SUN-WA TECHNOS CORPORATION

8137

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Index

Summary

Expansion Possible Ahead of Schedule with Demand for Industrial Use Robots to Soar Due to COVID-19 Impact

SUN-WA TECHNOS CORPORATION <8137> (hereinafter, "the Company") is an independent trading company that specializes in technology products. Approximately 40% of its sales are to the factory automation and industrial equipment industries, which are its mainstay fields. 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. In FY3/20, although sales and profits declined due to the fall in demand for capital investment, growth for the automotive industry continued

In the Company's FY3/20 results, net sales and profits declined, with net sales of ¥137,943mn (down 5.1% YoY) and operating income of ¥1,846mn (down 45.8%). The main reason for the decline in results was that net sales to the mainstay factory automation and industrial equipment industries fell by double digits YoY due to the cooling of interest in capital investment in the manufacturing industry. This was caused by the economic slowdown alongside the protracted US-China trade friction, as well as the outbreak of the novel coronavirus pandemic from early in 2020. Over the past few years, sales to the high-growth automotive (on-board products) industry had been strong, growing at a double-digit YoY pace, aided by the increase in the ratio of cars equipped with advanced driving assist systems (ADAS). Elsewhere, for the semiconductor industry, which had been continuing to make inventory adjustments, there was some recovery seen in capital investment from 2H with a backdrop of increased demand for 5G related products and data center demand. For the entire fiscal year, sales were roughly the same level as the previous fiscal year. The operating margin declined from 2.3% in the previous fiscal year to 1.3%. This was mainly due to the decline in net sales and the drop in the gross margin caused by the change in the sales composition ratio.

2. Given the uncertain impact of the novel coronavirus, the Company only announced a results outlook for 1H FY3/21

Regarding the business results for FY3/21, the impact of novel coronavirus pandemic on management is uncertain, so the Company decided to only announce an outlook for 1H, leaving the outlook for the full fiscal year as undecided. For 1H, the Company is forecasting net sales of ¥70,000mn (up 3.5% YoY), and operating income of ¥750mn (down 17.6% YoY). Sales to the automotive industry (on-board products), which were strong through FY3/20, are expected to fall due to a dip in the number of finished vehicles produced. However, due to the recovery of semiconductor capital investment and the resumption of capital investment in the Chinese market, overall sales are expected to increase for the first time in two years. On the other hand, in terms of profits, given the fact that there are no special factors to push up costs, we feel that there is room for the Company's profits to be slightly higher than the forecast values as long as the forecast net sales are achieved.

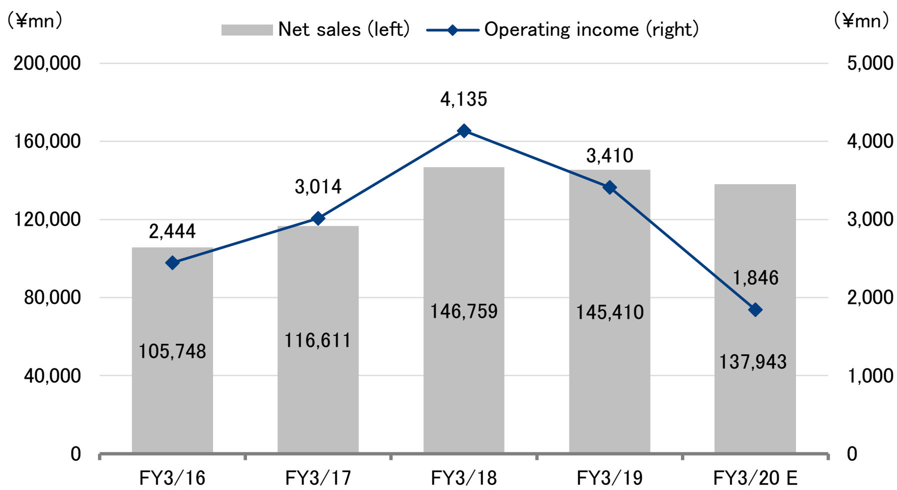
3. Status of progress on NEXT1800, the new medium-term management plan

The Company has formulated NEXT 1800, a three-year medium-term management plan that started from FY3/20. The plan's key policies include: strengthening the engineering business in order to raise profitability, bolstering the global SCM solutions business to expand its scale, investment and development of new businesses, and introduction of warehouse management systems (WMS) to increase the efficiency of logistics, all with the aim of increasing sales and enhancing profitability. With respect to the engineering business, FY3/20 net sales were approximately ¥12bn, which was less than 10% of total net sales, but the gross margin in the engineering business was higher than the Company's average. With the novel coronavirus pandemic, manpower-saving investment by manufacturers in various industries is expected to progress going forward. Since the manufacturing lines of each company have different specifications required, there is significant room for growth in the engineering business which proposes system optimization. On the other hand, in the global SCM solutions business which procures parts for customers' overseas bases, inquiries are increasing as customers relocate manufacturing bases, and future growth is expected. The Company started full-fledged operations of the Warehouse Management System (WMS) from April 2019. The WMS is expected to make logistics costs visible for each order received, and should have the effect of reducing logistics costs. Due to the effects of the global economic slowdown and the novel coronavirus pandemic, the Company got off to a poor start in the first year of the medium-term management plan in terms of reaching the numerical targets (net sales of ¥180bn and operating income of ¥4.8bn in FY3/22). However, by implementing these priority measures, the Company is seeking to build a management foundation for sustainable growth, and aims to achieve net sales of ¥250bn in FY3/26, which the Company has set as a long-term vision.

Key Points

- Forecasts higher net sales and lower operating income in 1H FY3/21, but results could be higher than forecast given the solid capital investment in the semiconductor industry and the recovery in sales to China
- As a part of the NEXT 1800 medium-term management plan, the Company will build a management foundation eyeing medium- to long-term sustainable growth
- The plan is to grow the scale of both the engineering business and the global SCM solutions business, while focusing on profitability

Results trends



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

Results trends

FY3/20 sales and profits declined due to the decline in demand from the mainstay factory automation and industrial equipment industries

1. FY3/20 results overview

The Company reported lower sales and profits for the second consecutive year in FY3/20, with ¥137,943mn in net sales (-5.1% YoY), ¥1,846mn in operating income (-45.8%), ¥2,144mn in ordinary income (-40.9%), and ¥1,341mn in net income attributable to owners of the parent (-49.0%). In 1H, the Company's business was impacted by the economic slowdown caused by the prolonged US-China trade friction and other factors, as well as the accompanying suppression of capital investment in the manufacturing sector. In 2H, as a recovery was taking place, the novel coronavirus pandemic spread around the world at the start of 2020 and caused the cautious stance towards capital investment to continue. Due to this, the Company, whose mainstay customer base is in the factory automation and industrial equipment industries, felt the impact of the downturn.

