

Elematec Corporation

2715

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FISCO Ltd. Analyst

Hiroyuki Asakawa



FISCO Ltd.

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

■ Index

| | |
|---|-----------|
| ■ Summary | 01 |
| 1. Posted higher sales and profits in 1H FY3/18 with large gains in products for home electronics and automobiles | 01 |
| 2. Realizing sustainable growth through a switch in the target driver market from smartphones to automobiles | 01 |
| 3. Maintained initial forecast for FY3/18, closely monitoring the impact of OLED smartphones | 01 |
| ■ Company profile | 02 |
| 1. History and business overview | 02 |
| 2. Company features and strengths | 03 |
| 3. Stable growth potential and earnings stability | 06 |
| ■ Business performance | 07 |
| 1. Overview of 1H FY3/18 results | 07 |
| 2. Trends by individual market | 09 |
| ■ Medium- to long-term growth strategy | 10 |
| 1. Overview of the medium- to long-term strategy | 10 |
| 2. Two priority measures for medium-term growth | 11 |
| 3. Growth strategies and progress by market | 12 |
| ■ Business outlook | 14 |
| 1. Overview of the FY3/18 full-year outlook | 14 |
| 2. Outlook by market | 16 |
| ■ Shareholder return policy | 19 |
| ■ Information security | 20 |

■ Summary

Return to a growth trajectory by switching from smartphone-related to automotive-related business as the driver

Elematec Corporation <2715> (hereafter, also “the Company”) 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. Posted higher sales and profits in 1H FY3/18 with large gains in products for home electronics and automobiles

Elematec posted sharply higher sales and profits in 1H FY3/18 with net sales at ¥104,134mn (+9.7% YoY) and ordinary profit at ¥3,103mn (+43.6%). We think these were upbeat results exceeding the Company’s expectations in light of fulfillment rates toward the FY3/18 full-year forecast. While sales of smartphone-related products eased in 1H, Elematec recorded substantially larger sales of products used in large LCD panels for home electronics (TVs and monitors). Sales to the automotive industry also climbed considerably.

2. Realizing sustainable growth through a switch in the target driver market from smartphones to automobiles

The most important point in 1H results was reconfirmation of Elematec’s characteristics of stable earnings growth potential and robust earnings stability. Sales of smartphone-related products, which lifted Elematec to all-time high results, are headed for a decline of ¥30bn in the two years from the FY3/16 peak to FY3/18. Despite this rapid change in the business environment, Elematec is maintaining strong sales and profits at its 2nd and 3rd all-time highest levels. We attribute Elematec’s resilience as an electronic materials trading firm to its more than 6,000 suppliers and over 7,000 customers and contributions from handling a broad range of products. Elematec has entered a growth phase in automotive products, and we believe it is repeating its past pattern of delivering sustainable growth by effectively capitalizing on growth market waves.

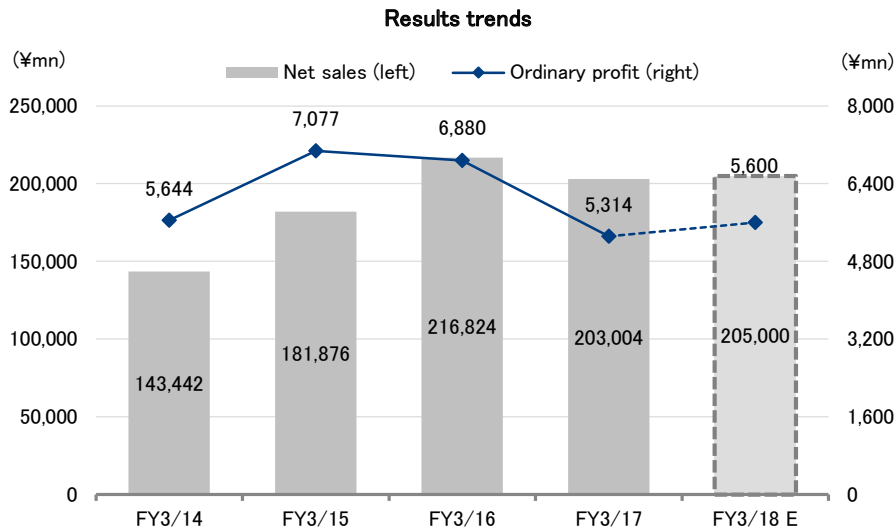
3. Maintained initial forecast for FY3/18, closely monitoring the impact of OLED smartphones

Elematec maintained its initial forecast of ¥205,000mn in net sales (+1.0% YoY) and ¥5,600mn in ordinary profit (+5.4%) for FY3/18. While sales of parts and materials used in smaller LEDs, mainly for smartphones, remained at a roughly flat level YoY in 1H, Elematec factored in sharply lower sales due to the impact of OLED smartphones in 2H. Nevertheless, it projects healthy expansion of sales to the automotive industry again in 2H and stable build-up of recurring business over the medium term.

Key Points

- Targeting ¥250bn in net sales and ¥8bn in ordinary profit through initiatives with six priority measures
- Initiatives focused on creation of added value and real globalization likely to facilitate realization of growth
- Pursuing strong growth in three markets with a theme of provision of sensing and communications solutions

Summary



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

Company profile

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 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 61 sites in Japan and overseas. The regional sales breakdown consists of Japan at 57.5%, China (including Hong Kong) 22.4%, other Asia (Taiwan, Korea, India, and Southeast Asia) 16.8%, and the US and Europe (US, Mexico, and Czech Republic) 3.3%.

Company profile

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: Prepared by FISCO from the Company's website and securities report

Five services and functions transform customer and product diversity into earnings

2. Company features and strengths

Customer and product diversity is an important feature of Elematec. It operates 61 sites in Japan and overseas and handles transactions of primarily electronic materials and components among about 6,100 suppliers and 7,200 sales destinations. Another major characteristic is its flexible response to growth markets. We believe that effective interaction of these two traits supports realization of stable earnings growth potential and robust earnings stability.

