COMPANY RESEARCH AND ANALYSIS REPORT

SUN-WA TECHNOS CORPORATION

8137

Tokyo Stock Exchange First Section

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Index

Summary

Aiming for further growth with realization of a decarbonized society and heightened supply chain risk as tailwinds

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. Steep rise in 1H FY3/22 profit driven by sharply higher orders in factory automation and industrial equipment fields

The Company booked robust 1H FY3/22 (Apr-Sep 2021) consolidated results at ¥70,978mn in net sales (+14.8% YoY) and ¥2,108mn in operating profit (+134.2%). Net sales increased at a double-digit pace and profit doubled. These results beat period-start guidance (¥66,500mn in net sales, ¥1,620mn in operating profit). Vibrant capital investments are continuing in China mainly in solar panel and EV-related areas. Main drivers of the strong results were increased demand in electrical machinery and electronic parts related to factory automation and industrial equipment. The Company switched to use of net value that removes paid-for supplied products from net sales due to a change in accounting standards from FY3/22, and this reduced net sales by ¥7,601mn. Net sales were up by 27.1% in a comparison applying the previous standard. Furthermore, orders value climbed sharply by 60.6% YoY to ¥95,625mn due to an increase in accelerated orders placement as a response to impact on production of shortages in supply of semiconductors and other parts and materials, and orders backlog expanded 136.7% to ¥52,211mn and reached about 2.5 times the normal level.

2. Expecting net sales and operating profit to set all-time highs for the first time in four years in FY3/22

The Company expects FY3/22 consolidated results to set all-time highs for the first time in four years at ¥148,700mn in net sales (+10.3% YoY; though +22.3% to ¥164,885mn using the previous accounting standard) and ¥4,200mn in operating profit (+95.1%). This seems to be a conservative plan that discounts for trends in the COVID-19 pandemic, impact of China's electricity shortages on production activities and capital investments, and other risks. Orders from China, however, remained upbeat in October. Despite the possibility of temporary slowdown in orders value because the Company is already receiving orders deals with a delivery period a year later, FISCO projects continued sales expansion in 2H and full-year earnings that exceed guidance.

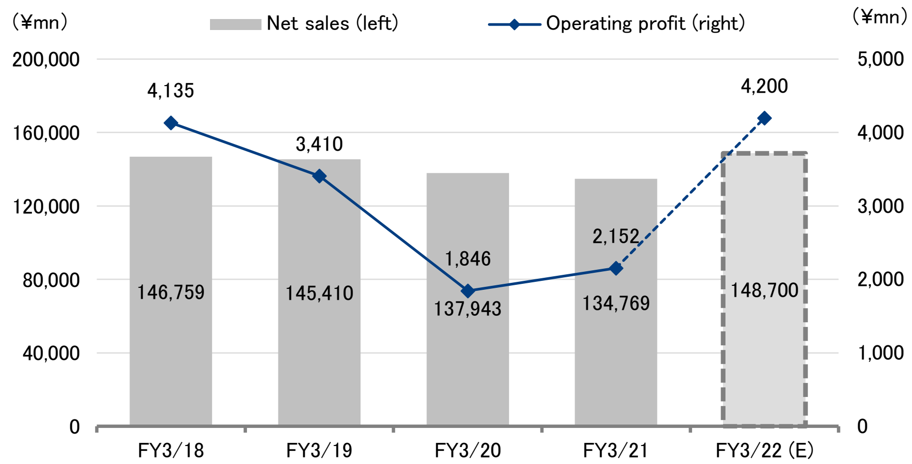
3. Tailwinds from expansion of capital investments aimed at realizing a decarbonized society and heightened supply-chain risk

Looking at the progress made for NEXT 1800, which is the three-year medium-term management plan started in FY3/20, the numerical results are being impacted by COVID-19, so it is highly likely that the FY3/22 numerical targets (net sales of ¥180bn and ordinary profit of ¥5bn) will not be achieved. However, the Company has started seeing manifestation of concrete results from new challenges for the great recovery in FY3/22 that it advocated, including to "overcome COVID-19 and acquire share of the 'new normal' market," "build a strategy that utilizes DX and complete its implementation system," and "output reliable results through deepening existing businesses, developing new businesses, and reviewing the business portfolio," Considering the prospect of sustained expansion of capital investments related to energy savings and clean energy over the medium term amid global advances in initiatives seeking realization of a decarbonized society, the Company should continue to receive tailwinds from FY3/23 as a supplier of related goods. Additionally, inquiries are increasing in the global SCM solutions business, which is one of the Company's focus businesses, due to heightened supply chain risk caused by recent shortages in parts and materials, and this is an excellent opportunity to substantially grow the business.

Key Points

- Posted higher sales and profits exceeding the initial forecast in 1H FY3/22 driven by expansion of factory automation and industrial equipment-related orders mainly from China
- Upbeat Chinese orders momentum continued in October, FY3/22 results have room to exceed the upward-revised guidance
- Plans to pay a ¥34 per share dividend in FY3/22 on par with the previous fiscal year, announced a share buyback program too

Results trends



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

Results trends

Posted higher sales and profits exceeding the initial forecast in 1H FY3/22 driven by expansion of factory automation and industrial equipment-related orders mainly from China

