

Elematec Corporation

2715

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FISCO Ltd. Analyst

Hiroyuki Asakawa



FISCO Ltd.

<http://www.fisco.co.jp>

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■ Summary

Formulated the new medium to long-term growth strategy “elematec x (cross)”; targeting growth markets through globalization and modularization

Elematec Corporation <2715> (also, referred to as the Company below) is an electronics trading company that specializes in electronic materials. It was formed through the merger of Takachiho Electric Co., Ltd. and Ohnishi Denki Co., Ltd. in 2009 and entered the TOYOTA TSUSHO CORPORATION <8015> Group in 2012.

1. Sales and profits weakened in FY3/17, though posted second highest net sales and third highest operating income

Elematec reported weaker sales and profits in FY3/17 at ¥203,004mn in net sales (-6.4% YoY) and ¥5,406mn in operating income (-21.3%). These results missed initial forecast, but exceeded lowered targets and posted second highest net sales and third highest operating income. We think it turned in a solid performance, despite pressure from roughly ¥30,000mn YoY decline in smartphone-related sales.

2. Globalization and modularization are key words in the growth strategy

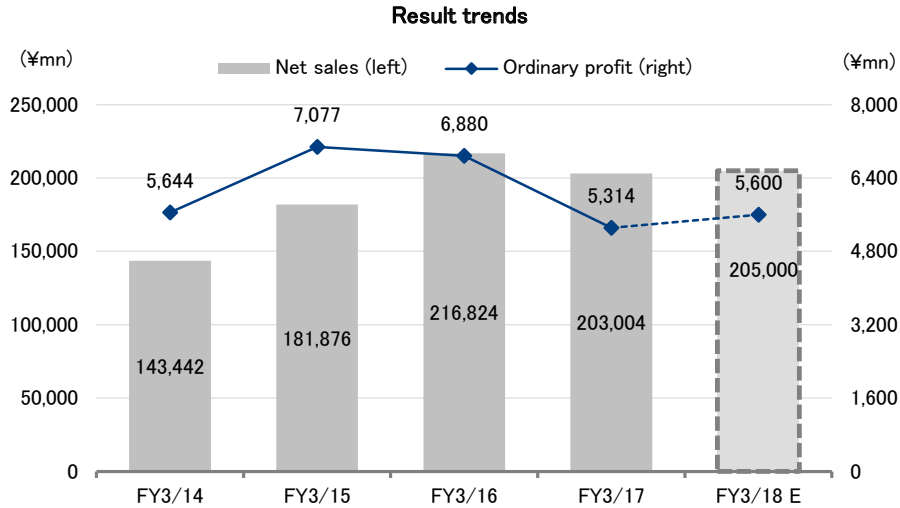
Elematec formulated a medium to long-term growth strategy with the new slogan “elematec x (cross).” It sets globalization and modularization as key words for medium to long-term growth. In “globalization,” Elematec seeks to leverage an overseas network to arrange direct accounts with end users worldwide. In “modularization,” Elematec plans and designs products that meet customer requirements and are sold as intermediate “component modules,” rather than selling individual items as standalone products. This approach strives to increase added value for planning, design, and production and thereby expand the Company’s earnings.

3. Expects increases in sales and profits in FY3/18, planning to sharply raise the dividend thanks to a rebound in Profit attributable owners of parent

The FY3/18 forecast aims for increases in sales and profits with net sales at ¥205,000mn (+1.0% YoY) and operating income at ¥5,800mn (+7.3%). Demand in smartphone-related business, which switched to a recovery from 2Q FY3/17, remains upbeat thus far in the new fiscal year. While Elematec takes a cautious view because of concerns about ramp up of OLEDs for smartphones from 2H, its current forecast appears conservative in light of the weaker yen trend in forex rates and other tailwinds. Elematec intends to pay a sharply higher dividend owing to a significant rebound in profit attributable owners of parent on non-recurrence of extraordinary losses.

Key Points

- Possesses strengths in planning and development that leverage a broad range of customers and products as well as robust operational capabilities
- Proposes solutions to customers based on planning, design, and prototyping capabilities that seek to expand added value
- Forecasts for increases in sales and profits in FY3/18 as expanded sales to the automotive industry more than offset decline in LCD-related sales



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

Company overview

Two companies with specialties in electronic materials merged in 2009, broadened to the automotive field by entering the Toyota Tsusho Group

1. History and business overview

The Company's predecessors were Takachiho Electric, established in 1947 in Tokyo, and Ohnishi Denki, founded in 1958 in Kyoto. Both companies began by handling insulation materials, subsequently broadened the scope of their product offerings to electronic materials used in electronic products following technology and development trends, and grew into being independent technology trading companies.

These companies merged in 2009 (with Takachiho Electric as the surviving entity) and adopted the Elematec name. The Company has steadily grown since the merger, even though both predecessors mainly handled electronic materials, thanks to complementary geographical positions in Tokyo and Kyoto. It became a subsidiary of Toyota Tsusho through a TOB transaction in 2012, and this is its current position.

The Company had 1,172 employees on a consolidated basis as of the end of FY3/17. It operates a domestic service network with 21 sites and an overseas service network with 39 sites. Regional sales breakdown consists of Japan at 57.5%, China (including Hong Kong) at 22.4%, other Asia (Taiwan, Korea, India, and Southeast Asia) at 16.8%, and the US and Europe (US, Mexico, and Czech) at 3.3%.