Behind the scenes, however, is the vital role of functions and mechanisms that match a massive number of products and an extensive customer network to customer needs.

The Company 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. The Company highlights five services and functions, and we think the presence of these functions is precisely why it can develop diverse products into businesses and deliver results.

Company profile

Services and functions the Company provides



Source: Company website

While each of the five services and functions highlighted by Elematec is important, processing services and planning and development functions stand out as defining features. We also think the overseas networking function is a key point in regards to the growth strategy explained below.

(1) Processing services

The Company 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. The Company 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.

The Company starts generating added value and increasing profitability once it gets to the point of supplying custom-ized 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.

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

Company profile

This is what the Company 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.

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

(2) Planning and development function

Planning and development business begins with appropriate understanding of customer needs. Fundamental flow in this business involves the Company identifying optimal parts and materials from its roughly 6,100 domestic and overseas suppliers to meet the wide-ranging needs of customers for electronics, mechatronics, exteriors, design, and other aspects; 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 the Company versus other companies. Additionally, adoption of new products based on the Company’s plans and designs means that it becomes the one and only to customers. 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 the Company’s role of modularization for delivery.

Elematec fully leverages these five services and functions in its provision of added value to customers and thereby earns customer trust and makes itself a vital presence to customers. We think diversity in its customers and products plays a major role in Elematec’s ability to build strong relationships of trust. While a chicken-or-egg dynamic exists, we believe the “positive cycle” of product and customer diversity and an organization that can deliver added value to customers are the biggest advantages.

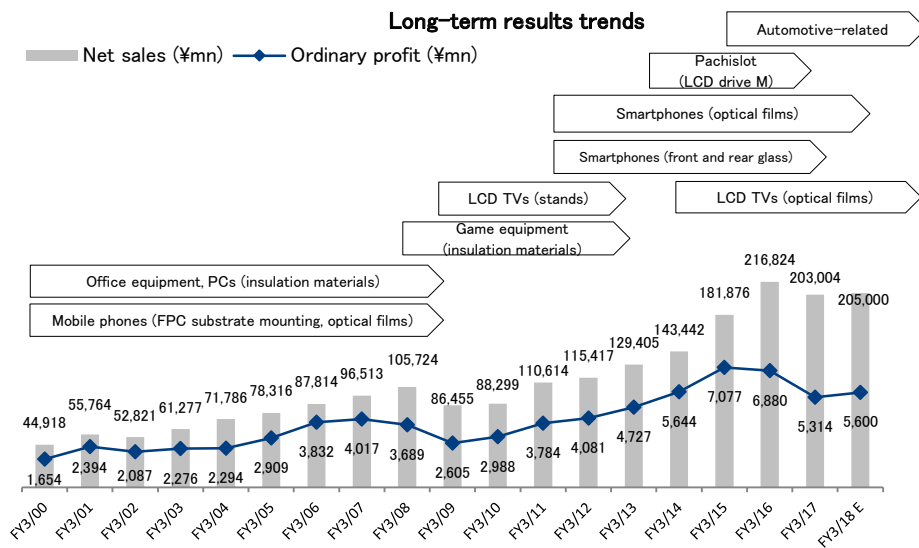
Realizes stable earnings growth potential by effectively understanding growth industries and markets of the particular era

3. Stable growth potential and earnings stability

We think Elematec’s primary features and strengths are stable earnings growth potential and robust earnings stability. Elematec has successfully achieved steady growth in past years by supplying parts and materials to growth industries and markets of the particular era, including mobile phones, game equipment, LCD TVs, and smartphones.

Elematec posted all-time highs in net sales in FY3/16 and in ordinary profit in FY3/15 thanks to its smartphone-related business. However, sales in smartphone-related business dropped by about ¥10bn from the FY3/16 peak to FY3/17 and are slated to decline another ¥20bn from FY3/17 to FY3/18.

Although Elematec’s sales and profits weakened YoY in FY3/17, they held at high levels and are headed toward increases in FY3/18. Details are reviewed below. However, the main driver of improved momentum, meanwhile, is cultivation of new growth markets and growth business (for Elematec), such as the automotive field. We think Elematec can successfully capitalize on these growth industry waves because of its product and customer diversity and also organizational strength of organically connecting this diversity to business, as explained above.



Source: Prepared by FISCO from the Company’s financial results, interviews, etc.

Business performance

Delivered higher sales and profits as growth in home electronics and automotive businesses offset the slump in smartphone business

1. Overview of 1H FY3/18 results

Elematec posted sharply higher sales and profits in 1H FY3/18 with net sales at ¥104,134mn (+9.7% YoY), operating income at ¥3,345mn (+52.8%), ordinary profit at ¥3,103mn (+43.6%), and profit attributable to owners of parent at ¥2,175mn (vs. an ¥879mn loss a year earlier).

We cannot compare these results with initial forecasts as Elematec did not disclose a 1H forecast. Fulfillment rates toward full-year forecast, however, exceeded 50% for sales and profit items. We think these were upbeat results exceeding the Company's expectations in light of fulfillment rates toward the FY3/18 full-year forecast.