1. 1H FY3/22 results overview

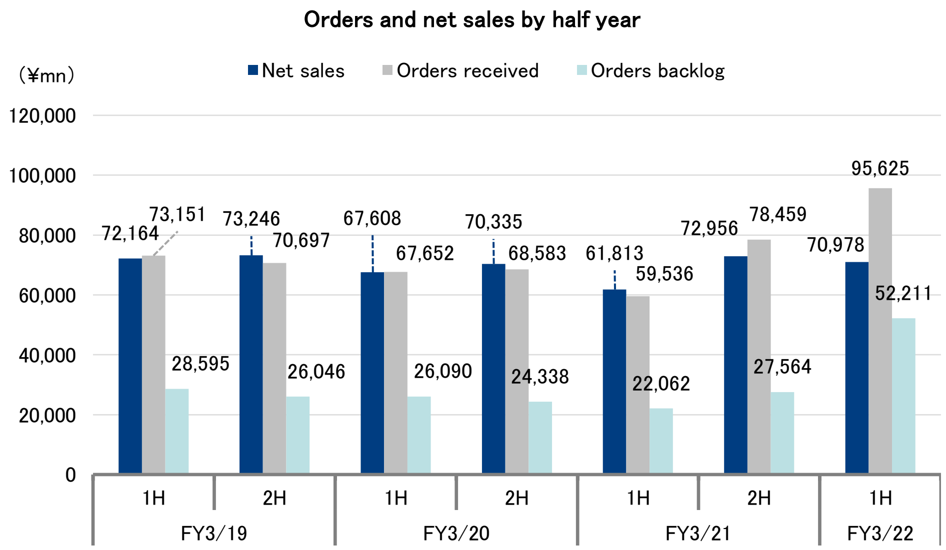
The Company booked robust 1H FY3/22 consolidated results at ¥70,978mn in net sales (+14.8% YoY), ¥2,108mn in operating profit (+134.2%), ¥2,195mn in ordinary profit (+115.0%), and ¥1,551mn in net profit attributable to owners of the parent (+119.7%). These results beat initial forecast. In FY3/21, despite a slump in net sales due to COVID-19 pandemic impact, capital investments recovered mainly in China from 2H, and this momentum continued during 1H FY3/22 and lifted results above expectations. Furthermore, orders value climbed sharply by 60.6% YoY to ¥95,625mn, including increase in accelerated orders placement as a response to impact on production of shortages in supply of semiconductors and other parts and materials, and 1H FY3/22 orders backlog expanded 136.7% to ¥52,211mn and reached about 2.5 times the normal level.

1H FY3/22 results (consolidated)

(¥mn)

	1H FY3/21		1H FY3/22				
	Result	% of sales	Initial forecast	Result	% of sales	YoY	vs. initial forecast
Net sales	61,813	-	66,500	70,978	-	14.8%	6.7%
(Previous standard)	-	-	-	78,580	-	27.1%	-
Gross profit	6,719	10.9%	-	8,749	12.3%	30.2%	-
Selling, general and administrative expenses	5,819	9.4%	-	6,640	9.4%	14.1%	-
Operating profit	900	1.5%	1,620	2,108	3.0%	134.2%	30.1%
Ordinary profit	1,020	1.7%	1,635	2,195	3.1%	115.0%	34.3%
Profit attributable to owners of parent	705	1.1%	1,055	1,551	2.2%	119.7%	47.0%
Orders received	59,536	96.3%	-	95,625	134.7%	60.6%	-
Orders backlog	22,062	-	-	52,211	-	136.7%	-

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



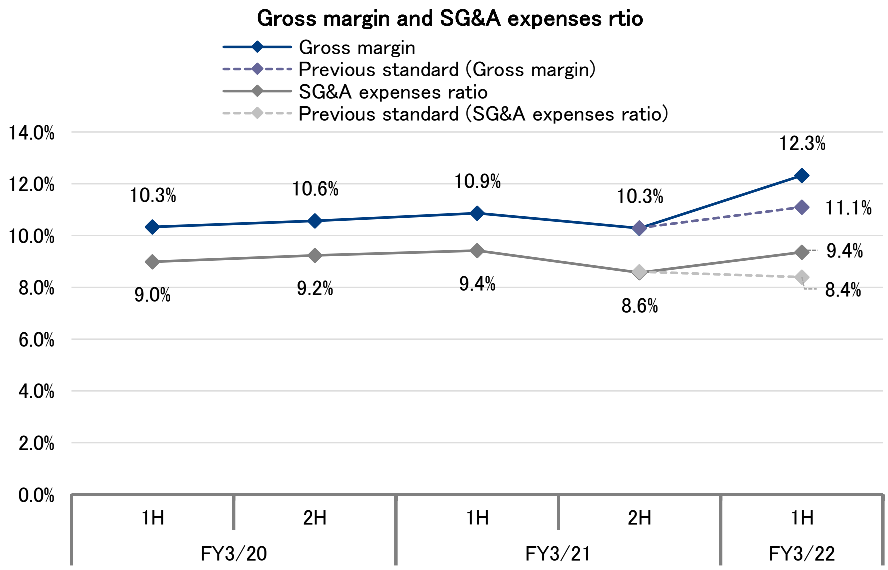
Source: Prepared by FISCO from the Company's financial results

The Company's change in accounting policy* from FY3/22 reduced net sales and cost of sales by ¥7,601mn compared to the previous standard. Net sales were up by 27.1% to ¥78,580mn in a comparison applying the previous standard and set an all-time high for the first time in three years as 1H.

* Application of the Accounting Standard for Revenue Recognition changed the method to not recognizing paid-for supplied products, which were previously booked in the same amount in net sales and cost of sales, as income from FY3/22. In the Company's case, this change affects domestic automotive electronic equipment business (Electronics Department).

Profit increase drivers in ordinary profit were ¥998mn from a rise in gross profit related to higher sales and ¥1,033mn from increase in gross profit linked to improvement in gross profit margin. These gains more than offset an ¥821mn increase in SG&A expenses and ¥35mn setback in non-operating income. While gross margin climbed from 10.9% in the previous fiscal year to 12.3%, it also had a real-basis 0.2ppt increase to 11.1% when viewed in terms of the former accounting standard. Primary sources of higher SG&A expenses were a rise in personnel costs, mainly from bonuses, and impact of expanded logistics volume in packaging and transportation costs. Even though freight rates moved upward, the Company absorbed the increase through efforts to curtail logistics costs per item using the Warehouse Management System (WMS)* and volume effect. The SG&A expenses ratio is flat YoY at 9.4%, but improved by 1.0ppt to 8.4% using the previous accounting standard. Non-operating income weakened mainly because of an increase in foreign exchange losses from ¥27mn in the previous year to ¥64mn.

* Warehouse Management System (WMS) refers to a system that supports improved efficiency in logistics costs by centrally controlling cargo, materials, and product inflow/outflow management and inventory management.



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

Asian sales climbed sharply mainly driven by China at the regional level, factory automation and industrial equipment, semiconductors, and environment and energy achieved double-digit increases at the industry level

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 profit as segment information by region, and discloses the sales composition ratio by industry and trend fluctuations as reference information.

(1) Trends in net sales by business segments

Main products handled by the electrical machinery segment are servo motors, motion controllers, inverters, programmable controllers, and power conditioners. The Company primarily handles products from Yaskawa Electric<6506>. Net sales expanded by 33.3% YoY to ¥14,392mn due to increases in sales by chip mounters and other electrical equipment and control equipment for the industrial machinery industry and electrical machinery for semiconductor production equipment.