History

April 1947	Takachiho Electric is established in Minato-ku, Tokyo.
September 1958	Ohnishi Denki is established in Kyoto
September 1979	Office opened in Singapore
January 1998	Office opened in the Philippines
September 2000	Office opened in Shanghai
April 2002	Local entity is established in Thailand
June 2002	Listed on the JASDAQ market
December 2003	Listed on the TSE Second Section
March 2005	Shares moved to the TSE First Section
December 2005	Opened an office in Hanoi
August 2006	Established a local entity in San Diego (US)
February 2008	Ohnishi listed shares on the JASDAQ market
October 2009	Takachiho Electric and Ohnishi Denki were merged, and the trade name was changed to Elematec
July 2010	Opened an office in Jakarta
March 2011	Opened an office in Bangalore (India)
August 2011	Formed a capital and business alliance with TOYOTA TSUSHO CORPORATION
March 2012	Became a consolidated subsidiary of TOYOTA TSUSHO through a TOB
April 2012	Opened an office in Chicago
January 2014	Opened a sales subsidiary in Mexico
December 2014	Absorption-type merger of TOMUKI CORPORATION (wholly owned subsidiary from October 2014)

Source: FISCO Inc. from the website and negotiable securities reports

Possesses strengths in planning and development that leverage a broad range of customers and products as well as robust operational capabilities

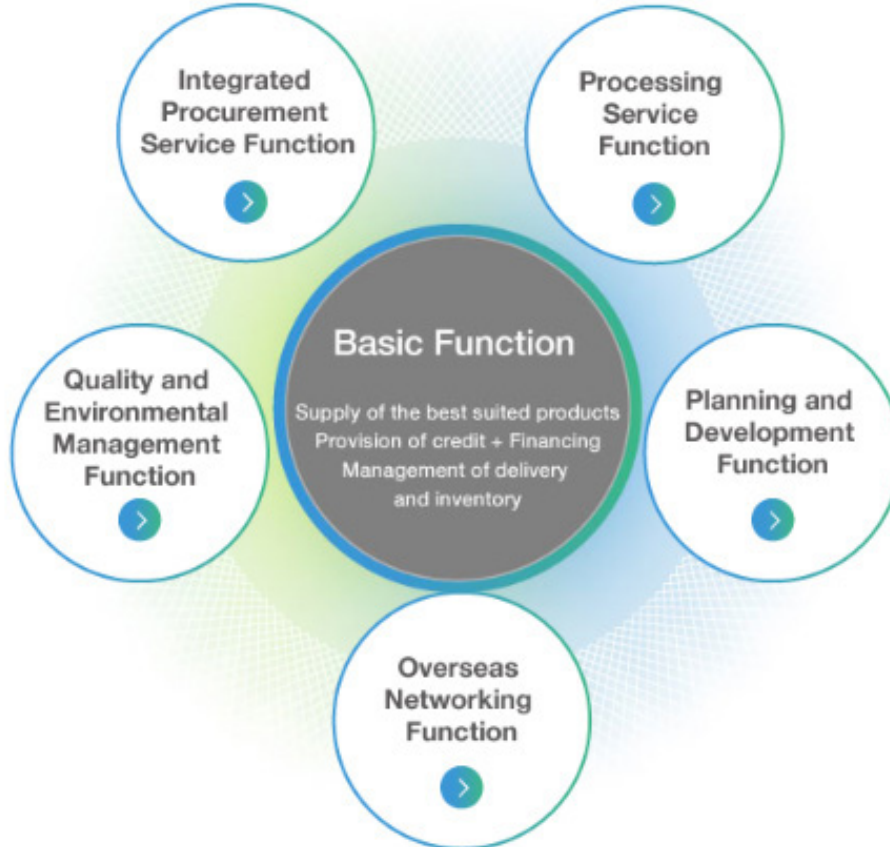
2. Company features and strengths

As explained in previous reports (including the report issued on December 16, 2016), we think Elematec possesses the following attributes and strengths: 1) significant diversity in counterparts and products, 2) flexible support for growth markets, and 3) manufacturing functions. To help in gaining an even deeper understanding of these features and strengths, below we analyze Elematec from the standpoint of services and functions its supplies to customers.

Elematec operates 60 sites in Japan and other countries and handles transactions of electronic materials and electronic components among about 6,000 supplier firms (roughly 4,000 in Japan and 2,000 from other countries) and 5,800 customer companies (around 3,600 in Japan and 2,200 in other countries).

Elematec goes beyond just the basic services and functions of an electronics trading company of optimal supply of parts and materials, credit provision and financing, and delivery timing and inventory management. It also supplies processing services, integrated procurement services, and other more advanced services and functions that generate higher added value. While Elematec highlights five services and functions, we think integrated procurement services, processing services, and planning and development functions stand out as core features and strengths.

Services and Functions Elematec Provides



Source: The Company's website

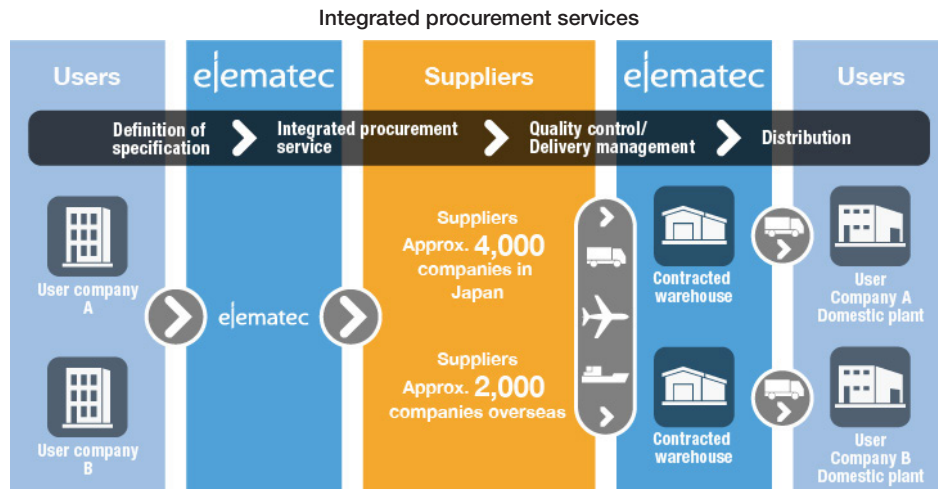
(1) Integrated procurement services

Integrated procurement services covers procurement of raw materials for customers plus internal logistics at customers. Key points are finding and procuring ideal parts and materials that meet the specifications required by users from roughly 6,000 domestic and overseas suppliers and supplying these items on a just-in-time basis to domestic and overseas plants of customer companies with Elematec responsible for quality and delivery timing management. We think this service provides differentiation from rivals and contributes to customer retention because few companies are capable of effectively handling this full range of operations.

We expect demand for integrated procurement services delivered by Elematec to continue growing, particularly in light of chronic manpower shortages in sections in charge of procurement and internal logistics, even at many large companies, amid efforts to improve business efficiency and reduce employee levels.