Summary of 1H FY3/18 results

| | FY3/17 | | FY3/18 | | |
|---|--------|---------|-----------------|--------------------|--|
| | 1H | 1H | YoY growth rate | Full-year forecast | Fulfillment rates (vs. full-year forecast) |
| Net sales | 94,966 | 104,134 | 9.7% | 205,000 | 50.8% |
| Operating income | 2,190 | 3,345 | 52.8% | 5,800 | 57.7% |
| Operating margin | 2.3% | 3.2% | - | 2.8% | |
| Ordinary profit | 2,160 | 3,103 | 43.6% | 5,600 | 55.4% |
| Profit attributable to owners of parent | -879 | 2,175 | - | 3,900 | 55.8% |

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

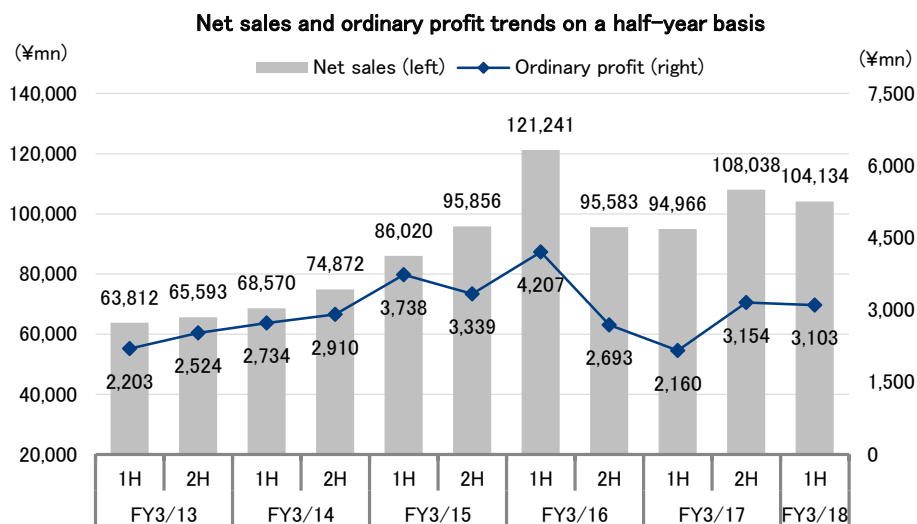
Income slumped in 1H FY3/17, but then sharply recovered from 2H and gains continued in 1H FY3/18. Net sales rose 9.7% (¥9,167mn) YoY in 1H FY3/18, including a boost of about ¥3,500mn from roughly ¥6 in yen depreciation from ¥105.20/USD a year ago to ¥111.04.

Elematec Corporation | 23-Jan.-2018
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Business performance

Gross profit climbed 25.0% (¥1,941mn) YoY to ¥9,700mn. Gross margin improved 1.1pp from 8.2% a year earlier to 9.3% mainly due to healthier product mix. SG&A expenses increased 14.1% (¥785mn) YoY, rising 0.2pp as a ratio of sales (worsening) to 6.1%. Primary drivers of higher SG&A expenses were increases in earnings-linked bonuses accompanying improved earnings and packing and freightage expenses related to stronger sales. Operating income continued to surge with an increase of 52.8% (¥1,155mn) YoY to ¥3,345mn, even with higher SG&A expenses, thanks to improved gross profit. Elematec returned to profit and recorded profit attributable to owners of parent at ¥2,175mn, compared to the previous year's ¥879mn loss. It incurred a loss a year ago due to booking provision of allowance for doubtful accounts of about ¥30bn under extraordinary losses, but there were no such items in FY3/18 and the Company returned to normal conditions.

We think Elematec's strength of decentralized and diversified products and customers stood out in 1H FY3/18 results. Sales in smartphone-related products that fueled growth in recent years are headed lower again in FY3/18 after a hefty decline in FY3/17. Nevertheless, Elematec reached its 2nd highest sales and 3rd strongest operating income and ordinary profit in 1H FY3/18, as it quickly offset the slump in smartphone-related products with gains in automotive and other products. Few companies are capable of making this type of switch in a short amount of time.



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

Business performance

Growth in the Automotive segment to more than 10% of total sales; sustained flat sales (YoY) in parts and materials for smaller LCDs

2. Trends by individual market

Breakdown of net sales trends by market

| Segments by market | 1H FY3/17 | | 1H FY3/18 | | | | Sales increase value (YoY) | |
|----------------------------|-----------|-------------|-----------|-------------|-------------|--------|---|-------|
| | Result | Composition | Result | Growth rate | Composition | Change | | |
| Digital Electronics | 60,143 | 63.3% | 64,742 | 7.6% | 62.2% | 4,598 | Home electronics (TVs, monitors, audio, etc.) | 3,522 |
| | | | | | | | Toys and hobbies | 1,065 |
| | | | | | | | Cameras and camera modules | 599 |
| | | | | | | | Mobile terminal | -738 |
| Automotive | 8,622 | 9.1% | 10,926 | 26.7% | 10.5% | 2,303 | Automotive | 2,303 |
| | | | | | | | Industrial machinery, etc. | 1,214 |
| Broad Market | 26,201 | 27.6% | 28,466 | 8.6% | 27.3% | 2,264 | Office equipment | 822 |
| | | | | | | | Medical equipment | 348 |
| | | | | | | | Infrastructure and energy | -798 |
| Total | 94,966 | 100.0% | 104,134 | 9.7% | 100.0% | 9,167 | | |

Note: Moved supercomputers, servers, and storage from Broad Market to Digital Electronics from FY3/18

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

Digital Electronics sales increased 7.6% (¥4,598mn) YoY to ¥64,752mn. Of the categories with large fluctuations from the previous year, sales in home electronics rose ¥3,522mn. This business mainly consists of parts and materials for large LCD panels used in TVs and monitors. Growth continues amid less pressure for replacement to new display formats, such as OLED, on TVs and monitors, than for smaller displays. Elematec also posted higher sales of parts and materials to the toys and hobbies category because of rising game equipment sales volume. In the mobile terminal category, while demand recovered for some parts and materials, Elematec's sales weakened on a slump in terminal sales volumes at customer companies.

We believe sales of LCDs, touch panels, and backlights, which are used in smaller LCD panels for smartphones, tablets, and other devices, were roughly flat YoY. Although Elematec expected sales to drop in light of adoption of OLED panels in smartphones, this segment held up better than expected in 1H. However, as full-scale impact of OLED smartphones is anticipated from 2H, we expect tougher conditions going forward.