The main products in the electronics segment are wide ranging, including general electronic parts such as capacitors, connectors, relays and switches, as well as fan motors, stepping motors, LEDs, and power supplies. Net sales increased 13.1% YoY to ¥52,301mn on higher sales of electronic components to the industrial machinery industry and automotive systems. This value rose 29.5% to ¥59,903mn YoY based on the previous accounting standard.

The main products in the general machinery segment include robots for Yaskawa Electric Corporation, as well as conveyors and reduction gears. Net sales decreased 10.2% YoY to ¥4,284mn, despite increase in transport equipment for the semiconductor-related industry, because of decline in sales of facilities equipment to the flat panel display (FPD) industry that had a major deal in the previous fiscal year.

Net sales by business segments

(¥mn)

	FY3/20		FY3/21		FY3/22	YoY
	1H	2H	1H	2H	1H	
Electrical machinery	10,565	10,572	10,793	12,364	14,392	33.3%
Electronics	52,470	53,930	46,249	56,408	52,301	13.1%
(Previous standard)					59,903	29.5%
General machinery	4,571	5,833	4,770	4,185	4,284	-10.2%
Total	67,608	70,335	61,813	72,956	70,978	14.8%

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

(2) Sales trends by industry

Looking at sales trends by industry (parent basis), sales climbed at upbeat paces of 22% YoY to the mainstay factory automation and industrial equipment industry and 14% to the semiconductor and LCD industry and also had solid gains of 13% to the environment and energy industry and 7% to the medical equipment and foods industry. Related goods sales increased thanks to robust capital investments in electric vehicle, solar panel, semiconductor, and other areas.

Meanwhile, sales decreased 23% to the automotive (on-board products) industry due to the change in accounting standards, 9% to the social infrastructure industry, 41% to the information and communications industry, and 46% to the security industry. Other than the automotive (on-board products) business, however, these areas have sales ratios of less than 5% and impact on overall sales is modest. Sales to the amusement industry, which dropped significantly in the previous fiscal year due to the COVID-19 pandemic, were flat amid limited recovery by the overseas casino market.

Increase-decrease trends in net sales by industry

Customers (industry)	Increase-decrease trend(arrow) and change rate (%)							
	2H FY3/19		1H FY3/20		2H FY3/20		1H FY3/21	
Factory automation/industrial equipment	→	–	↘	-5%	↗	10%	↗	22%
Automotive (on-board products)	→	–	↘	-19%	↗	44%	↘	-23%
Semiconductors/LCDs	↗	21%	↘	-13%	→	–	↗	14%
Social infrastructure	↗	16%	↘	-20%	→	–	↘	-9%
Information/communications	↗	10%	↘	-21%	↗	96%	↘	-41%
Medical equipment	↘	-9%	↘	-6%	↗	10%	↗	7%
Amusement	↘	-19%	↘	-47%	↘	-21%	→	–
Environment/energy	→	–	↘	-25%	→	–	↗	13%
Security	↘	-37%	→	–	↘	-7%	↘	-46%
Food	↗	1928%	↘	-76%	↘	-88%	↗	7%
Total	→	–	→	–	↗	44%	↗	15%

Source: The Company's results briefing materials

(3) Trends in sales and profits by segment

Japanese business recorded ¥47,340mn in net sales (+6.2% YoY) and ¥1,187mn in operating profit (+150.4%). While sales increased in electrical equipment, control equipment, and electronic components for the industrial machinery industry, electrical machinery and transport equipment for the semiconductor-related industry, and electronic components for the automotive (on-board products) industry, sales of facilities equipment to the FPD-related industry declined. Net sales under the previous standard increased 23.2% to ¥54,941mn.

Asian business booked ¥20,670mn in net sales (+39.6%) and ¥892mn in operating profit (+136.3%). While sales increased in electrical machinery and electronic components for the industrial machinery industry and electric products for the semiconductor-related industry, sales of facilities equipment to the FPD-related industry declined. Chinese sales, which contribute just under 80% to Asian sales, recovered quickly in 2H FY3/21 and have continued this momentum.

In Europe and the US, net sales increased 32.0% YoY to ¥2,601mn and the operating profit decreased 18.4% YoY to ¥13mn. Net sales improved thanks to sales of facilities equipment to mask production lines in the US and Europe, though decline in European profit on weaker sales mix had an impact.

Net sales by region

(¥mn)

	FY3/20		FY3/21		FY3/22	YoY
	1H	2H	1H	2H	1H	
Japan	49,249	51,689	44,578	53,433	47,340	6.2%
(Previous standard)					54,941	23.2%
Asia	14,529	15,982	14,809	17,208	20,670	39.6%
Europe/US	3,351	2,173	1,970	1,879	2,601	32.0%
Other	477	490	455	435	365	-19.8%
Total	67,608	70,335	61,813	72,956	70,978	14.8%

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

Operating profit by region

(¥mn)

	FY3/20		FY3/21		FY3/22	YoY
	1H	2H	1H	2H	1H	
Japan	529	756	474	723	1,187	150.4%
Asia	289	303	377	540	892	136.3%
Europe/US	35	-119	17	-18	13	-18.4%
Other	21	-14	24	-8	9	-62.1%
Total	909	937	900	1,252	2,108	134.2%

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

Upbeat Chinese orders momentum continued in October, FY3/22 results have room to exceed the upward-revised guidance

3. Outlook for FY3/22 results

The Company expects double-digit sales and profit gains in FY3/22 results at ¥148,700mn in net sales (+10.3% YoY), ¥4,200mn in operating profit (+95.1%), ¥4,340mn in ordinary profit (+69.0%), and ¥3,040mn in net profit attributable to owners of the parent (+70.2%). This outlook means all-time highs for the first time in four years in net sales and operating profit. Despite continued uncertainties, including COVID-19 pandemic impact, shortages in supplies of semiconductors and other parts and materials, and impact on production activity caused by electricity shortages in China, the Company raised guidance from period-start plan levels in light of progress through 1H and anticipated trends in the market environment. Regionally, Chinese sales are outpacing expectations and serving as the main source of upward revisions.