The challenge with integrated procurement services, meanwhile, is inherently low profitability. While integrated procurement service is effective as the initial entry point in building transaction relationships with customers, it can wind up just increasing sales and not delivering profits on its own. After beginning the relationship with an integrated procurement service framework, other aspects must be added, such as proposals to revise specifications, switching to parts and materials that are more profitable, and expanding transactions to other parts and materials.

These measures should be pursued after obtaining strong customer satisfaction through reliable provision of initial integrated procurement services. Elematec has been largely succeeding in realization of this type of positive spiral (even if not in every case). We think it is important for Elematec to solidify a pattern of enhancing profitability in integrated procurement services in light of significant latent outsourcing demand.



Source: The Company's website

(2) Processing services

Elematec is a trading company and adheres to a stance of avoiding competition with manufacturers, who are transaction counterparts. However, customers (sales destinations) often request delivery of processed items. Elematec has its own processing sites to accommodate these needs – one in Japan and two in China.

In Japan, Elematec Logi Serve Corporation (based in Yokohama) processes and manufactures electric materials and other products, conducts acceptance inspections, and handles environment-related material measurements. In China, Elematec Electronics (Dalian) Co., Ltd. implements surface mounting of parts into electronic circuit boards and Elematec Wuxi Technology Co., Ltd. handles silk-screen printing, for plastic panels, cutting and processing, and assembly.

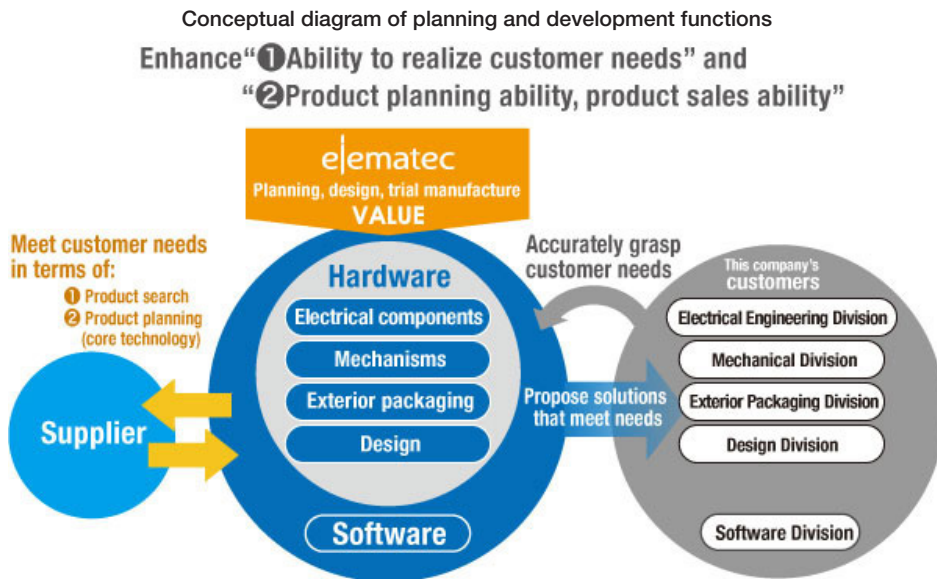
Elematec starts generating added value and increasing profitability once it gets to the point of supplying customized products that it has planned and designed utilizing new product development information and information about the latest technology trends and other developments that it possesses. This is what Elematec refers to as “modularization.” Its promotion of modularization often overlaps with promotion of planning and development functions explained below. If planning and development functions work well and deals are arranged, modularization business naturally occurs.

Elematec does not limit itself to manufacturing and processing at only its own processing sites in modularization business. However, it is beneficial to outsource from a position of directly having processing and manufacturing technologies. We will be looking for Elematec to accumulate experiences and technologies in processing services and apply them to module processing at its own plants.

(3) Planning and development functions

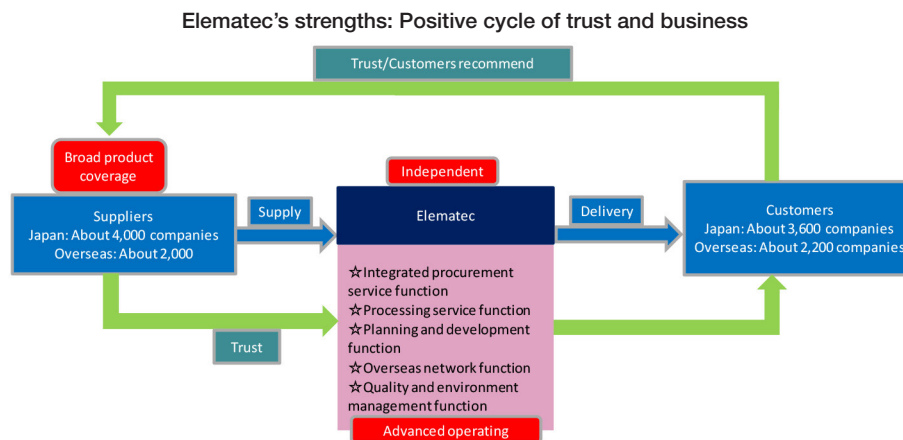
Planning and development business begins with appropriate understanding of customer needs. Fundamental flow in this business involves Elematec identifying optimal parts and materials from its roughly 6,000 domestic and overseas suppliers to meet wide-ranging needs at customers for electronics, mechatronics, exteriors, design, and other aspects or planning products that satisfy requirements (even creating product prototypes in some cases) and submitting proposals to customers.

Two essential ingredients in this business are “grasping” and “realizing” needs. Not many rival companies have both of these capabilities, and we believe this function is another source of differentiation for Elematec versus other companies. Additionally, adoption of new products based on Elematec’s plans and designs means that it becomes an only-one presence to the customer firm. We think this is a very effective way of strengthening relationships with customers. As explained above, these new products should generate high profitability due to Elematec’s role of processing into modules for delivery.



Source: The Company's website

The three services described above are similar in their provision of “differentiation,” as services and functions that cannot be easily achieved by other companies in the same industry, and “customer retention,” by securing trust from customers through the process and positioning Elematec as a vital presence to customers. We believe the diversity of transaction partners and products in Elematec’s business enables it to deliver these functions and services. These broad transaction relationships naturally put Elematec into contact with the latest products and technologies. Elematec leverages knowledge obtained from its activities, together with planning and proposal capabilities as a technology trading company, to cultivate new relationships and offer new products. We think Elematec’s primary strength resides in its establishment of this “beneficial cycle.”