Automotive sales rose 26.7% (¥2,303mn) YoY to ¥10,926mn, moving above the 10% threshold of overall sales to 10.5% for the first time. Elematec achieved steady sales increases of a few ten million to a few hundred million yen in a variety of products, such as auto headlight materials, auto interior decorative panels, and sensors, lifting overall segment sales. Many companies involved in automotive business have predictable outlooks following the model-change cycle. The same is true in Elematec's case with its healthy growth trend roughly in line with the medium-term earnings forecast.

Broad Market sales expanded 8.6% (¥2,264mn) YoY to ¥28,466mn. This segment covers products supplied to a variety of markets. By target market, industrial machinery, etc., and office equipment sales grew considerably, while infrastructure and energy sales dropped. Industrial machinery, etc., previously mainly consisted of parts and materials used in vibrating motors for mobile terminals, but expanded product supplies to industrial machinery and factory automation equipment manufacturers in 1H FY3/18. Office equipment posted higher sales of roller parts and materials for multifunction printers (MFPs), just as before. Infrastructure and energy sales decreased due to contraction of solar power-related business.

■ Medium- to long-term growth strategy

Targeting ¥250bn in net sales and ¥8bn in ordinary profit through initiatives with six priority measures

1. Overview of the medium- to long-term strategy

Elematec aims to be a “best partner that exceeds the framework of existing trading companies and continues to be selected by customers in the electronics industry.” It outlines six items, including strengthening value-added business, as priority measures and business strategies for realizing this goal.

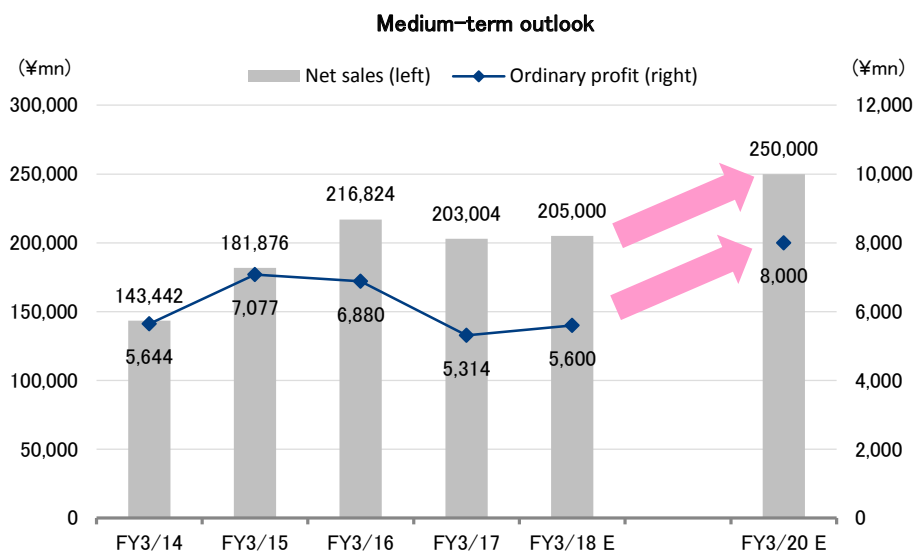
Elematec’s priority measures and business strategies

- | | |
|---|---|
| 1 | Strengthen value-added business |
| 2 | Promote global business development |
| 3 | Strengthen automotive-related business |
| 4 | Implement growth strategy investments |
| 5 | Strengthen governance and risk management |
| 6 | Pursue synergies with the Toyota Tsusho Group |

Source: Prepared by FISCO from the Company’s website

The Company does not prepare medium-term business plans with a fixed period, but 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.

For longer-term numerical goals, the Company discloses a two-year outlook along with a forecast for the fiscal year at the start of each year. This is called a rolling-type medium-term plan. At the start of FY3/18, the Company presented a forecast for FY3/20 of ¥250,000mn in net sales and ¥8,000mn in ordinary profit. 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 the Company’s materials

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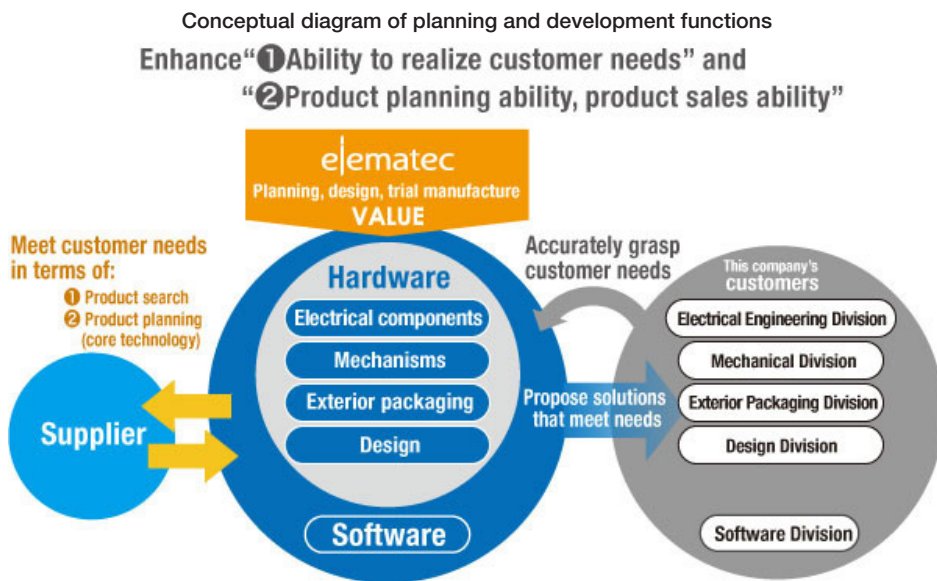
Medium- to long-term growth strategy

Initiatives focused on creation of added value and real globalization likely to facilitate realization of growth

2. Two priority measures for medium-term growth

We think strengthening value-added business and promoting global business development are particularly important in the above-mentioned six priority items. Elematec consistently stresses these measures in “elematec x (cross)” as initiatives creating technical solutions and added value and initiatives aiming for real globalization.