FY3/22 consolidated results forecast

(¥mn)

	FY3/21		FY3/22				vs. initial forecast
	Results	% of sales	Initial forecast	Revised forecasts	% of sales	YoY	
Net sales	134,769	-	135,800	148,700	-	10.3%	9.5%
(Previous standard)	-	-	151,300	164,885	-	22.3%	9.0%
Operating profit	2,152	1.6%	3,430	4,200	2.8%	95.1%	22.4%
Ordinary profit	2,567	1.9%	3,500	4,340	2.9%	69.0%	24.0%
Profit attributable to owners of parent	1,786	1.3%	2,250	3,040	2.0%	70.2%	35.1%
Earnings per share (¥)	113.23		142.62	192.51			

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

The Company expects sales decline impact of ¥16,185mn from the change in the accounting standard related to income recognition from FY3/22 that uses net values that remove automotive (on-board products) paid-for supplied products from net sales and cost of sales. When compared to the previous standard, the outlook is for net sales to increase 22.3% YoY to ¥164,885mn. Profit increase drivers in ordinary profit are ¥1,476mn from a rise in gross profit related to higher sales and ¥2,174mn from increase in gross profit linked to improvement in gross margin. These gains should more than offset a ¥1,597mn increase in SG&A expenses and ¥280mn setback in non-operating income.

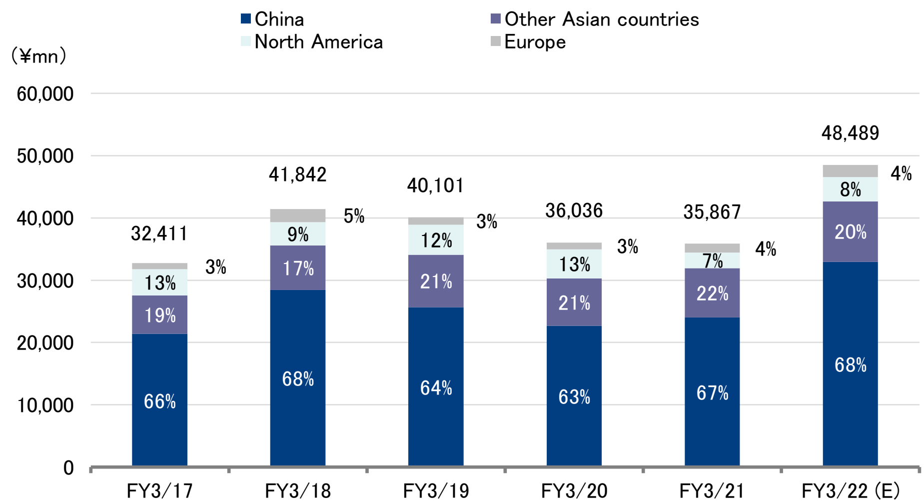
The Company expects modest decline in gross margin from 12.3% reported in 1H FY3/22 to 12.0% for the full year (vs. 10.6% in the previous year). This seems to be a conservative stance due to uncertainty in the market environment because the Company does see notable factors weighing on gross margin in 2H. The SG&A expenses ratio is slated to decline from 9.4% in 1H FY3/22 to 9.2% for the full year (vs. 9.0% in the previous year), mainly because of sales increase in 2H. Using the previous accounting standard, the outlook puts gross margin at a 0.2ppt YoY increase to 10.8% and the SG&A expenses ratio at a 0.7ppt decline to 8.3%.

Anticipated increase in SG&A expenses reflects higher personnel costs and packaging and transportation costs and also factors in a rise in business trip costs following the decision to fully lift the ban on business trips in October 2021. Additionally, the telework ratio held at the 70% level under the state of emergency declarations, but dropped to 20% in October and the Company is strengthening development of new customers and other sales activities.

Orders remained at a high level, mainly from China, in October 2021, and slowdown in China's economic activity does not appear to be affecting the Company's customers at this point. Capital investment appetites continue to be robust at electric vehicle and solar panel manufacturers. Japanese companies with local operations are sustaining strong orders too. Concerns about impact of shortages of semiconductor and parts/materials on production persist as seen in recent booking of orders deals with delivery periods of a year and the emergence of consultations about deliveries two years ahead on an inquiry basis. While orders might exhibit a slower pace at some point considering these trends, we see a possibility of FY3/22 results exceeding guidance amid extensive orders backlog absent a major change in the market environment.

Assuming an exchange rate of ¥111.9 to US$1 (¥110 to US$1 in the previous period), overseas net sales (on a local-corporation basis) will increase 35.2% YoY to ¥48,489mn, and their sales composition ratio will be 32.6% (26.6% in the previous period). The Company expects double-digit sales growth in all regions and continued growth in demand from automotive, semiconductor, and environment and energy industries in China, which contributes about 68%. Furthermore, it anticipates rising sales of global SCM solutions in other parts of Asia and recovery in capital investment-related demand on exhaustion of COVID-19 pandemic impact in the US and Europe. The Company mainly sells products on a USD-denominated basis in overseas business, and the estimated positive impacts on results from a single yen of depreciation against the USD are roughly ¥500mn on net sales and ¥50mn on ordinary profit. Also, the fiscal year for all of the 13 overseas subsidiaries ends in December, so these subsidiaries' October-to-December 2021 results will be reflected in the 4Q FY3/22 consolidated results.

Overseas net sales (on a local-corporation basis)



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

Progress of the medium-term management plan

Progressing new measures toward a great recovery

1. 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 with FY3/22 as its final fiscal year. It has positioned this three-year fiscal year as the fiscal year to build a structure toward realizing "Sun-Wa Vision 2025,"* which is the Company's long-term management vision. The plan has four fundamental policies, including "Contributing to customers' manufacturing by enhancing core businesses," and it is working on priority measures based on each of these basic policies.

* In "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."

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. It is also focusing on workstyle reforms to increase productivity through utilizing ITC in the form of responding to societal changes, on realizing a corporate culture that provides work satisfaction, and on contributing to SDGs (Sustainable Development Goals). Particularly in relation to the utilization of ICT, the Company is being required to respond to the new normal social style during the COVID-19 pandemic. But in this situation, even by 2019 it had already introduced and completed a working environment ahead of its peers, including introducing online communication tools, and it rapidly transitioned to a teleworking system without any decline in work productivity. This has also been a factor behind it achieving an early earnings recovery.

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) The NEXT 1800 numerical management targets and taking on new challenges toward a great recovery

The NEXT 1800 numerical management targets achievement for FY3/22, the plan's final fiscal year, of net sales of ¥180,000mn, operating profit of ¥4,800mn, and ordinary profit of ¥5,000mn. Nevertheless, the Company's results missed initial plan goals through FY3/21 due to facing harsh environments after plan formulation, including downturn in investment sentiment due to ramp-up of trade friction between the US and China and global economic weakness related to the COVID-19 pandemic. While FY3/22 results are likely to undershoot the initial goals too, profits have almost completely caught up. The Company is implementing the following three points as focus policies in pursuit of new challenges in the Great Recovery and is achieving some results in FY3/22.

