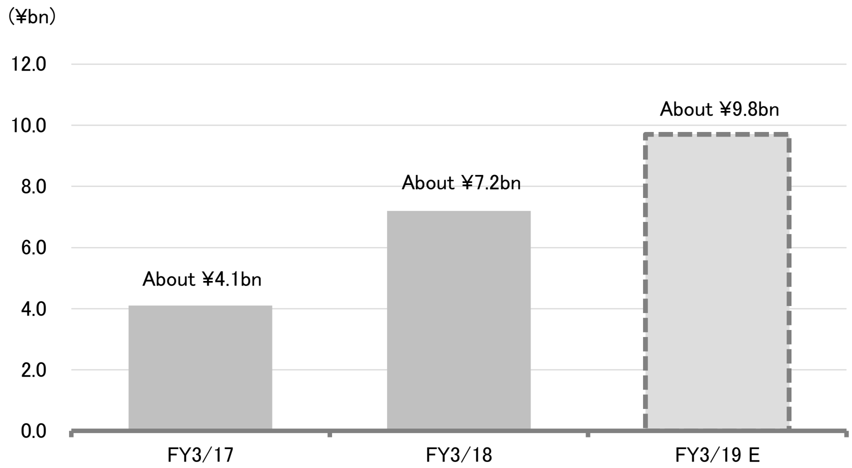
Trends in global SCM solutions business sales



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

Outlook

Lowered the sales target, but kept ordinary income at the period-start level

(1) Overview

The Company partly revised the FY3/19 forecast in light of 1H results. Updated targets are ¥150,000mn in net sales (+2.2% YoY), ¥4,400mn in operating income (+6.4%), ¥4,500mn in ordinary income (+3.5%), and ¥3,150mn in net income attributable to owners of the parent (+2.1%).

While the Company lowered net sales by ¥7,500mn and operating income by ¥50mn, it kept ordinary income and following values at initial levels.

Overview of FY3/19 forecasts

(¥mn)

	FY3/18			FY3/19					
					2H		Full year		
	1H	2H	Full year	1H	Forecast	YoY	Initial forecast	Revised forecast	YoY
Net sales	67,348	79,411	146,759	72,164	77,836	-2.0%	157,500	150,000	2.2%
Operating income	1,773	2,362	4,135	2,129	2,271	-3.9%	4,450	4,400	6.4%
Operating margin	2.6%	3.0%	2.8%	3.0%	2.9%	-	2.8%	2.9%	-
Ordinary income	1,951	2,398	4,349	2,312	2,188	-8.8%	4,500	4,500	3.5%
Net income attributable to owners of the parent	1,359	1,726	3,085	1,651	1,499	-13.2%	3,150	3,150	2.1%

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

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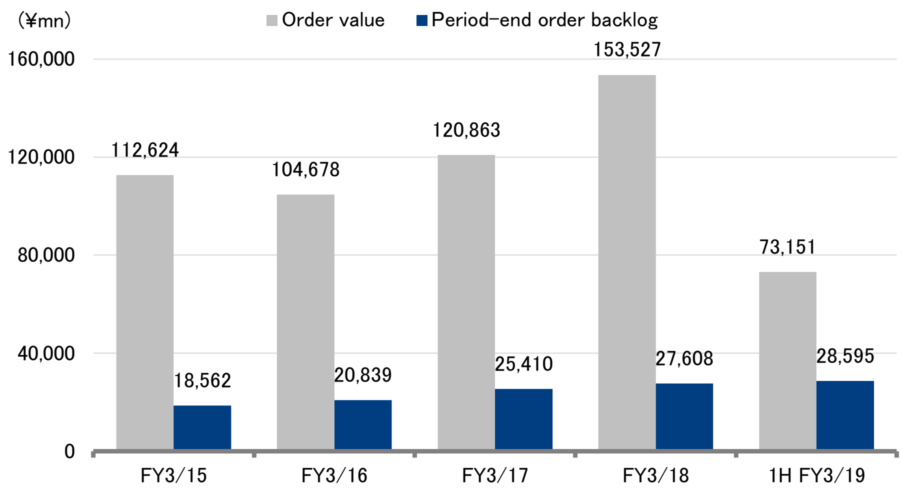
Increased internal eliminations were the primary reason for lowering the sales estimate as explained above. While shortfalls in orders versus the forecast due to weaker capital investment demand in China and Japan affected the outlook on a real basis, we estimate that these impacts only amounted to about 20% of the downward revision. This content limited impact on profits from reducing the sales outlook to just ¥50mn at the operating income stage. The Company retained ordinary income and following values at initial levels.