The initiatives creating technical solutions and added value use the planning and development function, which is one of Elematec’s attributes and strengths, to propose optimal solutions to customers. Proposal of “optimal” to customers means creation of added value by Elematec. This begins with an appropriate understanding of customer needs and then involves the Company identifying optimal parts and materials from its roughly 6,100 domestic and overseas suppliers to meet the wide-ranging needs of customers for electronics, mechatronics, exteriors, design, and other aspects; planning, designing, and prototyping products that satisfy requirements; and proposing solutions to customers.



Source: Company website

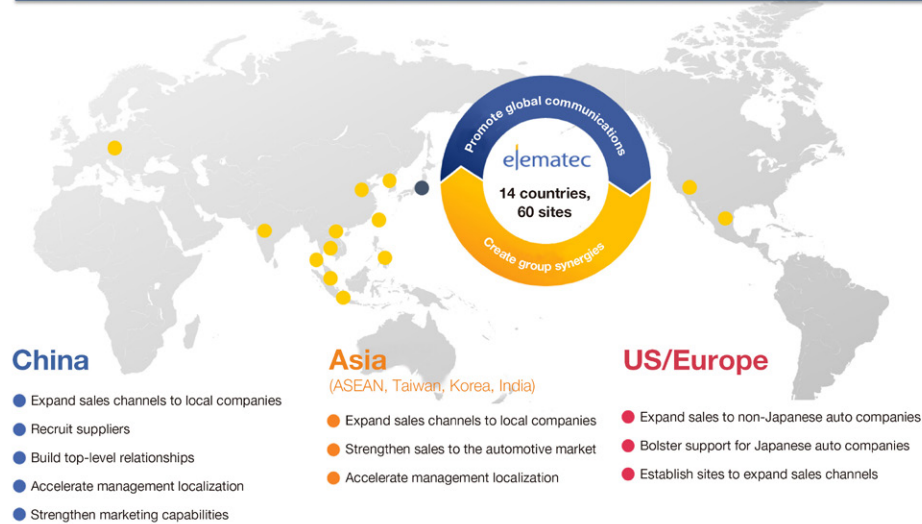
The initiatives aiming for real globalization promote a shift to direct global accounts utilizing Elematec’s overseas networking function. The Company’s overseas business until now has been supplying electronic materials and other parts and materials to Japanese device and electronic part manufacturers and these firms sold parts and materials they produced to overseas assemblers and final product manufacturers. This approach limited direct transactions with overseas companies. In the shift to direct global accounts, meanwhile, Elematec will establish its own accounts with overseas final product manufacturers and conduct transactions directly.

An important backdrop to its decision to establish direct global accounts is a relative decline in the standing of Japanese electronics firms, which are Elematec’s direct customers. We think concern that continued reliance on Japanese manufacturers could ultimately lead to shrinking business provided the catalyst for Elematec to move forward with full-fledged globalization.

Medium- to long-term growth strategy

Content of initiatives aiming for real globalization

Aim for global direct accounts by fully utilizing the overseas network



Source: Company's results briefing materials

Pursuing strong growth in three markets with a theme of provision of sensing and communications solutions

3. Growth strategies and progress by market

The Company envisions a market breakdown for its FY3/20 net sales target of ¥250,000mn with the Digital Electronics segment contributing ¥142,000mn, Automotive segment ¥33,000mn, and Broad Market segment ¥75,000mn. In order to achieve the goal, each segment requires an upbeat growth rate, and the Company hopes to reach them through further expansion mainly driven through modularization business.

Sales breakdown by markets for the medium-term outlook

(¥mn)

| Segments by market | FY3/17 results (new categories) | FY3/18 | | | Target | FY3/20 | | |
|---------------------|---------------------------------|------------------|-------------|---------------|----------------|-----------------------|---------------|---------------|
| | | Revised forecast | Growth rate | Composition | | Difference vs. FY3/17 | | Composition |
| | | | | | | Growth rate | Change | |
| Digital Electronics | 129,226 | 119,108 | -7.8% | 58.1% | 142,000 | 9.9% | 12,774 | 56.8% |
| Automotive | 18,357 | 24,605 | 34.0% | 12.0% | 33,000 | 79.8% | 14,643 | 13.2% |
| Broad Market | 55,421 | 61,287 | 10.6% | 29.9% | 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 supercomputers, servers, and storage from Broad Market to Digital Electronics from FY3/18
 Source: Prepared by FISCO from the Company's materials

Medium- to long-term growth strategy

While the Company 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 and progress of the Digital Electronics segment

The Company's assessment of current conditions in the Digital Electronics segment 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 priority fields are in-vehicle display devices, mobile housings and embedded parts, OLED parts and materials, and tempered glass.

Elematec expects further downturn in product supply to smaller LCDs, a specialty area, in FY3/18 due to ramp up of models using OLEDs amid continued weak growth in the smartphone market itself because of maturation. While business for home electronics (parts and materials used in large LCD panels) and the toys and hobbies category should expand, this internal growth is unlikely to be enough and segment sales are likely to miss last year's level.

Within priority items, demand is recovering for tempered glass for smartphones, and mobile housings, in-vehicle display devices, and other items are making steady advances. However, we do not expect full-fledged movement in OLED parts and materials until at least FY3/19 because of lagging response from Elematec's customers.