Management goals in the NEXT1800 medium-term plan, results/plan

(¥mn)

	FY3/19	FY3/20		FY3/21		FY3/22	
	Results	Target	Results	Target	Results	Target	Plan
Net sales	145,410	150,000	137,943	165,000	134,769	180,000	148,700
Operating profit	3,410	3,100	1,846	3,800	2,152	4,800	4,200
Ordinary profit	3,627	3,300	2,144	4,000	2,567	5,000	4,340
Ordinary margin	2.5%	2.2%	1.6%	2.4%	1.9%	2.8%	2.9%

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

a) Overcome COVID-19 and acquire share of the 'new normal' market

The new normal market refers to industries and equipment that contribute to realization of a decarbonized society. Companies are inevitably increasing initiatives in energy savings as part of the effort to reduce CO_2 emissions, and the Company aims to reliably recruit this demand. Key products that it handles are inverters and high-efficiency motors and facilities equipment that provide energy savings. In the past, companies shied away from more expensive equipment even if it could support energy savings. However, large companies are now willing to accept higher costs as a necessary investment from the standpoint of achieving carbon neutrality or contributing to SDGs. This activity is likely to broaden from large companies to medium-sized companies and in China and other overseas markets. FISCO expects these conditions to deliver tailwinds to the Company with its extensive offerings of energy-savings equipment.

b) Build a strategy that utilizes DX and complete its implementation system

The Company achieved a smooth shift to remote work operations in the COVID-19 pandemic because it had already installed an internal online communications tool by 2019 as explained above and managed to curtail groupwide logistics costs through WMS deployment and operation. As a current initiative, it is working on moving the in-house server to a data center in order to realize energy savings and strengthen security measures.

c) Output reliable results through deepening existing businesses, developing new businesses, and reviewing the business portfolio

As new business, the Company has projects with reduction of CO_2 emissions as the main theme and is also addressing local 5G projects. It intends to focus on capturing these projects.

Aims to further expand results by recruiting opportunities related to realization of a decarbonized society and heightened supply chain risk

2. Update on progress with fundamental policies

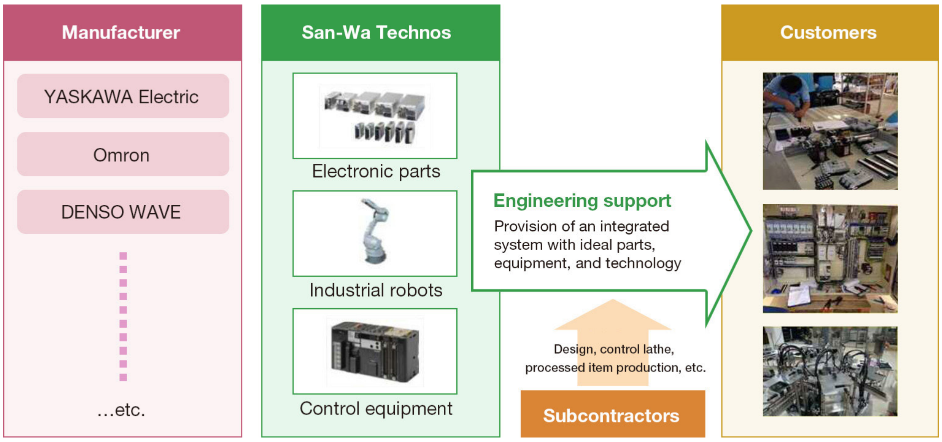
(1) Progress for "contribute to customer production activities by strengthening core businesses"

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.

a) 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 underlying reasons for focusing on this business include the advancing functions of factory automation equipment such as industrial robots, and diversification in response to customer demands, which cannot be met by stand-alone sales of individual products. The Company's view is that it will be possible to increase profitability through the added value of engineering while expanding the scale of orders per project.

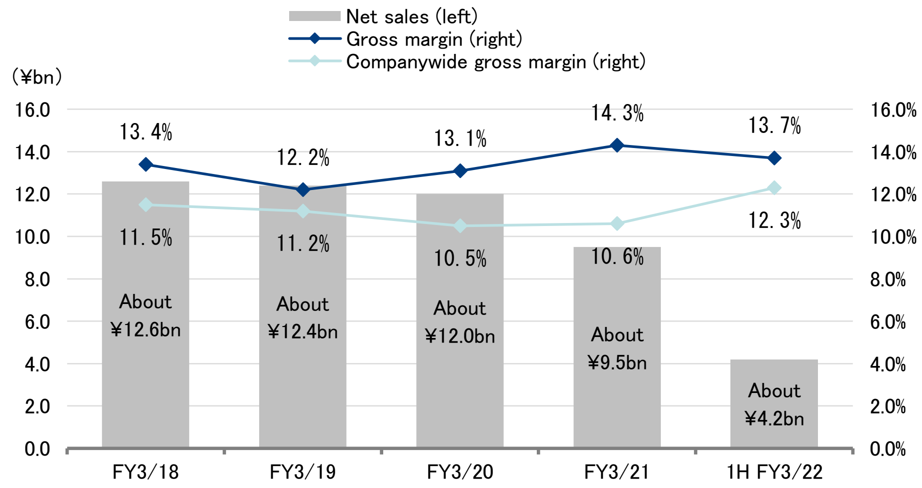
Overview of engineering business



Source: The Company's website

Engineering business had about ¥4.2bn in 1H FY3/22 sales, a slight decline versus the previous year due to COVID-19 pandemic impact. The Company also expects lower full-year sales than the roughly ¥9.5bn in FY3/21. While sales had been in the ¥12bn range through FY3/20, shift to a sales strategy with emphasis on profitability and curtailment of sales activities due to the COVID-19 pandemic weighed on results. The Company's engineering business requires detailed interactions with customers because of its business characteristics. While it opened the Tokyo Technology Center in 2020 to attract customers, recruitment was sluggish due to sustained COVID-19 pandemic conditions. Nevertheless, orders deals are likely to increase as in-person sales activities pick up. Business opportunity examples are the control panel in substrate drilling equipment and line speed-up modification for the semiconductor-related industry, assembly line modifications and part transport line projects in the automotive industry, and inspection equipment upgrades in the papermaking industry. Demand is likely to increase for installation of automated transport robots as labor-saving measures and energy-saving systems, and provision of smart factory-related facilities utilizing IoT and local 5G technologies. In particular, FISCO expects healthy orders expansion opportunity in energy-saving solutions that leverage the Company's strength as a technology trading firm as more companies pursue SDGs because of its ability to handle total deployment projects that involve not just equipment but also LED lighting and other related facilities.

