Sanki Engineering Co., Ltd.

1961

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Summary

Major facilities construction company with strengths of advanced technology and credibility cultivated over a long history

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, manufacture, maintenance, installation, sale and consultation of systems and equipments for construction and plant facilities, such as office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive inter-disciplinary engineering capabilities across a diverse range of business operations, combined with advanced technology and credibility accumulated over a history of more than 90 years.

1. In FY3/18, operating income increased 9.7% YoY and the balance carried forward rose 16.9% on the end of the previous fiscal year

In FY3/18 results, orders received were ¥191,113mn (up 2.8% year on year (YoY)), net sales were ¥170,157mn (up 1.0%), gross profit was ¥25,060mn (up 11.2%), operating income was ¥6,593mn (up 9.7%), and ordinary income was ¥7,434mn (up 8.1%). However, profit attributable to owners of parent was ¥3,906mn (down 16.9%) due to the recording of an extraordinary loss, which was mainly a loss on the disposal of noncurrent assets related to the Yamato Site Redevelopment Project. The balance carried forward remained at a high level at ¥144,712mn (up 16.9% YoY). Continuing on from the previous fiscal period, profitability improved, including due to rigorous cost management and the progress made in improving operating efficiency, and the gross profit margin rose by 1.3 percentage points YoY to 14.7%.

2. The balance of construction work carried forward is being maintained at a high level, and increases in net sales and profits are forecast for FY3/19

The forecasts for the FY3/19 full year, which is currently underway, are for higher sales and profits, of orders received of ¥175,000mn (down 8.4% YoY), net sales of ¥187,000mn (up 9.9%), operating income of ¥7,500mn (up 13.8%), ordinary income of ¥8,000mn (up 7.6%), and profit attributable to owners of parent of ¥5,500mn (up 40.8%). Since it has a plentiful balance of construction work on hand, these forecasts would seem achievable as long as there are no unexpected unprofitable projects. Rather, they may be further upwardly revised if sales increase from orders during this period.

3. Achieving the targets in "Century 2025" Phase 1, the medium-term management plan, is in sight

The Company is approaching the 100th anniversary of its establishment, and so as its 10-year goals, in March 2015 it announced "Century 2025" as its long-term vision. As the final goal in the long-term vision, it intends to be "The Company of Choice," and in "Century 2025" Phase 1, which is the first three years of the medium-term management plan, it has first set quantitative targets for FY3/19 of net sales of ¥195bn and operating income of ¥7.5bn, and these targets already look achievable. As for specific measures, the Company announced the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>, and it is making steady progress. The Sanki Techno Center, which is a comprehensive R&D and training facility that is a major pillar of this project, is scheduled to open around October 2018.

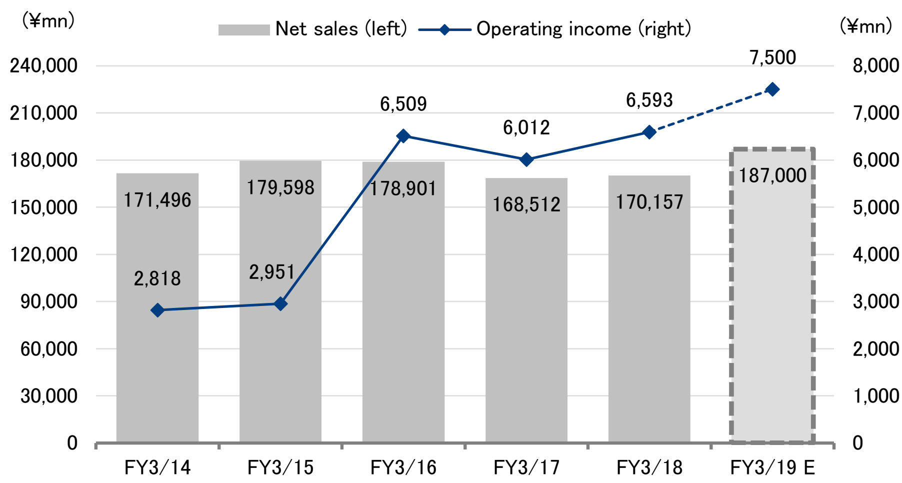
4. In FY3/18, in addition to an annual dividend of ¥35, retired 3 million treasury shares and newly acquired 3 million treasury shares

The Company not only stably pays dividends as it has done in the past, and increases the dividend as it has done in recent years, it also actively returns profits to shareholders through acquiring treasury shares and other methods. In FY3/18, it paid a regular dividend of ¥20.0 and also, for the third consecutive fiscal period, an extra dividend of ¥15.0, for an annual dividend of ¥35.0 (dividend payout ratio, 55.5%). This was an increase of ¥5 on the annual dividend of ¥30.0 (regular dividend of ¥20.0 + extra dividend of ¥10.0) in the previous fiscal year. For FY3/19, at the present time it is planning to maintain the base, of a regular dividend of ¥20.0. But in the previous fiscal year it paid an extra dividend of ¥15.0 (annual) due to the favorable results, so it is possible that it will increase the dividend in this fiscal year also, based on the results going forward. In addition, as part of its measures to return profits to shareholders, during the fiscal period under review, on May 22, 2017, it retired 3 million of the treasury shares it held, and moreover it newly acquired 3 million treasury shares (all have been acquired).