We are not pessimistic about prospects in the Digital Electronics segment. Elematec booked all-time high sales in FY3/16 (ordinary profit reached a high in FY3/15) and sales are remaining above ¥200,000mn through FY3/18 (FY3/18 is an estimate). Smartphone-related sales are headed for a decline of about ¥30,000mn over two years during this period, mainly on declines in smaller LCD panel parts and materials. We think the ability to almost entirely absorb this scale of negative impact through sales growth in other markets for a company known as a smartphone-related stock attests to Elematec's resilience. While income fluctuated, we believe Elematec has not lost its earnings stability. We expect the Digital Electronics segment to restore positive sales growth (YoY) in FY3/19, even if smartphone-related product sales continue to weaken, because the impact should be much smaller and products from other markets are likely to deliver gains.

(2) Strategy and progress of the Automotive segment

In the Automotive segment, the Company 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 other items that enable people to operate the machine) and decorative business, and boosting direct transactions with overseas Tier 1/Tier 2 parts manufacturers.

We think the Automotive segment is doing very well with the 26.7% YoY rise in 1H FY3/18 sales and Elematec's upward revision to a 34.0% gain for the full year. While synergies with Toyota Tsusho are clearly having an impact on healthy growth in this segment, primary drivers appear to be strengths cultivated by Elematec as an electronic materials trading company and steady efforts to have its products incorporated in customer specifications.

This segment handles a very broad range of products, similar to the other segments. While it does not have a symbolic product, such as smartphones, it accumulates sales from many products, including headlamp-related parts and materials, HMI-related parts and materials, glass, light sources, heat dissipation sheets, plastic parts, and optical products.

Medium- to long-term growth strategy

ADAS, vehicles without side mirrors, and other new formats are likely to make steady advances in the automotive industry. Cameras and other sensing devices and smaller LCD panels and other monitors should become increasingly important as this happens. Note, however, that Elematec books sales of parts and materials for LCD panels in the Digital Electronics segment, while it recognizes automotive sensor sales in the Automotive segment. Elematec has already started transactions with Tier 1 automotive parts manufacturers for sensors, and we expect its business to continue growing with inroads from ADAS and other technologies.

(3) Strategy and progress of the Broad Market segment

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

Similar to the Automotive segment, sales increased in 1H FY3/18 and Elematec raised the FY3/18 forecast for the Broad Market segment. While income trends in this segment cannot be explained with a single area because of its wide range of products and target markets, we think it is evident that it is advancing smoothly as a whole. Industrial machinery, etc., deserves attention from 1H activity. As explained earlier, while this business has comprised smartphone-related business (vibrating motors used in mobile terminals) up to now, transactions with factory automation equipment manufacturers expanded from FY3/18. We expect further progress in stable earnings from diversification of Broad Market customers if this activity continues to grow.

■ Business outlook

Uncertain OLED smartphone impact with room for upside; operating margin is improving on enhanced product mix

1. Overview of the FY3/18 full-year outlook

The Company forecasts ¥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 to owners of parent (+190.5%) in FY3/18. These figures were left unchanged from the initial forecast.

As mentioned earlier, Elematec posted upbeat results in 1H with fulfillment rates toward FY3/18 targets well above 50%, but kept its initial forecast unchanged for FY3/18. The Company cited that this is due to the uncertainty of the impact from OLED-equipped smartphones. Sales of LCDs, touch panels, and backlights held firm at a flat YoY level in 1H. However, Elematec expects full-scale impact from releases of major OLED smartphone products in 2H.

Elematec Corporation | **23-Jan.-2018**
 2715 Tokyo Stock Exchange First Section | <http://www.elematec.com/en/ir/>

Business outlook

We understand the cautious stance adopted by Elematec. It is difficult for anyone to forecast the sales prospects of OLED smartphones in 2H. We think it would be misleading to investors to forcibly revise forecasts for a bet in a certain direction at this point.

Overview of the FY3/18 outlook

(¥mn)

| | FY3/17 | | | FY3/18 | | | | |
|---|--------|---------|-----------|---------|---------|-----------------|--------------------|-----------------|
| | 1H | 2H | Full year | 1H | 2H E | YoY growth rate | Full year forecast | YoY growth rate |
| Net sales | 94,966 | 108,038 | 203,004 | 104,134 | 100,866 | -6.6% | 205,000 | 1.0% |
| Operating income | 2,190 | 3,216 | 5,406 | 3,345 | 2,455 | -23.7% | 5,800 | 7.3% |
| Operating margin | 2.3% | 3.0% | 2.7% | 3.2% | 2.4% | - | 2.8% | - |
| Ordinary profit | 2,160 | 3,154 | 5,314 | 3,103 | 2,497 | -20.8% | 5,600 | 5.4% |
| Profit attributable to owners of parent | -879 | 2,221 | 1,342 | 2,175 | 1,725 | -22.3% | 3,900 | 190.5% |

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

Factoring in this impact, Elematec projects ¥205,000mn in net sales for FY3/18, an increase of 1.0% (¥1,995mn) YoY. Below we review details by market trends. The main dynamic, however, is higher sales in the Automotive and Broad Market segments offsetting the impact of a steep sales decline in the Digital Electronics segment due to the smartphone impact.

Elematec expects operating income to climb 7.3% (¥393mn) YoY to ¥5,800mn and a 0.1pp rise in operating margin to 2.8%. Both operating income and operating margin are headed upward just as in 1H. While sales in the Digital Electronics segment are slated to drop sharply in 2H, the content mainly covers mounting business with thin margins. Higher sales in the Automotive segment and other areas with larger profit margins should boost overall profitability through improved product mix.

Profit attributable to owners of parent is likely to increase greatly with a 190.5% YoY rise to ¥3,900mn thanks to the absence of extraordinary losses in 2H.

Gains in automotive-related and other business in the Digital Electronics segment are likely to offset continued shrinkage of smartphone-related business

2. Outlook by market

Elematec maintained its initial forecast for FY3/18, but adjusted the sales breakdown by reducing sales in the Digital Electronics segment by ¥3,744mn and upwardly revising sales in the Automotive and Broad Market segments by ¥1,875mn and ¥1,870mn, respectively.