Results trends

Sales and profits weakened in FY3/17, though posted second highest net sales and third highest operating income

1. Review of FY3/17 results

Elematec reported weaker sales and profits in FY3/17 at ¥203,004mn in net sales (-6.4% YoY), ¥5,406mn in operating income (-21.3%), ¥5,314mn in ordinary income (-22.8%), and ¥1,342mn in profit attributable owners of parent (-73.4%). (However, consolidation of 15 months for some subsidiaries in FY3/16 exaggerated sales and profit decline rates.)

Elematec lowered FY3/17 forecast at the 2Q announcement, and operating income and other profit items exceeded the revised values in FY3/17. While sales and profits weakened, Elematec posted second highest net sales and third highest operating income. We think it turned in a solid performance, despite pressure from steep decline in mainstay smartphone-related sales over the past few years.

Summary of the FY3/17 results

	FY3/16		FY3/17		Full year Results	YoY Growth rate	Difference with updated forecast Growth rate
	Results (reporting basis)	Results (12-month basis)	Period-start forecast Full year	Updated forecast			
Net sales	216,824	205,370	220,000	203,500	203,004	-6.4%	-0.2%
Gross profit	18,763	17,947	-	-	17,127		
SG&A expenses	11,894	11,406	-	-	11,720		
Operating income	6,868	6,540	6,150	4,850	5,406	-21.3%	11.5%
Ratio of operating income	3.2%	3.2%	2.8%	2.4%	2.7%		
Ordinary profit	6,880	6,538	6,100	5,100	5,314	-22.8%	4.2%
Profit attributable owners of parent	5,048	4,794	4,400	1,300	1,342	-73.4%	3.2%

Note: FY3/17 YoY comparisons use the FY3/16 reporting basis

Source: Prepared by FISCO from Company materials

Net sales dropped ¥13,820mn YoY in FY3/17. We give a detailed explanation of decline factors below. However, the largest setback by demand segment came from the roughly ¥30,000mn YoY decline in smartphone-related sales. Overall sales decline totaled ¥13,820mn (as noted above), even with this downturn in smartphone business and suspension of the Company's sales to building materials, thanks to expansion of surface-mounting business (for LCD parts) to the ¥20,000mn range.

In earnings, meanwhile, surface-mounting business gains were not enough to fully offset profits lost from steep decline in smartphone-related sales. This is because of low profit margin in surface-mounting business that is similar to integrated procurement service. Gross margin fell 0.2pp from FY3/16's 8.6% to 8.4% due to lower sales plus less favorable product mix.

In SG&A expenses, personnel costs declined due to a drop in bonus payments that are linked to earnings, but transportation costs moved upward on expansion of surface-mounting business and other expenses increased from booking provisions to the bad credit allowance. SG&A expenses narrowed by ¥173mn YoY, though the ratio of SG&A expenses to sales climbed by 0.3pp from 5.5% to 5.8%. Given these results, operating income slipped ¥1,462mn (21.3%) YoY to ¥5,406mn and operating income margin contracted 0.5pp to 2.7%.

The larger decline in profit attributable owners of parent, meanwhile, stemmed from booking ¥2,801mn in extraordinary losses, including a provision of ¥2,787mn to the bad credit allowance. Elematec booked reserves for the full value of credits to a building materials counterpart in China. It already ended activity with this company and took a one-time loss in FY3/17.

Sales dropped mainly on declines in smartphone-related sales and building materials business in China; automotive business continues to expand at a healthy pace

2. Trends by individual markets

Elematec discloses sales by three market segments – Digital Electronics, Automotive, and Broad Market.

Sales trends by market

Segments by market	FY3/16 (reporting basis)	FY3/17						
	Result	Period-start forecast	Updated forecast	Result	Growth rate	Composition share	Main target markets	YoY Sales increase value
Digital Electronics	127,084	132,163	124,786	128,282	0.9%	63.2%	LCDs, touch panels, and backlights	8,445
							TVs, monitors	3,526
							Toys, hobbies	1,635
							Mobile terminal	-10,728
Automotive	17,961	17,829	19,634	18,357	2.2%	9.0%	Automotive	395
							Aftermarket	2,690
Broad Market	71,779	70,007	59,080	56,364	-21.5%	27.8%	House building	-9,072
							Industrial machinery, etc.	-8,007
Total	216,824	220,000	203,500	203,004	-6.4%	100.0%		

Note: TP = touch panel, BL = backlight

Source: Prepared by FISCO from Company materials

Digital Electronics sales rose ¥1,197mn YoY in FY3/17. Smartphones are the final product market for LCDs, touch panels (TPs), and backlights (BLs) sold under this segment. This area posted a sales gain of ¥8,445mn due to a roughly ¥20,000mn lift from mounting business. Its sales hence were down by about ¥11,500mn on a real basis. Mobile terminal, which also refer to smartphone business, encountered a setback of ¥10,728mn. Industrial equipment under the Broad Market segment recorded sales related to smartphones (vibration motor parts and materials) as well in FY3/17. These three areas worked out to a decline in smartphone-related sales of roughly ¥30,000mn, weighing heavily on Elematec's income. For other areas, sales improved by ¥1,635mn in toys and hobbies and ¥3,526mn in TVs and monitors.

Automotive sales climbed ¥395mn YoY in its only sub-segment of automotive-related business. The real gain, which excludes the impact of 15-month consolidation in the previous year, was ¥1,276mn. This result confirms healthy growth.

Broad Market sales fell sharply by ¥15,414mn YoY. While aftermarket sales increased ¥2,690mn, industrial machinery sales were off by ¥8,007mn and housing sales declined by ¥9,072mn. Industrial machinery business faced a decline in sales of smartphone vibration motors, as noted above. House building weakness reflected the drop in transactions for building materials in China, which were the cause of the extraordinary loss.

■ Medium to long-term growth strategy

Formulated the new slogan – “elematec x (cross)”

1. Overview of the medium to long-term strategy

Elematec does not prepare medium-term business plans with a fixed period, but it formulates basic policies for initiatives related to a medium to long-term strategy and proceeds with business on this basis.

It updated the internal slogan in FY3/18, switching from “elematec + (plus)” to “elematec x (cross).” “Cross” means combining things to create synergies and accelerate business. It also refers to “agility” for emphasis on timely action.