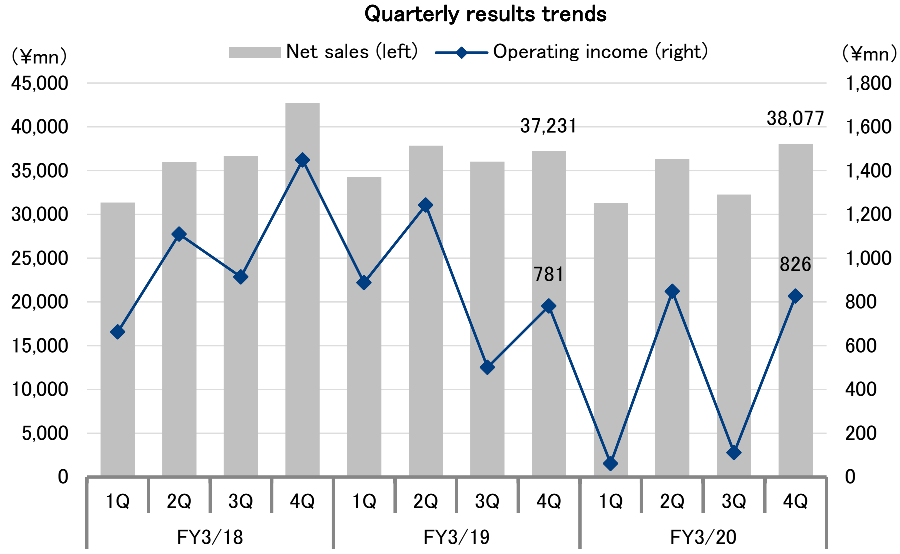
FY3/20 results

(¥mn)

	FY3/19			FY3/20					
	1H results	2H results	Full year results	1H results	2H results	Full-year Company forecast	Full year results	YoY	Versus forecast
Net sales	72,164	73,246	145,410	67,608	70,335	140,000	137,943	-5.1%	-1.5%
Operating income	2,129	1,281	3,410	909	937	1,600	1,846	-45.8%	15.4%
Operating margin	3.0%	1.7%	2.3%	1.3%	1.3%	1.1%	1.3%	-	-
Ordinary income	2,312	1,315	3,627	1,036	1,108	1,900	2,144	-40.9%	12.8%
Net income attributable to owners of the parent	1,651	977	2,628	689	652	1,400	1,341	-49.0%	-4.2%

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

However, looking on a quarterly basis, in 4Q net sales increased 2.3% YoY to ¥38,077mn and operating income increased 5.8% YoY to ¥826mn, as sales and profits increased for the first time in six quarters, as companies in the semiconductor industry resumed capital investment. For this reason, in its market outlook at the start of 2020 the Company was expecting 2020 to be a year of recovery, but the outlook is now uncertain due to the novel coronavirus pandemic.



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

As stated above, net sales declined 5.1% (¥7,467mn) YoY, while by business segment, net sales decreased 14.0% (¥3,432mn) in the electrical machinery segment, which had the biggest impact, while net sales declined 2.7% (¥2,970mn) in the electronics segment, and dropped 9.3% (¥1,066mn) in the general machinery segment, as all three segments saw a decline in net sales. The reason for the only slight decrease in the electronics segment is that sales to the automotive (on-board products) industry continued to increase by double digits. On October 30, 2019, the Company announced a revised forecast of ¥140,000mn in net sales for FY3/20, but ultimately sales fell short by 1.5% (¥2,057mn). This is seen as being due to the novel coronavirus pandemic.

Trends in net sales by business segments

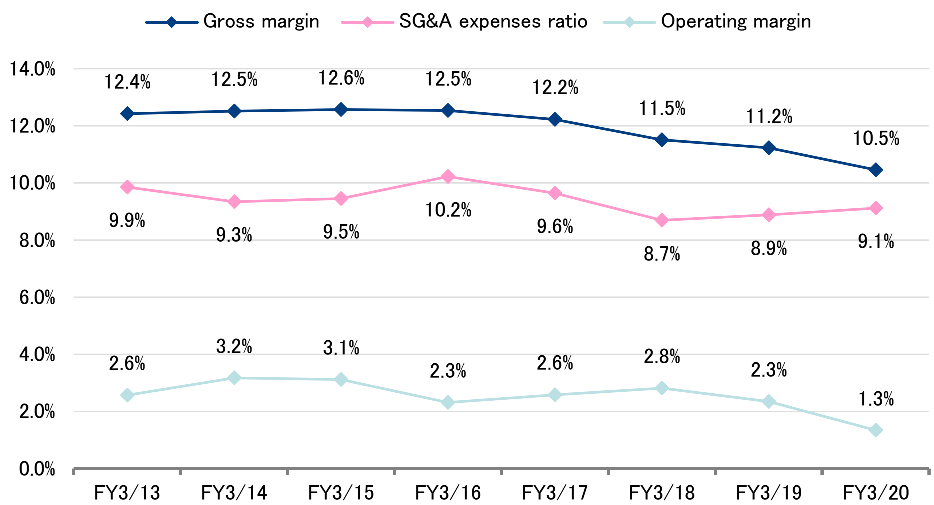
(¥mn)

	FY3/19			FY3/20		
	1H	2H	Full year	1H	2H	Full year
Electrical machinery	13,332	11,237	24,569	10,565	10,572	21,137
YoY	7.6%	-24.0%	-9.6%	-20.8%	-5.9%	-14.0%
Electronics	53,553	55,817	109,370	52,470	53,930	106,400
YoY	6.4%	-7.1%	-1.0%	-2.0%	-3.4%	-2.7%
General machinery	5,278	6,192	11,470	4,571	5,833	10,404
YoY	14.3%	36.5%	25.3%	-13.4%	-5.8%	-9.3%
Total net sales	72,164	73,246	145,410	67,608	70,335	137,943
YoY	7.2%	-7.8%	-0.9%	-6.3%	-4.0%	-5.1%

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

Operating income fell 45.8% (¥1,563mn) YoY. This was partly due to the fact that the gross profit margin declined from 11.2% in the previous fiscal year to 10.5% in conjunction with the change in the sales composition ratio, in addition to the decrease in sales. This was impacted by the fact that although sales to the factory automation and industrial equipment industries dropped by double digits, low-profit-margin sales for the automotive (on-board products) industry grew by double digits, and the sales composition ratio increased from 18.4% in the previous fiscal year to 22.4%. The SG&A expense ratio increased from 8.9% in the previous fiscal year to 9.1% due to the decline in sales, despite the efforts to reduce costs and improve operational efficiency. As a result, the operating margin fell from 2.3% to 1.3%. This was 15.4% higher than the Company's revised forecast, as the effects of cost reductions and work efficiency improvements were greater than expected.

Trends in various margins



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

Despite the decline in sales to the mainstay factory automation and industrial equipment industries, sales to the automotive (on-board products) industry stayed strong, growing by double digits

2. Segment, industry and regional trends

The Company discloses net sales after breaking them down into the three business segments of electrical machinery, electronics, and general machinery, according to the products handled. In addition, the Company discloses net sales and operating income as segment information by region, and discloses the sales composition ratio by industry and the trends up or down as reference information.