In the Digital Electronics segment, Elematec forecasts a 7.8% (¥10,118mn) YoY decline in sales in FY3/18 to ¥119,108mn, including a steep ¥18,233mn drop in LCDs, touch panels, and backlights. This reflects a larger setback in segment sales than initially anticipated because of adopting a more cautious view of the impact from OLED smartphones. However, we think roughly half of the sales drop comes from mounting business with thin margins and this aspect should considerably alleviate pressure on earnings from lower sales. Elematec expects a ¥1,728mn decline in sales related to mobile terminals, continuing the trend from 1H. Conversely, it projects increases in full-year sales of ¥5,215mn for home electronics and ¥2,999mn for toys and hobbies. The background to these trends is the same as explained for 1H results. Home electronics business should remain stable in FY3/19 as well.

In the Automotive segment, Elematec projects a 34.0% (¥6,247mn) YoY increase in sales to ¥24,605mn with healthy growth in sales of a variety of automotive-related products again in 2H, just as seen in 1H. As explained earlier, automotive business has a strong recurring presence because of the model change cycle and certification program for parts and materials. We see considerable certainty in the FY3/18 earnings outlook from this perspective.

In the Broad Market segment, Elematec expects a 10.6% (¥5,866mn) YoY rise in sales to ¥61,287mn. By market, it anticipates a ¥2,001mn increase in sales in industrial machinery, etc., on track with the healthy trend from 1H and also higher sales in aftermarket business, medical equipment, and other areas. Aftermarket business covers rear-view camera modules and monitor systems for trucks and although these are effectively for automotive, it is booked under the Broad Market segment for distribution channel reasons.

Elematec Corporation | 23-Jan.-2018
 2715 Tokyo Stock Exchange First Section | <http://www.elematec.com/en/ir/>

Business outlook

Full-year sales outlook by market

(¥mn)

| Segment by market | FY3/17 | | FY3/18 | | | | | Sales increase value (YoY) |
|---------------------|----------------|---------------|------------------|------------------|-------------|---------------|---|----------------------------|
| | Results | Composition | Initial forecast | Revised forecast | YoY | Composition | Main target market | |
| Digital Electronics | 129,226 | 63.7% | 122,852 | 119,108 | -7.8% | 58.1% | LCDs, touch panels, and backlight | -18,233 |
| | | | | | | | Mobile terminal | -1,728 |
| | | | | | | | Home electronics (TVs, monitors, audio, etc.) | 5,215 |
| | | | | | | | Toys and hobbies | 2,999 |
| Automotive | 18,357 | 9.0% | 22,730 | 24,605 | 34.0% | 12.0% | Automotive | 6,247 |
| Broad Market | 55,421 | 27.3% | 59,417 | 61,287 | 10.6% | 29.9% | Industrial machinery, etc. | 2,001 |
| | | | | | | | Aftermarket | 1,103 |
| | | | | | | | Medical equipment | 667 |
| Total | 203,004 | 100.0% | 205,000 | 205,000 | 1.0% | 100.0% | | |

Note: Moved supercomputers, servers, and storage from Broad Market to Digital Electronics from FY3/18
 Source: Prepared by FISCO from the Company's results briefing materials

Income statement summary

(¥mn)

| | FY3/15 | FY3/16 | | FY3/17 | FY3/18 | |
|---|----------|-----------------|----------------|----------|----------|--------------------|
| | | Reporting basis | 12-month basis | | 1H | Full-year forecast |
| Net sales | 181,876 | 216,824 | 205,370 | 203,004 | 104,134 | 205,000 |
| Growth rate | 26.8% | 19.2% | 12.9% | -1.2% | 9.7% | 1.0% |
| Gross profit | 18,443 | 18,763 | 17,947 | 17,127 | 9,700 | - |
| Gross margin | 10.1% | 8.7% | 8.7% | 8.4% | 9.3% | - |
| SG&A expenses | 11,068 | 11,894 | 11,406 | 11,720 | 6,354 | - |
| SG&A expenses ratio | 6.1% | 5.5% | 5.6% | 5.8% | 6.1% | - |
| Operating income | 7,375 | 6,868 | 6,540 | 5,406 | 3,345 | 5,800 |
| Growth rate | 40.6% | -6.9% | -11.3% | -17.3% | 52.8% | 7.3% |
| Operating margin | 4.1% | 3.2% | 3.2% | 2.7% | 3.2% | 2.8% |
| Ordinary profit | 7,077 | 6,880 | 6,538 | 5,314 | 3,103 | 5,600 |
| Growth rate | 25.4% | -2.8% | -7.6% | -18.7% | 43.6% | 5.4% |
| Profit attributable to owners of parent | 5,105 | 5,048 | 4,794 | 1,342 | 2,175 | 3,900 |
| Growth rate | 32.2% | -1.1% | -6.1% | -72.0% | - | 190.5% |
| EPS (¥) | 249.38 | 246.58 | - | 65.57 | 106.27 | 190.49 |
| Dividend (¥) | 75.00 | 75.00 | - | 20.00 | 25.00 | 58.00 |
| Net assets per share (¥) | 2,095.95 | 2,170.74 | - | 2,175.80 | 2,281.79 | - |

Note: The FY3/16 financial statements consolidated 15 months for 9 overseas subsidiaries linked to changes in the fiscal year. 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 the Company's materials

Elematec Corporation | 23-Jan.-2018
 2715 Tokyo Stock Exchange First Section | <http://www.elematec.com/en/ir/>