Order value and order backlog, which are key amounts for assessing 2H FY3/19 prospects, reached all-time highs in 1H. These values will be booked as sales in 2H. Additionally, for the 2H orders outlook, sales activities are showing signs of recovery in the Chinese market at the start of next year. If this happens, expectations are likely to build for sales upside in 2H. Yet we advise against excessive expectations because of stalled economic activity for about two weeks in February for the Chinese New Year.

Order value and order backlog trends



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

From an industry perspective, automotive (on-board products) business is likely to continue growing. The Company supplies parts and materials mainly for the safe driving assistance. Demand should steadily increase in this area, even if total automobile output modestly declines, because usage begins with luxury vehicles and then broadens to other models. The Company books sales from these parts and materials under the electronics segment among its three divisions.

For profits, conditions in 2H should fundamentally continue trends seen in 1H. The Company needs ¥2,271mn in 2H operating income in order to reach the FY3/19 target. This corresponds to a 2.9% operating margin, a slightly lower level than 1H's 3.0%. We think the discrepancy simply reflects how the values worked out and does not constitute a message.

Nevertheless, we recommend a cautious approach to 2H margin because of the outlook for a rise in the ratio of automotive (on-board products) sales. Growth in this area might weigh on profit margin due to less favorable product mix since it typically has lower margin than the Company's average. While there is a possibility of sales upside on large order backlog and early recovery by the Chinese market, as noted above, we think emphasis should be placed first on whether the Company achieves forecast.

We encourage readers to review our complete legal statement on "Disclaimer" page.

(2) Business segment outlooks

a) Electrical machinery

The FY3/19 sales target is ¥27,500mn (+1.2% YoY). The Company reduced the target by ¥2,400mn from the period-start level of ¥29,900mn. We believe internal eliminations had a large impact, just as with the general machinery segment covered below. Domestic sales to the semiconductor and FPD industries rose in 1H, and we expect this trend to continue in 2H. We also project stronger electrical machinery sales if Chinese demand has an early recovery.

b) Electronics

The FY3/19 sales target is ¥109,000mn (-1.3% YoY). The Company reduced the target by ¥2,000mn from the initial level. We do not expect a major setback for this segment because it handles sales of a wide range of products to many industries and think the downward revision reflects media reports forecasting a 30% YoY decline in orders placed for factory automation and other industrial equipment industries that are the main source of customers. While the outlook implies a 7.7% YoY drop in 2H sales, this stance seems reasonable given the 1H trend in orders from Chinese companies. However, there is also a possibility of upside in the case of an early recovery in Chinese demand, just as for the electrical machinery segment.

c) General machinery

The FY3/19 sales target is ¥13,500mn (+47.4% YoY). The Company reduced the target by ¥3,100mn from the initial level, though primarily due to higher internal eliminations. It expects a steep rise in sales on the prospect of booking large-scale deals from automotive and food product manufacturers. These opportunities seem to be proceeding roughly as planned and have not been lost. We will be closely monitoring trends.

Net sales outlook by segment

(¥mn)

	FY3/18			FY3/19			
	1H	2H	Full year	1H	2H E	Full year (initial forecast)	Full year (revised forecast)
Electrical machinery	12,390	14,776	27,166	13,332	14,168	29,900	27,500
YoY	35.9%	27.1%	31.0%	7.6%	-4.1%	10.1%	1.2%
Electronics	50,339	60,097	110,436	53,553	55,447	111,000	109,000
YoY	37.1%	22.4%	28.7%	6.4%	-7.7%	0.5%	-1.3%
General machinery	4,619	4,537	9,156	5,278	8,222	16,600	13,500
YoY	10.4%	-22.7%	-8.9%	14.3%	81.2%	81.3%	47.4%
Total net sales	67,348	79,411	146,759	72,164	77,836	157,500	150,000
YoY	34.7%	19.2%	25.9%	7.2%	-2.0%	7.3%	2.2%

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

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Summary income statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19	
					1H	Full year (revised forecast)
Net sales	111,276	105,748	116,611	146,759	72,164	150,000
YoY	9.8%	-5.0%	10.3%	25.9%	7.2%	2.2%
Gross profit	13,988	13,256	14,255	16,883	8,609	-
Gross margin	12.6%	12.5%	12.2%	11.5%	11.9%	-
SG&A expenses	10,516	10,812	11,240	12,747	6,479	-
YoY	11.1%	2.8%	4.0%	13.4%	5.0%	-
SG&A expenses ratio	9.5%	10.2%	9.6%	8.7%	9.0%	-
Operating income	3,471	2,444	3,014	4,135	2,129	4,400
YoY	8.1%	-29.6%	23.3%	37.2%	20.1%	6.4%
Operating margin	3.1%	2.3%	2.6%	2.8%	3.0%	2.9%
Ordinary income	3,761	2,645	3,215	4,349	2,312	4,500
YoY	9.4%	-29.7%	21.6%	35.3%	18.5%	3.5%
Net income attributable to owners of the parent	2,466	1,690	1,584	3,085	1,651	3,150
YoY	13.8%	-31.5%	-6.3%	94.8%	21.4%	2.1%
EPS (¥)	171.83	117.76	113.64	222.65	103.23	196.93
Dividend (¥)	26.00	28.00	28.00	30.00	17.00	34.00