(1) Trends in net sales by business segments

FY3/20 trends in net sales by region and industry

	Japan			Asia			Europe/US		
	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery	Electrical machinery	Electronics	General machinery
Industrial machinery industry	×		×	×	×			×	
Automotive industry		○							
FPD industry			○						
OLED-related industry							×		
Amusement industry		×							

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

The main products in the electrical machinery segment include servo motors, motion controllers, programmable controllers, inverters, and power conditioners. Sales to the industrial machinery industry decreased in Japan and Asia, falling 14.0% YoY to ¥21,137mn.

The main products in the electronics segment are wide ranging, including general electronics parts such as capacitors, connectors, relays and switches, as well as fan motors, stepping motors, LEDs, power supplies, and heat sinks. Although sales to the automotive (on-board products) industry increased in Japan, sales to the amusement industry decreased in Japan, and sales to the industrial machinery industry decreased in Asia, Europe and the United States. Overall, sales were down 2.7% YoY to ¥106,400mn.

The main products in the general machinery segment include Yaskawa Electric's <6506> robots, as well as conveyors and reduction gears. Sales decreased 9.3% YoY to ¥10,404mn, as the increase in sales of conveyors for the FPD industry in Japan was offset by the decline in sales of equipment to the industrial machinery industry in Japan.

(2) Trends in sales composition ratio by industry and sales increase/decrease

Table of sales composition ratio and increase/decrease by industry

Customers (industry)	FY3/18		FY3/19		FY3/20	
	Ratio	YoY	Ratio	YoY	Ratio	YoY
Factory automation/industrial equipment	40.5%	○	40.4%	-	34.2%	×
Automotive (on-board products)	15.2%	○	18.4%	○	22.4%	○
Semiconductors/LCDs	12.0%	○	9.1%	×	9.5%	-
Social infrastructure	3.6%	○	3.4%	×	3.7%	○
Amusement	3.3%	×	4.0%	○	3.3%	×
Information/communications	3.6%	-	2.7%	×	2.3%	×
Medical equipment	1.2%	○	1.4%	○	1.6%	○
Environment/energy	1.3%	×	1.4%	○	1.3%	×
Food	0.2%	×	0.6%	○	0.6%	○
Security	0.2%	○	0.3%	○	0.1%	×
Other	18.9%	○	18.3%	-	21.0%	○
Total	100.0%		100.0%		100.0%	

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

Looking at the highest sales composition ratios by industry, sales to the mainstay factory automation and industrial equipment industries fell from 40.4% in the previous fiscal year to 34.2%. When sales are calculated on a trial basis from the sales composition ratio, it is estimated that sales decreased by about 20% from the previous fiscal year. Capital investment has generally cooled off, especially in Japan and Asia, and the Company has also been affected by this. Some of the products in Other are indirectly sold to the factory automation and industrial equipment industries, and the sales composition ratio for these industries, including these products, is in the 40% range.

For the automotive (on-board products) industry, which has the next highest sales composition ratio, the ratio increased from 18.4% in the previous fiscal year to 22.4%, and sales increased by approximately 16%. The electronic parts handled by the Company are mainly for so-called ADAS (advanced driver assistance systems) such as automatic brakes and collision prevention devices, and the increase in the on-board installation rate of ADAS is a key factor for high growth. However, because the gross margin is low, an increase in the sales composition ratio actually acts to reduce the profit margin.

The sales composition ratio for the semiconductor and LCD industries was generally flat YoY, increasing from 9.1% in the previous fiscal year to 9.5%, and net sales moved sideways. Sales were sluggish in the fiscal first half, but in 2H major semiconductor manufacturers began to resume investment, and the Company recovered in 2H.

(3) Trends in net sales and profits by region

Trends by sales region and by segment

(¥mn)

		FY3/19			FY3/20		
		1H	2H	Full year	1H	2H	Full year
Japan	Net sales	57,653	58,340	115,993	53,889	56,446	110,335
	YoY	10.1%	-6.8%	0.9%	-6.5%	-3.2%	-4.9%
	Operating income	1,065	874	1,939	529	756	1,285
	YoY	13.9%	-37.5%	-16.9%	-50.3%	-13.5%	-33.7%
	Operating margin	1.8%	1.5%	1.7%	1.0%	1.3%	1.2%
Asia	Net sales	18,646	18,542	37,188	16,243	18,211	34,454
	YoY	5.1%	-14.8%	-5.8%	-12.9%	-1.8%	-7.4%
	Operating income	778	430	1,208	289	303	592
	YoY	15.4%	-47.2%	-18.8%	-62.9%	-29.5%	-51.0%
	Operating margin	4.2%	2.3%	3.2%	1.8%	1.7%	1.7%
Europe/US	Net sales	4,204	3,880	8,084	3,746	2,652	6,398
	YoY	11.9%	-24.0%	-8.8%	-10.9%	-31.6%	-20.9%
	Operating income	275	-21	254	35	-119	-84
	YoY	69.7%	-	-18.3%	-87.2%	-	-
	Operating margin	6.5%	-0.5%	3.1%	0.9%	-4.5%	-1.3%

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

In Japan, net sales were ¥110,335mn (down 4.9% YoY) and operating income was ¥1,285mn (down 33.7%). Although sales of electronic parts for the automotive (on-board products) industry and conveyors for the FPD industry increased, sales of electrical machinery parts and equipment for the industrial machinery industry declined, while sales of electronic parts for the amusement industry fell, resulting in a decline in both sales and profits. The operating margin fell from 1.7% in the previous fiscal year to 1.2% due to the decrease in sales and the change in the sales composition ratio.

In Asia, net sales were ¥34,454mn (down 7.4% YoY) and operating income was ¥592mn (down 51.0%). The decline in sales of electrical machinery parts and electronic parts for the industrial machinery industry were the factors behind the decline in sales and profits. Results were impacted by the economic slowdown and cooling of capital investment in China, which accounts for just over 70% of net sales in the Asia region.

In Europe/US, net sales were ¥6,398mn (down 20.9% YoY) and operating loss was ¥84mn (compared to operating income of ¥254mn in the previous fiscal year). Sales of electronic parts for the industrial machinery industry and sales of electrical machinery parts for the OLED industry both declined. Sales decreased in both the US and Europe, but sales to Europe fell sharply by more than 50%.

With solid capital investment in the semiconductor industry and a recovery in sales to China, FY3/21 1H results are expected to be on par with FY3/20 2H results

3. Outlook for FY3/21 results

For FY3/21, it is unclear to what extent the novel coronavirus pandemic will affect capital investment by companies, and it is difficult to make an appropriate and rational forecast at this time. Therefore, the Company has only announced a forecast for 1H, and has left its full fiscal year forecast as undetermined. Specifically, for FY3/21 1H, the Company is forecasting ¥70,000mn in net sales (+3.5% YoY), ¥750mn in operating income (-17.6%), ¥800mn in ordinary income (-22.8%), and ¥500mn in net income attributable to owners of the parent (-27.5%).