The new slogan presents four visions. We are primarily interested in Vision 3 “Innovation: Planning and developing important technologies” and Vision 4 “Global: Realizing support on par with domestic operations worldwide (including emerging markets).” While more details are given below, we think the growth strategy in “elematec x (cross)” can be readily understood with the two key words of “globalization” and “modularization.”

Vision in the medium to long-term strategy elematec x (cross)

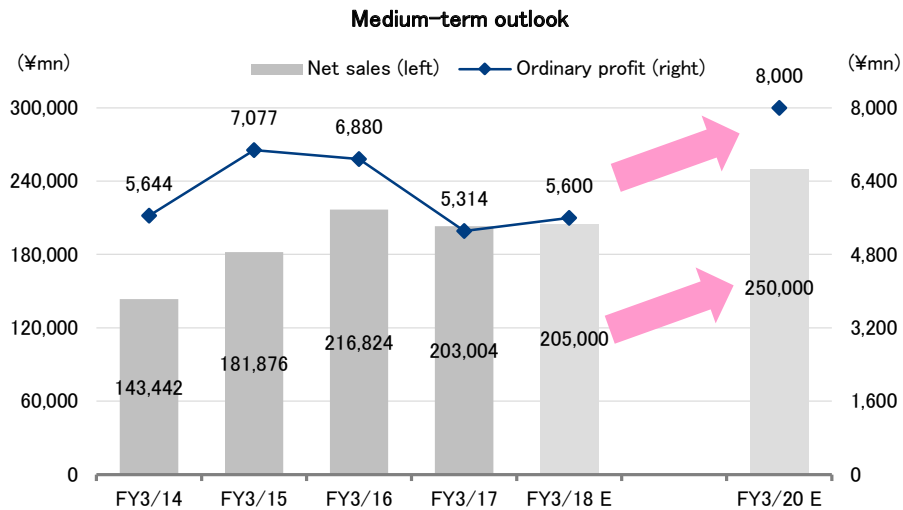
elematec x (cross)

VISION 1	VISION 2	VISION 3	VISION 4
No.1 No.1 electronic materials trading company in sales and profits	Major Establish a world-leading attractive customer base and supply base	Innovation Plan and develop important technologies (realize customer needs and high value-added business)	Global Realize the same level of support as Japan throughout the world (including emerging countries)

Advancing from the strength of "plusses" to a stage of "cross" in our endeavor to become "the number one electronic materials trading company steadily supplying high value-added business worldwide."

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

As longer-term its numerical goals, Elematec discloses a two-year forward outlook along with forecast for the fiscal year at the start of each year. This is a rolling-type medium-term plan. Elematec presented a FY3/20 forecast for ¥250,000mn in sales and ¥8,000mn in ordinary income this time. While these are the same goals given for FY3/19 from a year ago, we think it restated the ¥250,000mn in sales because it is an important threshold value.



Source: Prepared by FISCO from Company materials

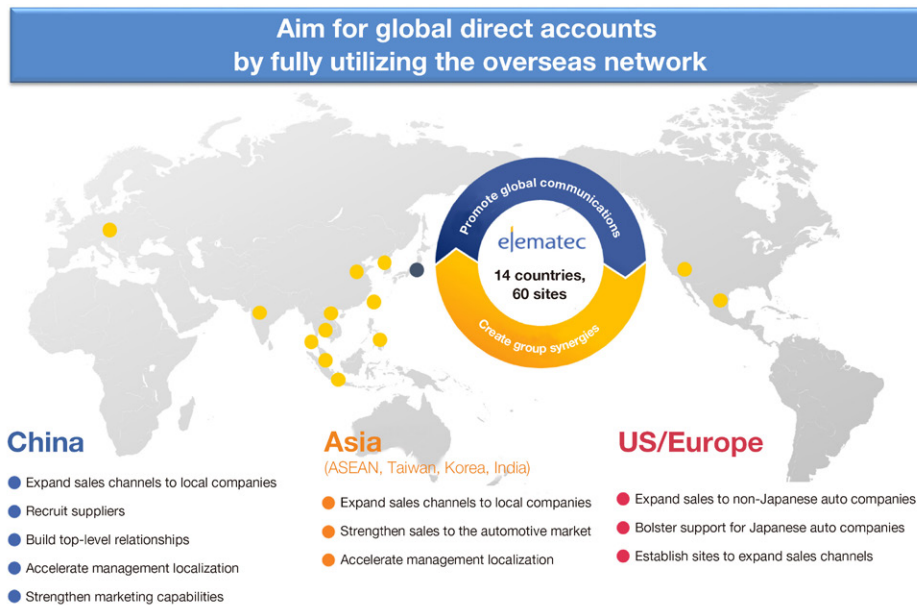
Pursuing direct accounts with overseas final customers to avoid the impact of weakening at Japanese manufacturers

2. Globalization: Initiatives with global direct accounts

Globalization is one of the two vital measures being promoted under “elematec x (cross).” This means promotion of global direct accounts. In past overseas business, Elematec mainly supplied electronic materials and other parts and materials to Japanese devices and electronic parts manufacturers and sold parts and materials produced by these companies to overseas assemblers and final product manufacturers. This approach limited direct transactions with overseas companies. In the new initiative, meanwhile, Elematec wants to establish its own accounts with overseas final product manufacturers and conduct transactions directly.

An important backdrop of its decision to pursue establishment of global direct accounts is relative decline in the standing of Japanese electronics companies, which are Elematec’s direct customers. Using smartphones as an example, few manufacturers have businesses with sufficient presence in not only the global market, but the Japanese market as well. The same can be said for LCD and OLED panels, a key component. We think concern that continued reliance just on Japanese manufacturers could ultimately lead to shrinking business provided the catalyst for Elematec to move forward with full-fledged globalization.

Content of initiatives aiming for real globalization



A specific action is revision of business style to address regional conditions. In China, we expect Elematec to primarily target final assemblers of smartphones, TVs, and other consumer electronics. In this process, Elematec has raised topics such as recruitment of local suppliers for cost reasons, building personal ties with top executives in light of business practices, and localizing management from the standpoint of business practices.