Trend in net sales and gross margin in the engineering business



Source: Prepared by FISCO from results briefing materials and interview

Engineering business gross margin was just under 14% in 1H FY3/22. While it exceeded the Company's 12.3% overall gross margin, it still considerably less than the 25-30% initial goal for this business. This is considered because there are still few projects proposed to customers that utilize the knowledge and experience that the Company has acquired in the past, and instead that the majority of projects are in the form of orders from customers, so it is unable to acquire sufficient compensation for the inherent value-added portion.

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.

The Company switched to a sales policy that emphasizes profitability from FY3/20 to break out this situation. However, to improve the profit margin even further, the key will be whether it can build a structure to provide customers with services in which, in some way, the expertise that the Company has accumulated up to the present time has been standardized. As explained above, the Company is likely to have more opportunities to recruit customers as demand for overall optimization in system development rises further amid anticipated increase in companies actively working on energy-saving capabilities in pursuit of a decarbonized society. Engineering business should steadily expand sales and raise profitability if it can deliver services that satisfy customer needs and offer cost benefits. In particular, if orders increase for large-scale projects that can be expected to be highly profitable, it is likely that it will have in sight achieving a gross margin of 25-30%. The Company has approximately 50 engineers working in this business, and for the time being the Company's plan is to expand the business with this team of engineers.

b) Global SCM solutions business

The global SCM solutions business is rooted in the services that the Company has provided since the distant past of services such as procurement agent, logistics agent, and delivery management services. The various manufacturing companies that are the Company's main customers are pursuing efficiency improvements to the same level as major companies, and they are conducting streamlining under the name of business structural reforms. In this process, they have targeted reducing personnel and bases in fields 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 functions that customer companies have so far procured independently from various suppliers, such as electronic parts and equipment, into the Company, these customers can enjoy benefits including reduced procurement costs and shortened lead times.

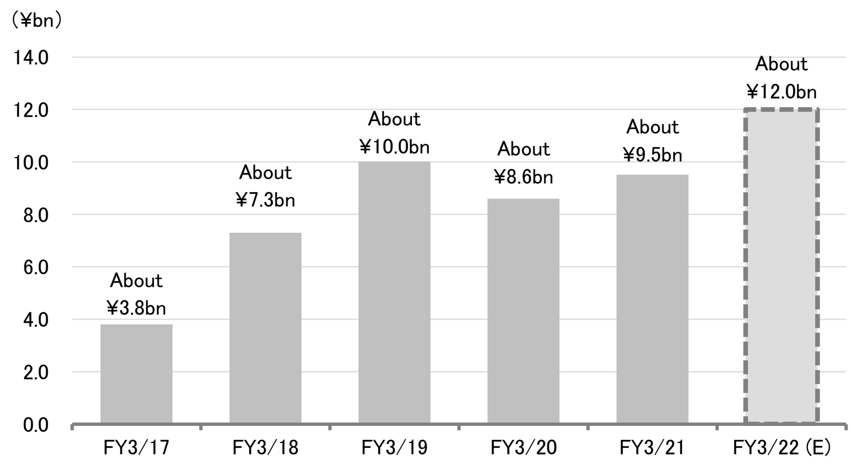
Using the moving business as an example, conventional procurement agent and logistics agent services just move a person's items from the former home to the new home. In global SCM solutions business, meanwhile, the service also extends to setting up televisions and PCs for immediate use after the move 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 strengths include the expertise it has accumulated over its long history as a technologies trading company and its expansive overseas network (28 bases around the world). It is aiming to utilize these strengths to respond to customers' outsourcing needs and to grow the scale of the global SCM solutions business.

Net sales increased by roughly ¥6bn, a double-digit YoY gain in 1H FY3/22. Main drivers were heightened parts/materials procurement and logistics outsourcing needs and stronger inquiries than in the past for the Company's services to stably acquire semiconductors and other parts and materials confronting significant shortages recently. While the Company raised the FY3/22 sales target from about ¥11.5bn in the initial forecast to roughly ¥12bn, it is likely to overshoot considering the current orders level.

Specific deals include a move by a broadcasting equipment manufacturer from a Chinese plant to a Vietnamese plant (¥200mn/year) and an SCM project at a US plant for a servo motor manufacturer (¥300mn/year), and deal opportunities are an SCM project at a Chinese plant by a medical equipment manufacturer (¥240mn/year), a local procurement initiative for production in Malaysia by a semiconductor inspection equipment manufacturer (¥300mn/year), an SCM project at a Chinese plant by an industrial processing laser equipment manufacturer (¥100mn/year), and a local procurement initiative for a Philippine plant by a DC motor manufacturer (¥200mn/year).

Global SCM outsourcing inquiries are likely to increase more than ever before because of efforts to distribute production sites aimed at lowering business risk in the COVID-19 pandemic and the growing importance of SCM functions. Customer companies are also finding that consignment of the SCM system to an external specialty firm, rather than building it on their own, is more effective at reducing business risk and provides cost benefits. For the Company, this business expands transaction value with existing customers and is a good opportunity to acquire new customers. In order to strengthen the competitiveness of SCM services, the Company is reviewing the global logistics infrastructure at the same time as establishing a business division, and is starting improvement activities. As one part of this, it has begun fully fledged operations of Warehouse Management System (WMS), and it is aiming to improve profitability by making visible the logistics costs of each project.

Trends in net sales in the global SCM solutions business



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

(2) Progress made in "Expanding global business and supporting market demand"

With this theme, the Company opened a business site in Ho Chi Minh, Vietnam in August 2019 with the aim of strengthening sales operations in the country by having two locations. However, it has struggled to recruit new customers since 2020 because of needing to conduct remote sales operations due to COVID-19 impact and focused on sales activities with existing customers. It plans to put emphasis on acquiring new customers as the pandemic settles down.