FY3/21 results forecast

(¥mn)

	FY3/20			FY3/21	
	1H results	2H results	Full year results	1H Company forecast	YoY
Net sales	67,608	70,335	137,943	70,000	3.5%
Operating income	909	937	1,846	750	-17.6%
Operating margin	1.3%	1.3%	1.3%	1.1%	-
Ordinary income	1,036	1,108	2,144	800	-22.8%
Net income attributable to owners of the parent	689	652	1,341	500	-27.5%

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

Looking on a half-year basis, net sales are expected to be about the same level as in the second half of the previous fiscal year. This is due to several negative factors. For example, as discussed above, at the beginning of 2020 the Company had been expecting the recovery trend to continue, but with the impact of the novel coronavirus pandemic an increasing number of companies have taken a cautious stance towards capital investment. In addition, it has become highly likely that sales of electronic parts that go on-board vehicles will decline for a period of time due to the decrease in the number of automobiles produced. However, it is not all bad news. In addition to the growing demand for semiconductors for 5G and data centers, demand for PCs is increasing due to the growth of teleworking, and capital investment to increase the production of cutting-edge semiconductors is on a recovery trend. In fact, orders from semiconductor manufacturing equipment manufacturers seem to have been stronger than expected since April. Orders from China, which had been sluggish, also recovered rapidly to the second highest level ever in April. It seems that orders from solar cell manufacturers have begun to come in. Lockdowns are gradually been lifted in China, Europe, and the United States, and production activities in the manufacturing industry are gradually beginning to resume. Sales up to 2Q are basically visible, and the Company expects to be able to maintain the same level of sales as in FY3/20 2H. Although the outlook for 2H is still uncertain, there is a possibility that capital investment in the semiconductor industry will remain solid, and that industrial robots will begin to be used as a manpower-saving measure for companies.

Meanwhile, with respect to the factors behind the decline in operating income, we are not anticipating any special increases in costs, and the Company's forecast is believed to be conservative given the uncertain market environment. In fact, with regard to FY3/20 results, net sales were slightly lower than the Company's forecast, but operating income was higher than the Company's forecast. The gross margin is also likely to improve due to a decline in the sales composition ratio for the automotive (on-board products) industry, and we at FISCO believe that if net sales are achieved as forecast, there is a little bit of room for additional profit.

Two risk factors to watch are a second wave of the novel coronavirus outbreak in China and Western countries resulting in a stoppage of companies' production activities, and serious damage to China's manufacturing industry due to the re-flaring of US-China trade friction. Regarding the latter in particular, on May 15, the US government announced a new export ban against telecommunications equipment giant Huawei*, and the Chinese government responded by announcing that it will consider a response. The situation is tenuous, and a close eye must be kept on related developments. The assumed exchange rate is ¥110/US$.

* In May 2019, the US government announced an export ban against Huawei and related companies covering semiconductors and other electronic components. This action bans the supply of products that use manufacturing devices based on US technology, even if they are foreign-made semiconductors.

Progress of medium-term management plan

In NEXT 1800, the medium-term management plan, the Company is working to build the management foundation toward realizing sustainable growth over the medium to long term

1. New medium-term management plan NEXT 1800

(1) Overview of the medium-term management plan

In May 2019, the Company announced NEXT 1800, its three-year medium-term management plan. The Company's medium- to long-term growth strategy is to use this three-year medium-term management plan as a signpost, and to position this as a period to build a management foundation that will allow the company to achieve sustainable growth over the medium- to long-term by steadily implementing the plan's priority measures.

In its long-term management vision "Sun-Wa Vision 2025," the Company calls for "strengthening core businesses to build operations that contribute to advances in industrial activity in local societies as a total coordinator of production sites and distribution and help in attaining the goal of ¥250bn in consolidated net sales in FY3/26." Similar to the Company's previous medium-term management plans, NEXT 1800 is positioned as a three-year action plan toward the realization of the corporate mission and Sun-Wa Vision 2025.

NEXT 1800 presents four items as fundamental policies, including "contribute to customer production activities by strengthening core businesses." It also highlights priority measures for each of the policies. We review the details of plan measures later in this report. In the core portion of income growth, the Company hopes to make improvements and achieve further advances versus Challenge 1500, the previous medium-term management plan, and realize a growth strategy with even higher certainty, while also carrying out initiatives for new business creation that lay the groundwork for growth over a longer term as a new initiative. Additionally, it places more emphasis on themes with strong social content, such as work style reforms that enhance productivity by utilizing ICT in a way that addresses changes in society, achievement of a corporate culture that stimulates interest in work, and contributions to SDGs (sustainable development goals), than previously.

Fundamental policies in NEXT 1800

Contribute to customer production activities by strengthening core businesses
★ Strengthen core businesses ★ Promote collaboration with business partners to bolster solution proposals
Expand global business capabilities to support market demand
★ Strengthen hiring of overseas local employees and organizational capabilities ★ Consider establishment of new locations
Pursue new business fields to accelerate sustainable growth
★ Strengthen investments in new business creation ★ Cultivate managerial personnel by adopting an intrapreneurship program ★ Create new value through SCM improvements
Initiatives to realize a sustainable society
★ Foster a corporate culture that stimulates interest in work by boosting employee engagement ★ Implement work style reforms that "enhance productivity" utilizing ICT ★ Conduct initiatives that contribute to SDGs ★ Fulfill corporate social responsibility (promote CSR and compliance)

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

(2) Numerical management goals in the NEXT 1800 plan

Management goals in NEXT 1800, as suggested by the plan name, are ¥180,000mn in net sales, ¥4,800mn in operating income, and ¥5,000mn in ordinary income in FY3/22, the final fiscal year.

In FY3/20, which was the first fiscal year of the plan, both net sales and profits fell short of the initial targets due to the market environment being less favorable than initially assumed as a result of the impacts of both the prolonging of the US-China trade tensions and the novel coronavirus outbreak. In addition, in FY3/21, net sales will likely only recover slightly, at least in the first half of the fiscal year, due to the novel coronavirus pandemic. It is also possible that the Company will push back the timing of its goal for when it aims to achieve the numerical management targets set for FY3/22.