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

Summary balance sheet

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	1H FY3/19
Current assets	49,239	46,857	55,507	65,852	65,158
Cash and deposits	7,584	6,359	6,759	8,596	12,631
Notes and accounts receivable	35,145	34,554	41,168	46,077	40,703
Non-current assets	9,509	8,581	9,309	11,401	10,395
Property, plant and equipment	3,879	3,788	3,056	3,005	3,022
Intangible assets	243	240	222	168	127
Investments and other assets	5,386	4,553	6,030	8,227	7,246
Total assets	58,748	55,439	64,816	77,254	75,554
Current liabilities	32,370	28,691	36,596	43,077	38,997
Notes and accounts payable – trade	27,496	24,732	31,182	34,298	30,009
Short-term loans payable, etc.	2,782	2,317	2,489	5,722	6,481
Non-current liabilities	4,426	4,484	4,581	6,182	4,945
Long-term loans payable	2,100	2,400	2,300	3,500	2,900
Shareholders' equity	18,929	20,217	21,034	23,731	28,351
Capital stock	2,553	2,553	2,553	2,553	3,727
Capital surplus	1,958	1,958	1,958	1,958	3,548
Retained earnings	14,472	15,761	16,950	19,647	21,077
Treasury shares	-54	-54	-427	-428	-
Total accumulated other comprehensive income	3,022	2,045	2,603	4,262	3,259
Net assets	21,951	22,263	23,637	27,993	31,611
Total liabilities and net assets	58,748	55,439	64,816	77,254	75,554

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

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Cash flow statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	1H FY3/19
Cash flow from operating activities	1,353	-60	1,679	-2,221	1,247
Cash flow from investing activities	-444	-384	-235	29	-119
Cash flow from financing activities	-470	-654	-818	3,962	3,001
Effect of exchange rate change on cash and cash equivalents	209	-125	-226	67	-94
Net increase (decrease) in cash and cash equivalents	647	-1,225	400	1,837	4,034
Cash and cash equivalents at beginning of period	6,453	7,100	5,875	6,275	8,112
Cash and cash equivalents at end of period	7,100	5,875	6,275	8,112	12,147

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

Shareholder return policy

Plans to pay a ¥34 dividend (+¥4) in FY3/19 based on healthy profit growth

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 the Company does not sharply raise dividends in response to temporary rapid profit expansion, it has steadily increased them in keeping with earnings growth.

The Company disclosed a dividend target of ¥34 (¥17 as an interim dividend and ¥17 as the period-end dividend), an increase of ¥4. This corresponds to a dividend payout ratio of 17.3% using the profit outlook for ¥196.93 per share. We think it decided to raise the dividend as a reflection of healthy profit growth given the forecast of higher sales and profits and a stance of paying shareholder return premised on sustaining a stable dividend.

The Company has not presented FY3/20 earnings and dividend outlooks yet, but arrival of the 70th anniversary in November 2019 during the fiscal year is likely to be a factor in assessing shareholder return in FY3/20.

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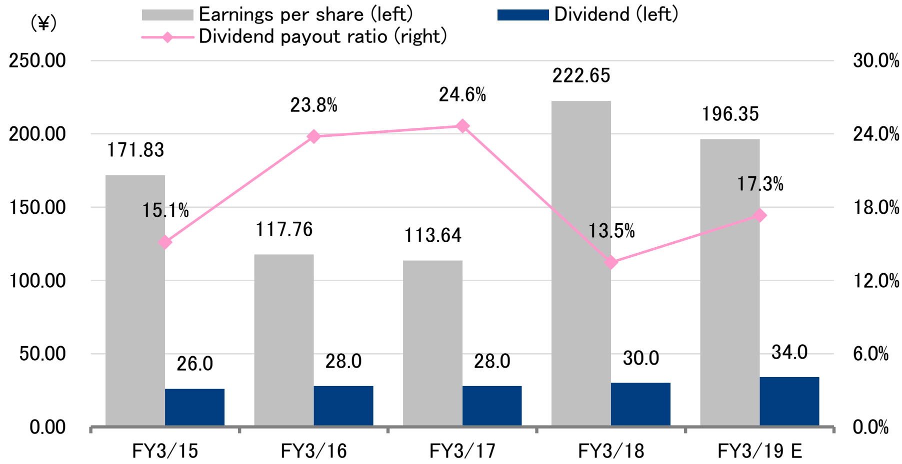
Earnings per share, dividend and payout ratio



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

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