Business outlook

Balance sheet summary

| | (¥mn) | | | | |
|---|--------------------|--------------------|--------------------|--------------------|---------------|
| | FY3/14 year-end | FY3/15 year-end | FY3/16 year-end | FY3/17 year-end | 1H FY3/18 end |
| Current assets | 68,426 | 79,170 | 74,935 | 87,662 | 94,158 |
| Cash and deposits | 14,809 | 10,004 | 12,551 | 10,282 | 18,469 |
| Notes and accounts receivable | 43,617 | 57,575 | 50,599 | 66,955 | 62,946 |
| Fixed assets | 4,999 | 5,021 | 5,636 | 5,621 | 5,593 |
| Tangible fixed assets | 2,962 | 2,627 | 2,465 | 2,398 | 2,401 |
| Intangible fixed assets | 228 | 236 | 1,349 | 1,115 | 984 |
| Investments, etc. | 1,808 | 2,156 | 1,821 | 2,107 | 2,207 |
| Total assets | 73,425 | 84,191 | 80,572 | 93,284 | 99,752 |
| Current liabilities | 36,374 | 40,931 | 35,892 | 48,521 | 52,853 |
| Notes and accounts payable | 34,094 | 36,199 | 33,419 | 42,734 | 49,205 |
| Short-term loans | - | 1,598 | 466 | 2,884 | 168 |
| Fixed liabilities | 107 | 349 | 238 | 217 | 183 |
| Long-term loans | - | - | - | - | - |
| Shareholders' equity | 35,681 | 39,672 | 42,980 | 43,401 | 45,372 |
| Capital | 2,142 | 2,142 | 2,142 | 2,142 | 2,142 |
| Capital surplus | 3,335 | 3,335 | 3,335 | 3,335 | 3,335 |
| Retained earnings | 30,897 | 34,888 | 38,196 | 38,618 | 40,589 |
| Treasury shares | -694 | -694 | -694 | -694 | -694 |
| Accumulated other comprehensive income | 1,017 | 3,238 | 1,462 | 1,143 | 1,343 |
| Non-controlling interests | 245 | - | - | - | - |
| Net assets | 36,943 | 42,910 | 44,442 | 44,545 | 46,715 |
| Total liabilities and net assets | 73,425 | 84,191 | 80,572 | 93,284 | 99,752 |

Source: Prepared by FISCO from Company's materials

Cash flow statement

| | (¥mn) | | | | |
|--|--------|--------|--------|--------|-----------|
| | FY3/14 | FY3/15 | FY3/16 | FY3/17 | 1H FY3/18 |
| Cash flow from operating activities | 2,132 | -5,942 | 7,573 | -3,309 | 10,953 |
| Cash flow from investing activities | 21 | -290 | -1,387 | -85 | -90 |
| Cash flow from financing activities | -1,145 | 318 | -2,837 | 1,504 | -2,921 |
| Effect of exchange rate change on cash and cash equivalents | 1,007 | 1,109 | -875 | -305 | 245 |
| Net increase (decrease) in cash and cash equivalents | 2,016 | -4,805 | 2,473 | -2,195 | 8,186 |
| Cash and cash equivalents at beginning of period | 12,793 | 14,809 | 10,004 | 12,477 | 10,282 |
| Cash and cash equivalents at end of period | 14,809 | 10,004 | 12,477 | 10,282 | 18,469 |

Source: Prepared by FISCO from the Company's materials

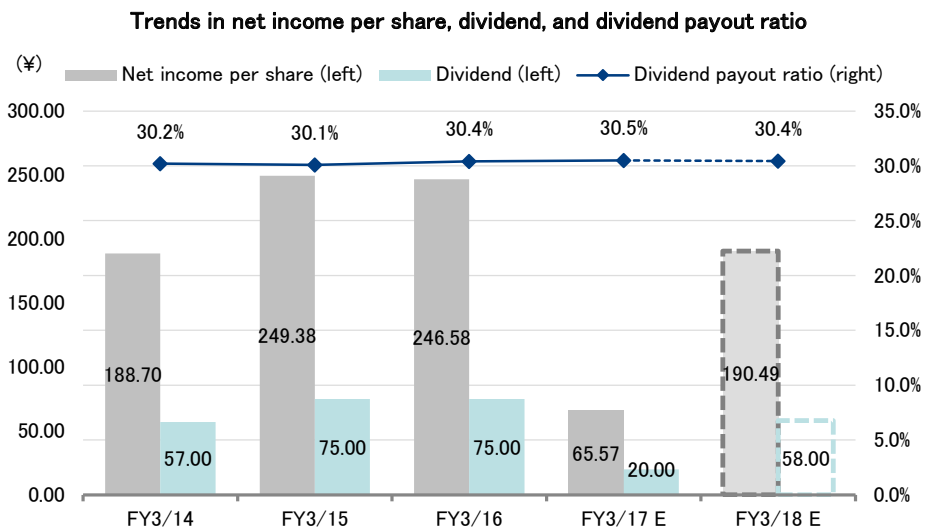
Shareholder return policy

Paid a ¥25 interim dividend in line with the initial forecast; possible change in the year-end dividend depending on full-year results

The Company 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.

Elematec has presented its FY3/18 dividend forecast of ¥58 (¥25 interim, ¥33 year-end) based on its outlook for sharply higher profit attributable to owners of parent. Fulfillment rates for both sales and income were well above 50% of full-year targets in 1H, as explained above. While this appears to be a very robust outcome, Elematec decided to pay a ¥25 interim dividend as outlined in the initial forecast.

It maintained the full-year dividend forecast at ¥58 because it has not changed the full-year results forecast after 1H results. However, the FY3/18 outlook appears cautious in light of 1H results. We expect revision of the dividend in accordance with the fundamental policy of a 30% payout ratio if earnings overshoot targets.



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

■ Information security

Strong awareness of information security

Elematec interacts with more than 6,000 suppliers and over 7,000 customers and possesses technology information and other important customer-related information. The Company has a strong awareness of information management and has established an information security system expected of a listed company, including limiting parties with information access rights and setting passwords. Nevertheless, it is a BtoB company and does not have personal information, credit card details, or other data for large numbers of customers as seen at BtoC companies. We thus see relatively less risk of cyber terrorism that targets such information as well as information leaks from within the Company.



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