Medium-term management plan numerical targets

(¥mn)

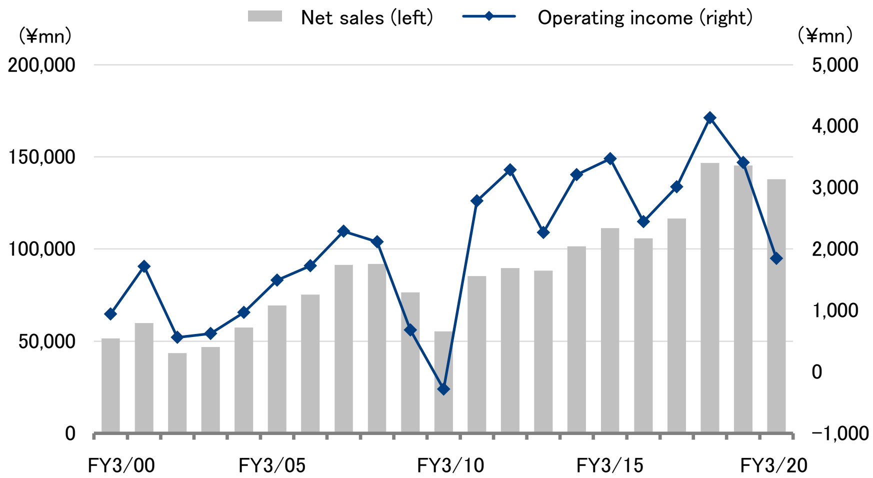
	FY3/19 results	Medium-term management plan NEXT 1800			
		FY3/2020		FY3/21 management targets	FY3/22 management targets
		Management targets	Results		
Net sales	145,410	150,000	137,943	165,000	180,000
Operating income	3,410	3,100	1,846	3,800	4,800
Operating margin	2.3%	2.1%	1.3%	2.3%	2.7%
Ordinary income	3,627	3,300	2,144	4,000	5,000
Ordinary margin	2.5%	2.2%	1.6%	2.4%	2.8%

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

However, due to the spread of the novel coronavirus, the risk of production lines being forced to stop has emerged, so there is a now a possibility that investment targeting manpower-saving, including the introduction of industrial robots, will become more active than before in industries such as the manufacturing industry and the logistics industry. In addition, when a company introduces industrial robots, it is necessary to construct a system suitable for each manufacturing line, and as discussed later, this can be viewed as a growth opportunity for the engineering business. Furthermore, due to the impacts of US-China trade friction, the Company's customers are beginning to move their factories from China to Southeast Asia and other regions, which presents business opportunities for the Company to offer them its parts procurement capabilities.

Although the market environment has temporarily deteriorated due to the novel coronavirus pandemic, it can be said that the possibility of seeing the changes as an opportunity and taking advantage of the opportunity to realize growth has increased. From a medium- to long-term perspective, capital investment is expanding alongside economic growth while tracking the positive and negative economic cycles. It seems that the Company's results over the years since FY3/00 have also trended similarly. In terms of the average annual growth rate over the 20 years from FY3/00 to FY3/20, net sales have grown at an average annual rate of 5.1%, while operating income has grown at an average annual rate of 3.4%. In the 18-year period up to FY3/18, which represents the most recent peak in results, net sales grew by an average of 6.0% per year, and operating income grew at an average of 8.6% per year. In order to achieve sales of ¥250bn, as targeted in the long-term vision for FY3/26, the pace of growth will have to become faster than before, but at FISCO we believe that if the priority measures in the medium-term management plan proceed smoothly, there is a good possibility of this happening.

Medium- to long-term results



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

In the engineering business and global SCM solutions business, the Company plans to expand the business scale while focusing on profitability

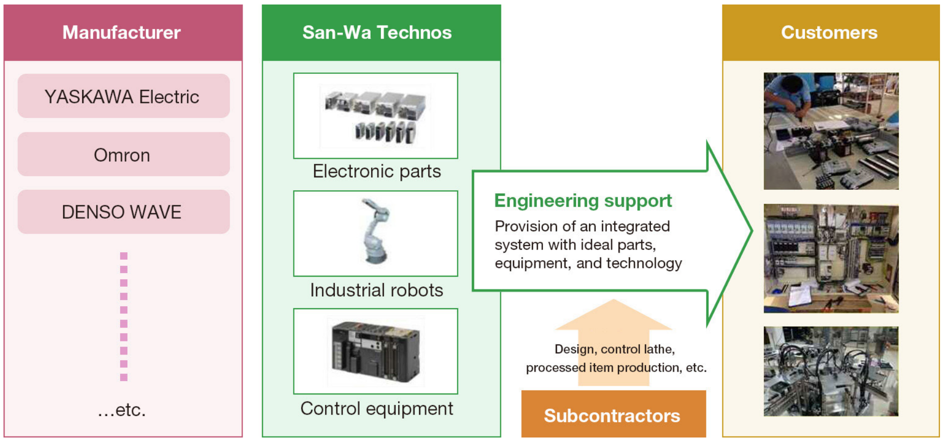
2. Progress for "contribute to customer production activities by strengthening core businesses"

Among the four fundamental policies set out in the medium-term management plan, the theme of “contribute to customer production activities by strengthening core businesses” is the most important within the Company’s growth strategy. Within this fundamental policy, the Company is focusing especially on the engineering business and the global SCM solutions business. Both of these businesses still only have annual sales of roughly ¥10bn, but these are seen as important businesses for realizing sales growth and improved profitability going forward. The progress made on each business is described below.

(1) Engineering business

The engineering business sells to customers what the Company itself combines and systemizes from the products previously sold individually that are handled in each of the three respective business segments of electrical machinery, electronics, and general machinery. In other words, the engineering business is not some sort of separate, new business, but it is a sales method in the trading company function. The background behind the Company focusing on this business includes increasing functionality of factory automation equipment such as industrial robots, as well as the associated diversification of customers’ needs. In this situation, selling only individual products did not meet these needs and also tended to create a situation in which it was difficult for business opportunities to grow. Also, the Company thought it would be possible to enhance profitability by adding the value-added of engineering.

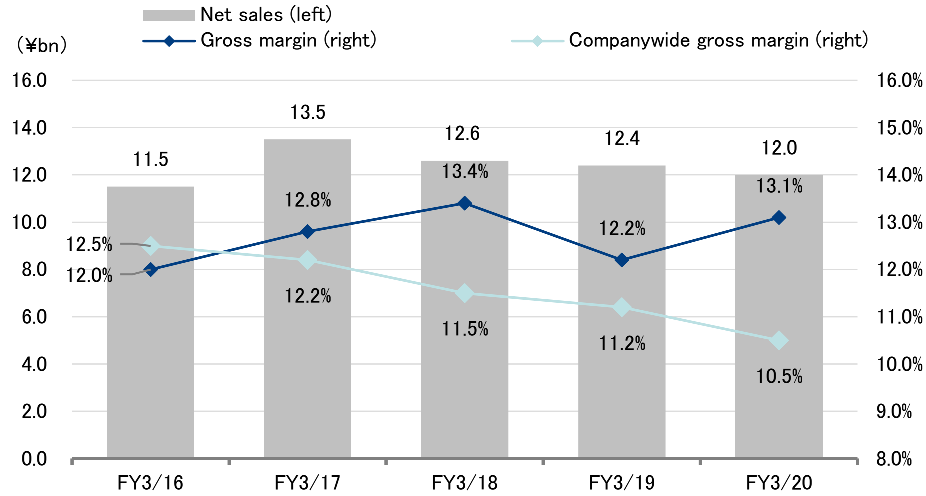
Overview of engineering business



Source: The Company's website

In FY3/20, the engineering business posted net sales of approximately ¥12bn, and over the past few years the business has been continuing to stably post sales above the ¥10bn level, which had been the near-term goal at the time of the business launch. In FY3/20, the Company received orders for inspection equipment and conveyors from the FPD industry, and received orders for assembly robots and mobile power source vehicles from the industrial machinery industry, among others. By focusing on areas of strength, gross margin also increased about one percentage point YoY to the 13% range. Still, the profit margin fell well short of the initially assumed level (which appears to have been in the 25-30% range), so this is something that will need to be addressed going forward.