In Japan, meanwhile, it has been opening smart sales sites in regional areas since 2019 as a new initiative. While it previously referred to these locations as "remote assistance sales sites," it adopted "smart sales site" as the official name this time. Smart sales site refers to a small-scale site with only about two sales members. These sites seek to deepen transactions by bolstering relationships with attractive customers scattered in smaller regional cities and also recruit new customers. Internal operations without clerical staff are supported by remote branch offices, which make it possible to reduce the costs associated with sales offices and the labor costs of internal staff During the COVID-19 pandemic, cases of online sales discussions are increasing, and in the B-to-B market, such as factory automation and industrial equipment, customers' requests are diverse and, in many cases, listening to what they say in direct discussions leads to building relations of trust with them and new sales discussions. In fact, at the Shikoku Sales Office (Niihama, Ehime Prefecture), which was the first smart sales office opened in 2019, and the Nagaoka Sales Office (Niigata Prefecture) and the Kofu Sales Office (Yamanashi Prefecture), which were newly opened in FY3/21, the numbers of sales discussions with customers are increasing, which is expected to lead to the growth of transactions in the future.

The Company has three conditions to open a smart sales office: that it opens it at a site exclusively for offices, not also for housing; that it has two or more sales staff; and that when opening the sales office, the person who wants to open the office prepares the planning document. At the stage when these three conditions are satisfied, it opens the smart sales office. The Company opened a sales site in Kanazawa (Ishikawa Prefecture) in October 2021 and plans to open the Kitakyushu sales site (Fukuoka Prefecture) in December 2021 and the Morioka sales site (Iwate Prefecture) in the first half of 2022. In overseas operations, it launched smart sales sites in Penang (Malaysia) in January 2021 and in Xiamen (China) in May 2021 with local staff aimed at deepening ties with local Japanese customer companies. It is also considering additional sales sites in India and Wuhan and Qingdao in China.

(3) Progress for "pursue new business fields to accelerate sustainable growth"

The Company recognizes that cultivation of management human resources is an important issue for this theme and is promoting such activities. Training executives is particularly vital. The human resources training system holds various events, such as "Global Next Leader Training," "Future Discussions Looking Ahead 100 Years," and "Vision and Medium-Term Executive Planning Committee," including an online format. Additionally, in order to grow the global business, the overseas bases are advancing measures to train and appoint local staff to be management human resources and to strengthen organizational capabilities.

Currently, because the majority of the customers of the overseas local corporations, which operate 28 bases in 13 countries, are Japanese companies, Japanese employees are involved in their management. However, to realize further growth, it is considered important to strengthen organizational capabilities even more by appointing local staff as managers. The number of consolidated employees has grown to approximately 1,000 people, of who, around 400 are foreign (non-Japanese) nationals (of who, around half are Chinese). As it is very costly to recruit human resources with management skills from outside the Group, the policy is to conduct training within the Group, and the training of management candidates starts in Japan. If the globalization of management human resources continues, we at FISCO anticipate that the Company will progress customer acquisition of foreign companies, which currently provide only around 10% of total sales (around 35% in the Chinese market), and that this will lead to the further growth of overseas sales. In the Chinese market, capital investments are likely to expand over the longer term considering the government policy of building semiconductor, electric vehicle, and other industries, and recruitment of many attractive local customers in these industries should contribute to sales growth.

(4) Progress for "Conduct initiatives to realize a sustainable society"

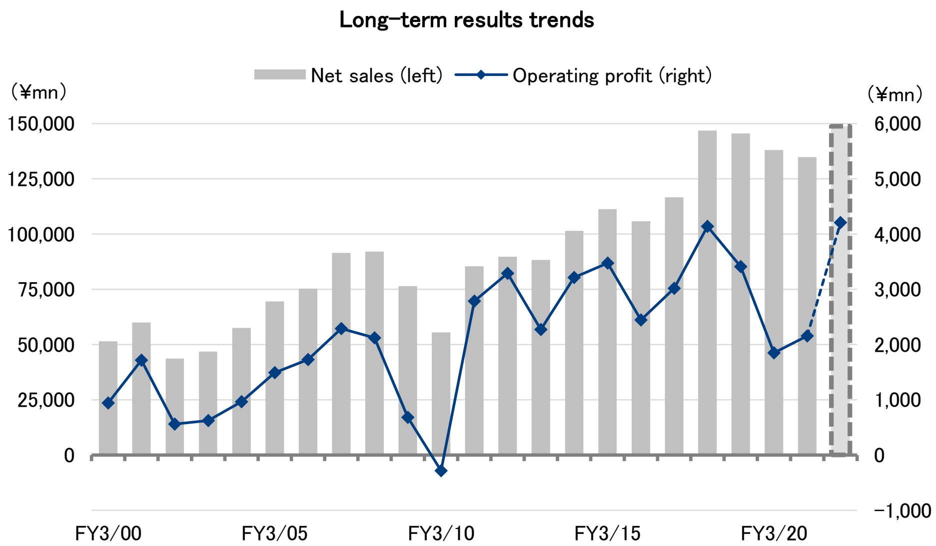
The Company is promoting workstyle reforms utilizing ICT and flexibly supporting telework and other new normal styles from an SDGs perspective. An internal SDGs-related initiative is establishment of an SDGs ambassador to promote activities that strive to increase awareness of SDGs and encourages individual employees to set individual goals related to SDGs. At the business level, it is strengthening sales activities for businesses with a clean energy theme targeting realization of a decarbonized society, such as solar panels and other renewable energy and electric vehicles and energy-saving business that contributes to lowering CO_2 emissions.

(5) Next medium-term management plan

The Company formulated Sunwa Vision 2025, a long-term vision, that sets a goal of ¥250bn in sales in FY3/26. While the next medium-term management plan slated to begin in FY3/23 should devise strategies for attaining the long-term vision while taking into account current market trends, the Company might revise the sales goal, including impact from the change in the accounting standard. Nevertheless, the Company's earnings are likely to rise over the longer term as the industries it targets steadily expand capital investments along with economic growth, albeit exhibiting a cycle of ups and downs along the way. In particular, the Company should receive tailwinds for business gains considering heightened expectations for energy-savings equipment and high-efficiency motors, control equipment, inverters, and other products that deliver labor savings driven by the global movement toward realization of a decarbonized society as a supplier of these products. Additionally, global SCM solutions business and engineering business support growth prospects.

Average annual growth rates in the 21 years from FY3/00 to FY3/21 were 4.7% in net sales and 4.0% in operating profit (growth rates for the 18 years through FY3/18, the recent earnings peak, were 6.0% in net sales and 8.6% in operating profit). FISCO thinks the Company is capable of accelerating the growth pace if it deepens existing business, recruits new business, finds new customers including from overseas, and successfully leverages tailwinds from the market environment through priority measures in the NEXT 1800 plan.