Initiatives in Asia (ASEAN, Taiwan, Korea, and India) are expanding sales to local manufacturers in the Digital Electronics segment and automotive market (such as onboard electronic devices) and localizing management (similar to China). For the US and Europe, Elematec aims to expand sales channels to non-Japanese automakers, strengthen support for Japanese automakers, and develop sites to facilities broader sales coverage.

Proposes solutions based on its own planning, design, and prototyping to customers with the aim of increasing added value

3. Modularization: Creating technical solutions and added value

The other core initiative in “elematec x (cross)” is creating technical solutions and added value. This involves the same content as the “planning and development function” explained in the section on the Company’s attributes and strengths. In other words, it begins with appropriate understanding of customer needs and then involves Elematec identifying optimal parts and materials from its roughly 6,000 domestic and overseas suppliers to meet wide-ranging needs at customers for electronics, mechatronics, exteriors, design, and other aspects or planning, designing, and prototyping products that satisfy requirements and proposing solutions to customers.

If customers select proposals (products) that Elematec has prepared and developed, Elematec delivers modularized products and can expand earnings from this added value in comparison to selling electronic materials and other items just as materials. Understanding customer needs, the first step in this process, needs to take place at the customer’s development stage that defines specifications. While Elematec has handled many products adopted at this early stage, we think it is important to increase this even more.

Modularization initiatives are useful in building business with Japanese manufacturers and should also serve as an effective tool in cultivation of global direct accounts mentioned above. Some examples that have been well received are decorative processing on the front panel of smartphones, touch panel and LCD alignment modules, and automotive decorative technology and plating technology.

Targeting new technology and demand opportunities in various markets through integration (modularization) of sensing and communications

4. Growth strategies by market

Elematec envisions a breakdown for its FY3/20 sales goal of ¥250,000mn of Digital Electronics at ¥142,000mn, Automotive at ¥33,000mn, and Broad Market at ¥75,000mn. These levels require upbeat growth rates, and Elematec hopes to reach them through “further expansion mainly driven by module product sales.”

Sales breakdown by markets for the medium-term goal

(¥mn)

Segments by market	FY3/17		FY3/18		Plan	FY3/20		Composition share
	Results (new categories)	Period-start forecast	Growth rate	Composition share		Difference versus FY3/17		
						Growth rate	Change	
Digital Electronics	129,226	122,852	-4.9%	59.9%	142,000	9.9%	12,774	56.8%
Automotive	18,357	22,730	23.8%	11.1%	33,000	79.8%	14,643	13.2%
Broad Market	55,420	59,417	7.2%	29.0%	75,000	35.3%	19,580	30.0%
Total	203,004	205,000	1.0%	100.0%	250,000	23.2%	46,996	100.0%

Note: Moved the supercomputer, server, and storage market from Broad Market to Digital Electronics from FY3/18

Source: Prepared by FISCO from Company materials

While Elematec presents strategies for individual markets, “provision of sensing and communications solutions” is a common strategy in all markets. This approach aims to secure sales channels in the most basic area for the IoT and ICT era. It then adds priority items for each of the three markets.

(1) Strategy for the Digital Electronics market

Elematec’s assessment of current conditions in the Digital Electronics market depicts 1) slower growth rates and tougher competition for smartphones, 2) rising demand for IoT-related devices, and 3) growing applications for OLEDs. Its business priorities are recruiting auto display business, increasing sales of mobile housings and embedded parts, promoting OLED parts and materials, and expanding sales of reinforced glass.

(2) Strategy for the Automotive market

In the Automotive market, Elematec sees the two most significant market changes as growing demand in driving assistance and reinforced development of connected cars. Its business priorities are expanding sales of parts and materials used in ADAS (advanced driver assistance systems), increasing HMI (human machine interface; switches, buttons, handles, and others items that enables people to operate the machine) and decorative business, and boosting direct transactions with overseas Tier 1/Tier2 parts manufacturers.

(3) Strategy for the Broad Market

For the Broad Market, Elematec is aware of the need for multiple overseas production sites in light of market diversity. It also expects growing demand for sensing devices with IoT advances. Its priorities are strengthening sales to aftermarket segments, expanding modules for consumer electronics, and increasing modules for medical and industrial equipment.

Elematec talks about alliances as a common strategy in pursuit of these three market. It is pursuing synergies with the TOYOTA TSUSHO Group and aims to bolster collaboration with new materials and parts manufacturers.

Steadily expanding products handled and customer volume for the massive display devices and automotive market

5. Progress in major markets

(1) Overall image

The wide range of suppliers, products, and customers is another Elematec strength as explained above. However, even this type company (or perhaps because it has such broad coverage) ends up with growing sales to products that have large markets or products with extensive related industries. Current examples are smartphones and automobiles.

While some observers refer to Elematec as a “company with strength in smartphones” or a “smartphone-related stock,” our view is that it is a “company with strength in display devices.” LCD panels are the primary type in the display market at this point and smartphones occupy a large presence as the application. This is why many of the products handled by Elematec are utilized in smartphones as the final product.

OLEDs, a new display device, are currently about to move from the initial emergence stage to a growth stage. Elematec naturally needs to clarify its standing in supply of parts and materials to OLEDs as a company that excels in display devices.

We think Elematec has two main approaches to the automobile market. One is expansion of applications and usage volume for display devices in vehicles. This business comes within the framework of display devices and is covered by Digital Electronics in Elematec’s disclosure information. The other is supply of parts and materials besides display devices. Elematec books sales in this business under the Automotive segment. It aims to achieve growth by capitalizing on both of these opportunities.

(2) Current state of LCD, touch panel, and backlight markets and progress

The “LCD, touch panel, and backlight” sub-segment under Digital Electronics in Elematec’s disclosure information covers products for display devices. While it has many destination (end user) markets, smartphones are the overwhelmingly largest market followed by onboard and consumer electronics.

a) Smartphone LCD panels

Elematec faced sharp production adjustments at the start of 4Q FY3/16, but business recovered from 2Q FY3/17 and continued a healthy recovery trend in 3-4Q. Business remains upbeat in FY3/18 too. Additionally, increased sales of high-precision and advanced parts and materials to high-end models in China lifted earnings in 4Q FY3/17. Elematec expects moderate increases in sales of parts and materials to Chinese high-end models again in FY3/18.

b) Onboard LCD panels

Car navigation systems were the primary onboard LCD panel in past years, but the emergence of vehicles without side mirrors is likely to contribute to expansion in the volume and size of LCD panels and other display devices mainly around the driver’s seat over the medium term. Provision of visibility is a key driver for onboard panels. Elematec has anti-reflection technology cultivated for smartphones and hopes to utilize these capabilities to expand business opportunities. Onboard LCD panels experience a much tougher usage environment than smartphone panels. Elematec intends to utilize its knowhow and technology to sell optimal display parts and materials (molded parts, glass, etc.), backlight films, and other items.

c) Response to OLEDs

Usage of OLEDs in smartphone displays is likely to ramp up in FY3/18. Elematec has been making proposals for OLED parts and materials and is delivering products to a Japanese OLED firm. However, this has not advanced as a specific business yet because the OLED firm is still in the prototype phase.