Trend in net sales and gross margin in the engineering business



Source: The Company's results briefing materials, FY3/20 data estimated by FISCO based on interviews with the Company

The Company's gross margin is in the 10% range, but would likely be above 11% if electronic parts for the automotive (on-board products) industry are excluded. Therefore, the added-value of the engineering business is about 2%. The reason that the profit margin is falling short of the initial expectation is that the Company handles few projects where is utilizes its past knowledge and experience to make proposals, and instead the majority of its projects are simply orders received from customers. As a result, the Company has not been able to sufficiently receive compensation for the value-added portion that it is capable of offering.

The Company's engineering business has been described by comparing it to curry. That is to say, previously it sold the meat, vegetables, and rice individually as the ingredients (an agency business). In contrast, the engineering business tries to use each of these ingredients to make and to sell curry rice, and the work to produce the curry roux and flavor the curry rice is the Company's expertise and is what provides the value added. However, in the current situation, the Company is not making and providing the curry using its own recipe, but rather it is making curry each time based on the customers' preferences, making it difficult to receive compensation for the costs involved and suppressing the profit margin.

Based on this situation, from FY3/20 the Company began to revise the business model for the engineering business, and switched to a strategy that focuses on receiving orders with an emphasis on profitability, by turning down orders for projects that do not utilize its past knowledge. As a result, while net sales were almost at the same level as the previous fiscal year, the gross margin was successfully increased by about one percentage point compared to the previous fiscal year. However, in order to further improve the profit margin, we at FISCO think that the key is how to build a system that standardizes the know-how accumulated by the Company and provides it to customers as a service menu. As discussed above, it is expected that manpower-saving investments will progress in various industries such as electronic component assembly and the food industry, and that opportunities to acquire customers will expand. If the Company can provide services that meet the needs of customers and enable them to feel a cost benefit it will lead not only to increased sales in the engineering business but also improved profitability. The Company has 49 engineers working in this business, and for the time being the Company's plan is to expand the business with this team of engineers.

(2) Global SCM solutions business

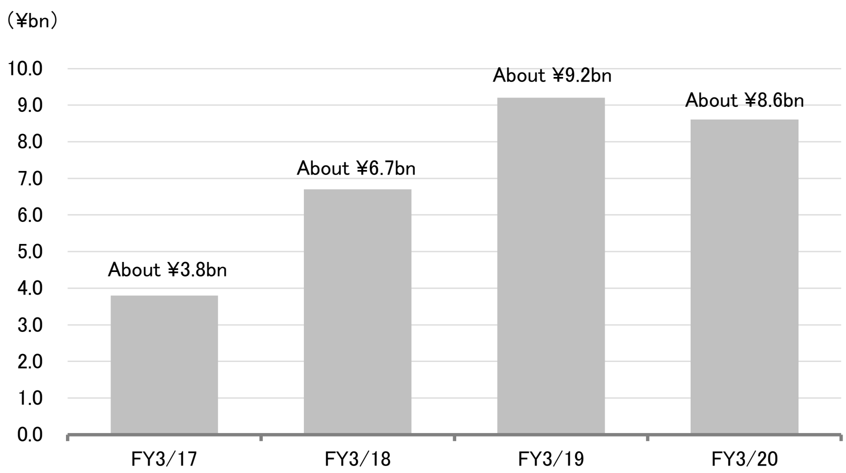
The global SCM solutions business is rooted in the services that the Company has provided since the distance past of procurement agent, logistics agent, and delivery management services. The various manufacturers that are its main customers have been pursuing efficiency as major companies and progressing business structural reforms and restructuring. In this process, they have targeted reducing personnel and bases in areas such as global logistics, inventory management, and materials procurement, so the reality is that they currently have shortages of personnel. The Company's global SCM solutions business captures the outsourcing needs that arise due to these shortages. By consolidating the electronic parts and equipment, etc., which the client manufacturers had been procuring from various suppliers on their own up until this point, in the Company, customers can enjoy such benefits as reduced procurement costs and shortened lead times.

Using the moving business as an example, conventional procurement agent and logistics agent services just moving a person's items from the former home to the new home. In global SCM solutions business, meanwhile, the service also extends to setting up televisions and PCs for immediate use after the move and procuring and installing antennas and Wi-Fi equipment. Engineering business corresponds to selection and procurement of antennas and Wi-Fi equipment suited to the new area and wiring installation. The move might lead to more business too if an order is received for landscaping and softscaping work. The Company is aiming to grow the global SCM solutions business by utilizing the expertise it has accumulated over its long history as a technology trading company and its strength of having a wide overseas network (26 bases worldwide).

In FY3/20, net sales were approximately ¥8.6bn, which was lower than the roughly ¥9.2bn in the previous fiscal year. This was mainly due to the deterioration in the market environment and the decline in overall net sales. In terms of new projects, the Company received an order from a leading machining tool manufacturer for the SCM business for factories in Europe and the US, as well as an order from an OA equipment manufacturer for the SCM business for electronic parts for commercial printers. The Company launched the global SCM solutions division in April 2019, and started working to expand the business, but profitability started to trend slightly lower, prompting the Company to recently change the direction of its sales strategy. Previously, the Company was entrusted with the SCM business at the request of the customer, so it was relatively profitable, but by setting a sales target as a business unit, the Company started actively going out to receive orders, which resulted in the Company starting to accept orders for low-profitability projects. For this reason, the Company is currently refraining from pro-active sales activities and is returning to its traditional sales method of waiting for customers' requests.

Even so, at FISCO we believe that the outsourcing needs for global SCM will continue to grow. This is because some companies are starting to move factories from China to Southeast Asia, Latin America, or Japan, due to intensifying trade friction between the US and China. When relocating a factory, it is inefficient to build a local parts procurement system independently from scratch. In fact, the number of inquiries to the Company is increasing, and it is expected that sales in this business will start to grow again if the market environment recovers. This business is expected to grow in the future as it not only leads to the expansion of the scale of transactions with existing customers, but also provides opportunities to acquire new customers. In addition, in order to strengthen the competitiveness of its SCM services, the Company began reviewing and improving the global logistics infrastructure at the same time as it established the business division. As part of that, the Company started full-fledged operations of WMS in April 2019 to allow for the visualization of logistics costs.