The Company prepared content in the medium-term management plan up to now using ideas from project teams comprised of talented mid-tier employees put together for that purpose (these activities were also part of employee education). This time, however, the executive strategy office is formulating the plan and revising operations to continue involvement permanently. If the Company assesses and analyzes results versus the medium-term plan through these efforts and can apply lessons to future improvements, its management capabilities should benefit.



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

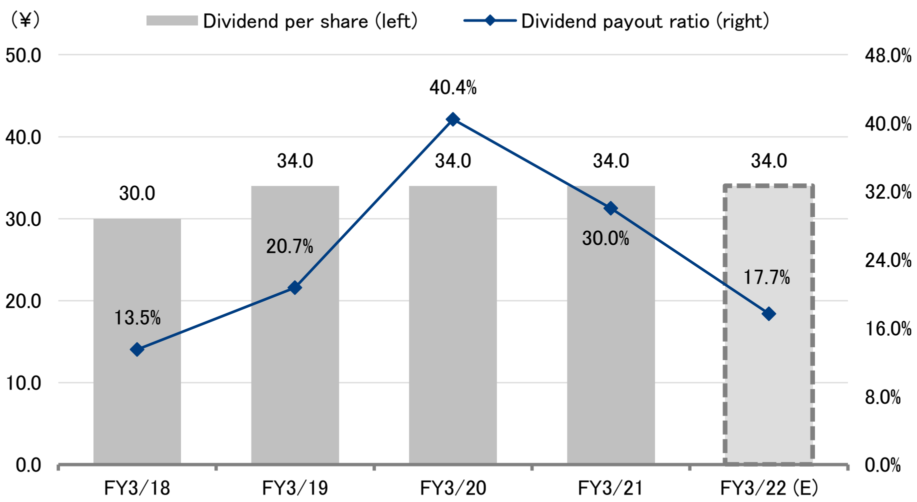
Shareholder return policy

Plans to pay a ¥34 per share dividend in FY3/22 on par with the previous fiscal year, announced a share buyback program

The Company's basic policy is to provide returns to shareholders in the form of dividends. Management prioritizes providing stable, continuous dividends. While the Company does not sharply raise the dividend due to temporary steep profit expansion, it sustained the dividend at the prior-year level even in the phase of two straight profit declines from FY3/19. In FY3/22, it intends to pay a ¥34.0 per share dividend (17.7% dividend payout ratio), planning the same amount as the previous fiscal year. However, it seems that the Company's policy is to consider increasing the dividend if it appears that results will steadily grow and the dividend payout ratio will fall to a low level.

The Company announced a share buyback program on October 29, 2021, that aims to enhance shareholder return and capital efficiency and dynamically implement capital policy in response to the management environment. The program calls for purchases up to 425,000 shares (2.69% of total outstanding share volume (excluding treasury shares)) or ¥600mn. The purchase period covers from November 1, 2021, to March 31, 2022.

Dividend per share and dividend payout ratio



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

Simplified income statement and main indicators

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22 2Q	FY3/22 (E)
Net sales	146,759	145,410	137,943	134,769	70,978	148,700
YoY	25.9%	-0.9%	-5.1%	-2.3%	14.8%	10.3%
Gross profit	16,883	16,318	14,421	14,224	8,749	17,874
Gross profit margin	11.5%	11.2%	10.5%	10.6%	12.3%	12.0%
Selling, general and administrative expenses	12,747	12,908	12,574	12,071	6,640	13,668
Selling, general and administrative expenses ratio	8.7%	8.9%	9.1%	9.0%	9.4%	9.2%
Operating profit	4,135	3,410	1,846	2,152	2,108	4,200
YoY	37.2%	-17.5%	-45.8%	16.5%	134.2%	95.1%
Operating profit margin	2.8%	2.3%	1.3%	1.6%	3.0%	2.8%
Ordinary profit	4,349	3,627	2,144	2,567	2,195	4,340
YoY	35.3%	-16.6%	-40.9%	19.7%	115.0%	69.0%
Profit attributable to owners of parent	3,085	2,628	1,341	1,786	1,551	3,040
YoY	94.8%	-14.8%	-49.0%	33.2%	119.7%	70.2%
EPS (¥)	222.65	164.08	84.11	113.23	98.23	192.51
Dividend (¥)	30.00	34.00	34.00	34.00	17.00	34.00

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

Simplified balance sheet

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22 2Q	Change amount
Current assets	65,852	64,209	62,713	64,430	73,813	9,383
Cash and deposits	8,596	10,005	12,052	13,113	16,692	3,579
Trade receivables	46,077	42,256	39,838	42,453	44,566	2,113
Non-current assets	11,401	9,905	9,024	11,951	12,111	160
Total property, plant and equipment	3,005	2,861	2,759	2,590	2,552	-38
Intangible assets	168	143	193	170	173	3
Total investments and other assets	8,227	6,900	6,072	9,190	9,385	195
Total assets	77,254	74,114	71,738	76,381	85,924	9,543
Current liabilities	43,077	37,199	35,402	36,372	46,203	9,831
Payment obligations	34,298	31,427	29,108	29,455	35,529	6,074
Non-current liabilities	6,182	4,970	4,608	4,978	2,623	-2,355
Total liabilities	49,260	42,169	40,011	41,350	48,827	7,477
Interest-bearing debt	9,222	6,705	6,709	7,048	7,317	269
Shareholders' equity	23,731	29,056	29,552	30,802	32,119	1,317
Accumulated other comprehensive income	4,262	2,888	2,174	4,228	4,978	750
Total net assets	27,993	31,944	31,726	35,030	37,097	2,067

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

Statements of Cash Flows

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21
Cash flows from operating activities	-2,221	1,636	3,238	1,589
Cash flows from investing activities	29	-153	-200	-141
Cash flows from financing activities	3,962	28	-945	-309
Cash and cash equivalents at end of period	8,112	9,521	11,568	12,629

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

Management indicators

(¥mn)

	FY3/18	FY3/19	FY3/20	FY3/21
Equity ratio	36.2%	43.1%	44.2%	45.9%
Interest-bearing debt ratio	32.9%	21.0%	21.1%	20.1%
ROE	12.0%	8.8%	4.2%	5.4%
Net cash	-626	3,300	5,343	6,065

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

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