OLEDs and LCD panels have overlapping applications so are competing and can replace each other. While this is often interpreted as a disadvantage for Elematec because its OLED business has not started yet, the replacement of LCDs with OLEDs is unlikely to take place suddenly and LCD panels should continue as the main format for the time being. Nevertheless, the LCD panel growth rate will be curtailed and Elematec is acting promptly with responses in light of this trend.

(3) Current state of the automotive market and progress

Main items besides display devices for the automotive market currently are HMI-related parts and materials, glass, light sources, heat dissipation sheets, plastic parts, and optical products. Elematec has accumulated technology and knowhow for glass front side panel processing, decorative molding, and plating used in smartphones and other products. Customers highly rate these capabilities, and Elematec utilizes them in automotive business as well.

Growth areas in recent years are LED headlamp light-source assemblies, molding sales, and cables and wire harnesses. In particular, LED headlamp light sources have emerged as a new business opportunity amid rapid advances in the shift to LED light sources in recent years and this area appears to be steadily expanding. Customers are not just Japanese auto companies. It appears that US and European auto companies are major final customers, reflecting favorable reactions to Elematec's global site deployment.

As explained above, integration of sensing and communications is the core theme in Elematec's medium and longer-term strategy. For sensing devices, it is focusing on IR sensors and other sensors as well as various camera module products. Camera modules are vital components in vehicles without side mirrors, ADAS, and driverless vehicles. Elematec is trying to work its way into this business. It appears to have already started sales initiatives for lens modules, CMOS sensors, shielding materials and housings, harnesses, and other parts and materials to multiple leading automotive parts manufacturers jointly with customers.

For communications, the other aspect, Elematec plans to strengthen its proposals for communications equipment modules. While it currently handles milliwave radar materials (heat discharge materials and shielding materials) in this general category, Elematec envisions communications equipment with modules that contain communications and sensing devices cultivated in the smartphone business. We will be waiting for advances in this business.

Business outlook

Targeting higher sales and profits as growth in automotive sales offset decline in LCD-related sales

Elematec guides for ¥205,000mn in net sales (+1.0% YoY), ¥5,800mn in operating income (+7.3%), ¥5,600mn in ordinary profit (+5.4%), and ¥3,900mn in profit attributable owners of parent (+190.5%) in FY3/18.

The large growth rate in profit attributable owners of parent stems from non-recurrence of the extraordinary loss booked in FY3/17. Elematec manages its budget on a full-year basis and does not prepare 1H forecast.

Overview of the FY3/18 outlook

	FY3/17		FY3/18	
	Full year Results	YoY Growth rate	Full year (estimates)	YoY Growth rate
Net sales	203,004	-6.4%	205,000	1.0%
Operating income	5,406	-21.3%	5,800	7.3%
Operating margin	2.7%	-	2.8%	-
Ordinary profit	5,314	-22.8%	5,600	5.4%
Profit attributable owners of parent	1,342	-73.4%	3,900	190.5%

Note: FY3/17 YoY comparisons use the FY3/16 reporting basis
 Source: Prepared by FISCO from Company materials

The low sales growth rate at just 1.0% YoY takes into account exhaustion of mounting business, forex assumption impact (it uses ¥105/USD versus FY3/17's ¥108.34), and anticipated impact from some customers switching from LCDs to OLEDs.

Elematec expects a 0.1pp rise in operating margin based on decreased demand of low-margin mounting business and sales replacement by products with average margin.

We think the projections of sales declines in LCDs, touch panels, and backlights and mobile handsets under Digital Electronics, reflecting the impact of the switch to OLEDs, stands out in the outlook for major markets. Conversely, Elematec forecasts a large ¥4,372mn (23.8%) YoY rise in Automotive sales thanks to the start of car models that contains its products from design specifications prepared a few years earlier.

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Sales outlook by markets

(¥mn)

Segments by markets	FY3/17		FY3/18			
	Results (adjusted)	Period-start forecast	Growth rate	Composition share	Main target market	Sales increase value (YoY)
Digital Electronics	129,226	122,852	-4.9%	59.9%	Electronic components	1,795
					Home electronics (Tv, Monitor, Audio, etc.)	1,254
					LCDs, touch panels, and backlight	-8,929
					Mobile terminal	-1,147
Automotive	18,357	22,730	23.8%	11.1%	Automotive	4,372
Broad Market	55,420	59,417	7.2%	29.0%	Infrastructure and energy	816
					Aftermarket	575
					Industrial machinery, etc.	569
Total	203,004	205,000	1.0%	100.0%		

Note: TP = touch panel, BL = backlight

Source: Prepared by FISCO from Company materials

We think Elematec's guidance and assumptions are convincing. However, the earnings outlook seems conservative in light of strong sales momentum from 4Q FY3/17 continuing in 1Q FY3/18 and the current forex rate that puts the yen at a cheaper level than the plan's assumption. While it is still too early to discuss the possibility of an upward revision at the 1Q announcement, it is worth thinking about Elematec's forex sensitivity (a single year of depreciation versus the USD adds ¥1.5bn to sales and ¥50mn to ordinary profit for the year).