Trends in net sales in the global SCM solutions business



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

Established a base in Ho Chi Minh City, Vietnam. Expected to contribute in the global SCM solutions business

3. Progress for “expand global business capabilities to support market demand”

With respect to this topic, the Company established a business base in Ho Chi Minh City, Vietnam in August 2019. The Company opened an office in Vietnam in the major northern city of Hanoi in 2013, but over the past few years more and more companies, particularly companies in the electronics industry, have been relocating factories to Vietnam due to the soaring personnel costs and rising political risks in China, or opening completely new factories there. In order to capture such demand, the Company opened a second office in Ho Chi Minh City, a major city in the south, to strengthen its sales platform. The office’s specific activities will include supporting Japanese companies, discovering excellent local companies and products, and expanding sales channels in the ASEAN region. In addition, the Company is expected to win orders in the global SCM solutions business.

In addition, in order to expand the global business, as a priority measure the Company is also working on developing and promoting locally-hired employees as management personnel in order to fortify its organizational strength. Currently, Japanese staff are stationed at all 26 overseas offices as managers. However, as the number of consolidated employees has increased to about 1,000, of which 400 are foreign nationals (of which about half are in China), and personnel are globalizing, the Company feels that globalizing management-level staff will lead to a stronger organization. As it is costly to bring in people with management skills from the outside, the Company’s policy is to develop people from within the group, and the Company is starting a training program in Japan for management candidates. If the globalization of management personnel progresses, we at FISCO believe that the Company will be able to cultivate more non-Japanese customers, which currently account for only around 10% of sales (about 35% in the Chinese market), and overseas sales will grow even more.

Generate added value and create new business opportunities through SCM improvement

4. Progress for “pursue new business fields to accelerate sustainable growth”

Regarding this, as discussed above, the Company started operating the WMS in April 2019, and is working to improve logistics quality, strengthen traceability, make logistics costs visible, and improve productivity. The effects have already begun to appear, such as inventory reduction, abatement of logistics costs, and a shortening of lead times, and the Company expects that the improvements will continue in FY3/21 and beyond. The advantages of making logistics costs visible are briefly explained as follows. For example, if a product acquired for ¥1mn is sold for ¥1.2mn, a gross profit of ¥200,000 is booked, but if the logistics costs are ¥300,000, the transaction will produce a loss. In the past, a Company was not able to ascertain such logistics costs for each project, but since the logistics costs can be visualized for each project with the introduction of WMS, for such loss-making projects, a company can consider methods to either lower the acquisition cost or lower the logistics costs, thereby making it a profitable transaction. Continuing these efforts will lead to improved profitability.

In addition, the Company has introduced an intrapreneur (in-house entrepreneur) system and is working on new businesses at a pace of 2-3 new businesses per year. In FY3/17, the Company established the Eco-New Life Support Division as part of efforts to promote opportunities for women to play an active role. This division sells automated external defibrillators (AED) and LED lighting equipment targeting the lifestyle-related market, and sales are growing year by year even though the scale is small. Most recently, the Company partially amended its articles of incorporation in April 2020, adding a new rental business to the business of selling electrical machinery, machinery equipment and tools, measuring instruments, and medical equipment. In addition to renting blood vessel age measuring instruments to nursing homes, the Company plans to provide UV sterilization air purifiers to business hotels. The use of robots may become widespread in the future even in the lifestyle area, and this can be considered an opportunity to build a customer base in preparation for that time. On top of this, the Company's policy is to look into M&A deals that would be expected to generate synergies.

Plenty of room to cultivate new customers in regional areas by developing sales bases utilizing ICT

5. Progress for "initiatives to realize a sustainable society"

For this theme, one of the targets is utilizing ICT to realize workstyle reforms that "improve productivity." In July 2019, the Company opened a sales base in Shikoku, and began allowing staff to telework on a trial basis. Conventional sales bases require 4 to 5 people, comprising both sales staff (front office) and administrative staff (back office), and operating costs tend to be high. In the case of the Shikoku sales office, by having people from the Osaka branch office (the Shikoku office's head office) cover back office operations via teleworking, only the front office staff (two people) work there on a full-time basis. Looking at the results for the first six months, sales increased, while costs were reduced by two-thirds compared to the normal level. While sales offices involve maintenance costs, the Company confirmed that these costs can be absorbed by the reduction of personnel expenses and travel expenses for administrative staff. Because sales have increased compared to before, productivity per person has also improved.

The increase in sales is thought to be due to the fact that the Company was able to execute sales in closer contact with customers than before. For a trading company focused on industrial equipment like the Company, it is important to be able to quickly support customers' needs (quality improvements, etc.). Therefore, it can be said that establishing a sales base near customers provides a shortcut to winning orders. EC transactions have become more common overseas in the field of factory automation and industrial equipment, but the fact that in-person sales will continue to be the main style of sales in Japan is a reason why the Company opened this sales office.

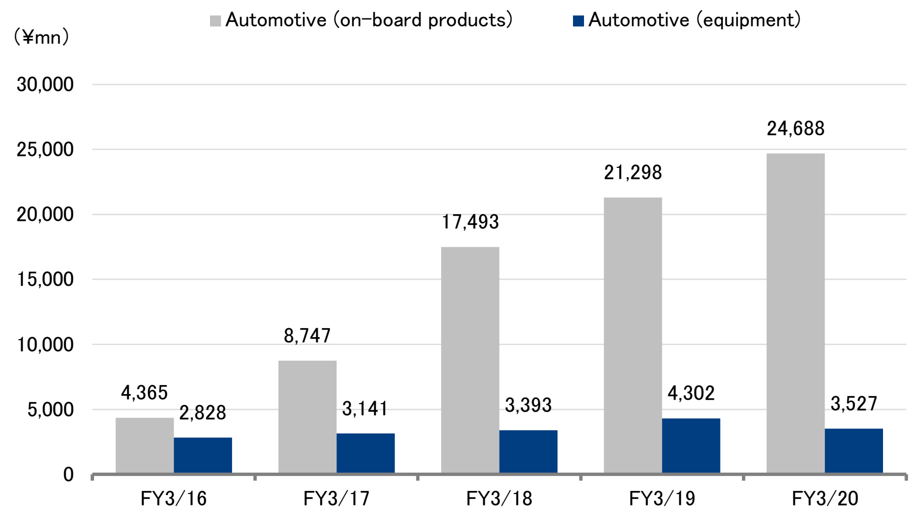
Since the Shikoku sales office has been a success, the Company is considering similar moves with other regional bases. The Company has established sales offices in the Tokyo metropolitan area, and the Chubu, Kansai, and Kyushu areas. However, looking at other areas, the sales network is still undeveloped. There are no sales bases in Hokkaido, and the Sendai sales office (4-6 members) covers all six prefectures in the Tohoku region, where a large number of electronic device production sites are concentrated, but we conjecture that the Sendai sales office is not actually able to adequately cultivate new customers. The same applies to the Hokuriku region and the Chugoku region, as there is only one sales office for both regions. In the factory automation and industrial equipment field, which represents the Company's targeted customers, there are many blue-chip companies scattered about in rural areas. By establishing sales offices for these kinds of customers in the same model as the Shikoku sales office, we at FISCO believe that the Company has plenty of room left to cultivate new customers.

Net sales for the automotive industry will decline for a period of time due to the production adjustments by finished vehicle manufacturers, but the growth trend will continue over the medium to long term.

6. Growth of the automotive business

The business for the automotive industry can be broadly divided into the electronic parts business for on-board electronic equipment, and the production equipment business for automakers' factories. Of these, the electronic equipment business for on-board electronic products has been growing at a rapid pace over the past few years, with net sales in FY3/20 of ¥24,688mn, a 15.9% YoY increase, as performance remained strong. Looking at the results since FY3/16, over these four years net sales have grown by almost six times, as sales have rapidly increased. For FY3/21, as discussed above, there is a strong likelihood that sales will decline in the short term, as the number of vehicles produced in Japan is expected to decline significantly from April onward. However, the technological evolution of automobiles is expected to continue in the future on the backdrop of the spread of EVs, the growing use of autonomous driving technology, and the spread of MaaS (Mobility as a Service) triggered by the launch of 5G commercialization services. New systems are expected to be installed along with these technological advances, and at FISCO we believe that the growth trend will continue over the medium to long term. The automotive business already accounts for more than 20% of the Company's overall sales, which is second only to the factory automation and industrial equipment field, and it is expected to grow as a mainstay field that will continue to support an increase in the Company's sales. The problem is that the profit margin is low, but at this point in time there are no concrete measures for improvement. This is another business where it seems possible to add value by selling parts as modules, rather than selling parts individually, but since it will take time to accumulate the technical expertise, this is an issue to address in the future.

Trend in net sales for the automotive industry



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

Summary income statement and key indicators

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21 1H E
Net sales	105,748	116,611	146,759	145,410	137,943	70,000
YoY	-5.0%	10.3%	25.9%	-0.9%	-5.1%	3.5%
Gross profit	13,256	14,255	16,883	16,318	14,421	-
Gross margin	12.5%	12.2%	11.5%	11.2%	10.3%	-
SG&A expenses	10,812	11,240	12,747	12,908	12,574	-
YoY	2.8%	4.0%	13.4%	1.3%	-2.6%	-
SG&A expenses ratio	10.2%	9.6%	8.7%	8.9%	9.1%	-
Operating income	2,444	3,014	4,135	3,410	1,846	750
YoY	-29.6%	23.3%	37.2%	-17.5%	-45.8%	-17.6%
Operating margin	2.3%	2.6%	2.8%	2.3%	1.3%	1.1%
Ordinary income	2,645	3,215	4,349	3,627	2,144	800
YoY	-29.7%	21.6%	35.3%	-16.6%	-40.9%	-22.8%
Net income attributable to owners of the parent	1,690	1,584	3,085	2,628	1,341	500
YoY	-31.5%	-6.3%	94.8%	-14.8%	-49.0%	-27.5%
EPS (¥)	117.76	113.64	222.65	164.08	84.11	31.69
Dividend (¥)	28.00	28.00	30.00	34.00	34.00	17.00

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

Summary balance sheet

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Current assets	46,857	55,507	65,852	64,209	62,713
Cash and deposits	6,359	6,759	8,596	10,005	12,052
Notes and accounts receivable	34,554	41,168	46,077	42,256	39,838
Non-current assets	8,581	9,309	11,401	9,905	9,024
Property, plant and equipment	3,788	3,056	3,005	2,861	2,759
Intangible assets	240	222	168	143	193
Investments, etc.	4,553	6,030	8,227	6,900	6,072
Total assets	55,439	64,816	77,254	74,114	71,738
Current liabilities	28,691	36,596	43,077	37,199	35,402
Notes and accounts payable - trade	24,732	31,182	34,298	31,427	29,108
Short-term loans payable, etc.	2,317	2,489	5,722	3,805	3,809
Other	1,642	2,925	3,057	1,967	15,550
Non-current liabilities	4,484	4,581	6,182	4,970	4,608
Long-term loans payable	2,400	2,300	3,500	2,900	2,900
Other	2,084	2,284	3,042	2,070	1,708
Total liabilities	33,176	41,178	49,260	42,169	40,011
Shareholders' equity	20,217	21,034	23,731	29,056	29,552
Total accumulated other comprehensive income	2,045	2,603	4,262	2,888	2,174
Net assets	22,263	23,637	27,993	31,944	31,726

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

Cash flow statement

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Cash flow from operating activities	-60	1,679	-2,221	1,636	3,238
Cash flow from investing activities	-384	-235	29	-153	-200
Cash flow from financing activities	-654	-818	3,962	28	-945
Cash and cash equivalents at end of period	5,875	6,275	8,112	9,521	11,568

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

Progress of medium-term management plan

Financial indicators

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Equity ratio	40.2%	36.5%	36.2%	43.1%	44.2%
Interest-bearing debt ratio	21.4%	18.0%	19.0%	25.8%	33.0%
ROE	7.6%	6.9%	12.0%	8.8%	4.2%
Net cash (¥mn)	1,642	1,970	-626	3,300	5,343

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

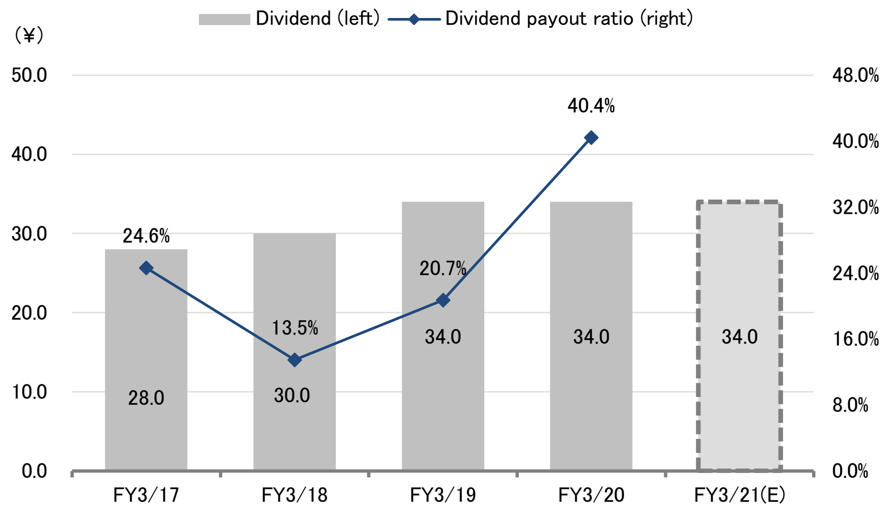
Shareholder return policy

Plans for FY3/21 dividend to be ¥34 per share, the same as the previous year

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.

For FY3/20, the Company left its dividend unchanged YoY at ¥34.0 (payout ratio = 40.4%), despite the decline in both net sales and operating income. In addition, for FY3/21, despite the unclear outlook for the full year results, the Company announced that the dividend would remain unchanged at ¥34.0. This shows just how much the Company emphasizes stable, continuous dividends.

Earnings per dividend and payout ratio



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

Disclaimer

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