Abbreviated income statement

(¥mn)

	FY3/14	FY3/15	FY3/16		FY3/17	FY3/18 E
			Reporting basis	12-month basis		
Net sales	143,442	181,876	216,824	205,370	203,004	205,000
Growth rate	10.8%	26.8%	19.2%	12.9%	-1.2%	1.0%
Gross profit	14,909	18,443	18,763	17,947	17,127	-
Gross margin	10.4%	10.1%	8.7%	8.6%	8.4%	-
SG&A expenses	9,662	11,068	11,894	11,406	11,720	-
SG&A expenses ratio	6.7%	6.1%	5.5%	5.6%	5.8%	-
Operating income	5,246	7,375	6,868	6,540	5,406	5,800
Growth rate	26.5%	40.6%	-6.9%	-11.3%	-17.3%	7.3%
Operating income margin	3.7%	4.1%	3.2%	3.2%	2.7%	2.8%
Ordinary profit	5,644	7,077	6,880	6,538	5,314	5,600
Growth rate	19.4%	25.4%	-2.8%	-7.6%	-18.7%	5.4%
Profit attributable owners of parent	3,863	5,105	5,048	4,794	1,342	3,900
Growth rate	28.9%	32.2%	-1.1%	-6.1%	-72.0%	190.5%
EPS (¥)	188.70	249.38	246.58	-	65.57	190.49
Dividend (¥)	57.00	75.00	75.00	-	20.00	58.00
Net asset value per share (¥)	1,792.52	2,095.95	2,170.74	-	2,175.80	-

Note: The FY3/16 financial statements consolidated 15 months for nine subsidiaries linked to changes in the fiscal year for overseas subsidiaries. The 12-month basis utilizes values that have been converted to 12-month statements in all cases. We calculated the FY3/17 YoY growth rates using a 12-month basis for FY3/16.

Source: Prepared by FISCO from Company materials

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Abbreviated balance sheet

	(¥mn)				
	End-FY3/13	End-FY3/14	End-FY3/15	End-FY3/16	End-FY3/17
Current assets	61,497	68,426	79,170	74,935	87,662
Cash and deposits	12,793	14,809	10,004	12,551	10,282
Promissory notes receivables and accounts receivables	40,168	43,617	57,575	50,599	66,955
Fixed assets	5,082	4,999	5,021	5,636	5,621
Tangible fixed assets	2,970	2,962	2,627	2,465	2,398
Intangible fixed assets	295	228	236	1,349	1,115
Investment, etc.	1,816	1,808	2,156	1,821	2,107
Assets total	66,579	73,425	84,191	80,572	93,284
Current assets	33,716	36,374	40,931	35,892	48,521
Payable promissory notes and accounts payable	30,491	34,094	36,199	33,419	42,734
Short-term loans, etc.	-	-	1,598	466	2,884
Fixed liabilities	179	107	349	238	217
Long-term loans	-	-	-	-	-
Shareholders' equity	32,964	35,681	39,672	42,980	43,401
Capital	2,142	2,142	2,142	2,142	2,142
Excess capital	3,335	3,335	3,335	3,335	3,335
Retained profits	28,180	30,897	34,888	38,196	38,618
Treasury shares	-694	-694	-694	-694	-694
Other comprehensive profit cumulative value	-467	1,017	3,238	1,461	1,143
Non-controlling shareholder equity	186	245	-	-	-
Net assets total	32,683	36,943	42,910	44,442	44,545
Liabilities and net assets total	66,579	73,425	84,191	80,572	93,284

Source: Prepared by FISCO from Company materials

Cash flow statement

	(¥mn)				
	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Cash flow from operating activities	152	2,132	-5,942	7,573	-3,309
Cash flow from investment activities	277	21	-290	-1,387	-85
Cash flow from financing activities	-982	-1,145	318	-2,837	1,504
Cash and deposits conversion disparity	609	1,007	1,109	-875	-305
Cash and deposit change	57	2,016	-4,805	2,472	-2,195
Period-start cash and deposits value	12,735	12,793	14,809	10,004	12,477
Period-end cash and deposits value	12,793	14,809	10,004	12,477	10,282

Source: Prepared by FISCO from Company materials

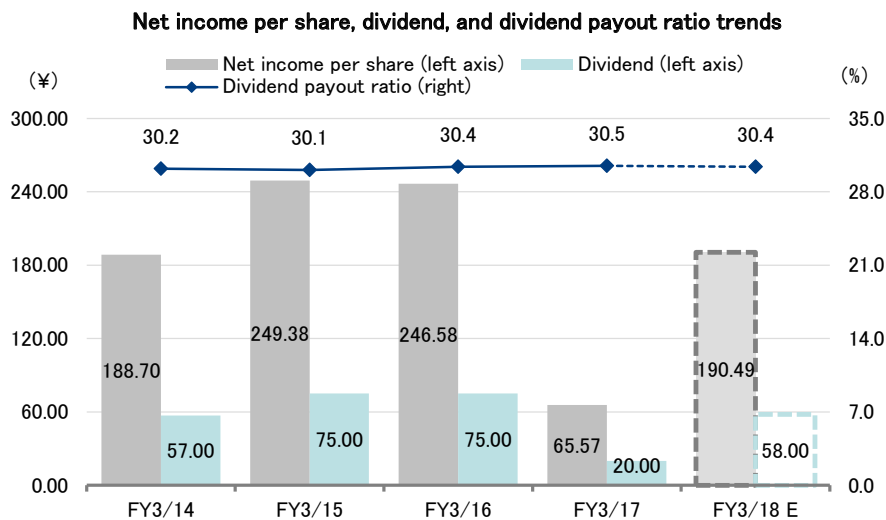
Shareholder return policy

Basic policy targets dividend payout of at least 30%, expecting a large dividend hike in FY3/18 that reflects profit recovery

Elematec primarily pays dividends as its shareholder return policy and aims to keep the dividend payout ratio at 30% or above while taking into account the earnings outlook (short-term and medium term), growth investments, cash flow, and other factors.

When Elematec lowered the FY3/17 forecast during FY3/17, it also reduced the full-year dividend target from ¥65 at period-start (¥30 interim, ¥35 period-end) to ¥20 (¥10 each for interim and period-end dividends). It announced the FY3/17 dividend as ¥20 in line with the revised view. The dividend payout was 30.5%.

For FY3/18, Elematec presented a ¥58 dividend target (¥25 interim, ¥33 period-end) that reflects the anticipated steep increase in net income attributable to parent shareholders. Dividend payout based on the ¥190.49 EPS estimate works out to 30.4%. We think the dividend could vary again this year depending on the earnings trend because the initial estimated payout ratio is very close to the 30% basic policy.



Source: Prepared by FISCO from the financial results summary



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