Key Points

- Mitsui-affiliated, domestically-leading facilities construction company that is currently implementing measures to improve the profit margin
- Sales and profits increased in FY3/18, and the forecast is also for higher sales and profits for FY3/19
- Positively returns profits to shareholders, and following on from retiring 3 million shares, it newly buys back 3 million treasury stock

Results trends



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

Company outline

A Mitsui-affiliated, domestically-leading facilities construction company with a long history

1. Company outline

Sanki Engineering is a facilities construction company that was established in 1925 as a spin-off of the machinery division of the former Mitsui & Co., Ltd. <8031> The first large projects for the Company were the Shiga manufacturing plant of Toyo Rayon (currently Toray Industries, Inc. <3402>), and a refrigerated warehouse for Aomori Seihyo. Initially, the Company engaged in heating, plumbing, steel frame construction and the supply of construction materials. It has subsequently branched out into electrical work, developing integrated plant construction planning, design and installation as its main operations.

After World War II, the Company operations expanded due to the demand derived from the Korean War, and in 1958, the Company's capital exceeded ¥1,000mn. In subsequent years, the Company participated in projects undertaken in preparation to host the Tokyo Olympic Games in 1964, and grew in tandem with the expansion of the Japanese economy. The Company diversified from the facilities construction business, such as heating, ventilation, air-conditioning (HVAC), plumbing, and electrical systems into other types of facilities, such as transport equipment, conveyance systems, water treatment facilities and waste treatment facilities. Today, it is a leading domestic facilities construction company. The Company's shares were listed on the Tokyo Stock Exchange in 1950.

2. History

The Company is presently a domestically-leading facilities construction company. In April 2015, prior to the 90th anniversary of its establishment in FY3/16, it appointed Mr. Tsutomu Hasegawa as President and Representative Director. Subsequently, at the end of fiscal 2015 it announced "Century 2025" as its long-term vision toward the 100th anniversary of its establishment in 2025, which adds President Hasegawa's new strategy to the policy it has taken up to the present time.

History

1925	Sanki Engineering Co., Ltd. established as a spin-off of the machinery division of the former Mitsui & Co., Ltd.
1935	10th anniversary of its establishment. Had 5 branches, 6 sub-branch offices, 3 affiliated companies, and around 300 employees
1958	Capital exceeded ¥1,000mn
1963	Completed the Sagami Plant (currently, the Yamato Plant)
1964	Participated in projects relating to the Tokyo Olympic Games, including the Yoyogi National Gymnasium, and the NHK Broadcast Center
1982	Newly established Technical R&D Institute in Yamato City, Kanagawa Prefecture, equipped with facilities for basic research and for large-scale experiments
2000	Opened the Shonan Training Center (Yokosuka City, Kanagawa Prefecture) and strengthened human resource development
2011	Relocated its head office to the current location in the Tsukiji area of Tokyo
2015	90th anniversary of its establishment. Announced its long-term vision "Century 2025"

Source: Prepared by FISCO from the Company's website, etc.

Business description

Four business segments comprising facilities construction, machinery systems, environmental systems, and real estate

1. Outline of business by segment

The Company's main operations are divided into four business segments: three facility business segments of facilities construction, machinery systems, environmental systems, and real estate business.

(1) Facilities Construction Business

The facilities construction business engages in activities including planning, design, installation, maintenance, and repair of facilities including office buildings, schools, hospitals, shopping centers, factories, R&D centers, and other facilities. This scope of activities handled by this business is extensive and may be further subdivided into the following businesses.

a) HVAC and plumbing for buildings

The HVAC and plumbing for buildings business provides HVAC, water supply and drainage systems, plumbing, cooling and freezing systems, area heating and cooling systems, kitchen systems, and disaster readiness systems for general buildings and facilities, such as office buildings, schools, hospitals, department stores, hotels, and warehouses.

b) Industrial HVAC

The industrial HVAC business provides HVAC and plumbing for factories and research facilities of all industries, especially clean room systems for plants requiring high levels of cleanliness, such as semiconductor plants, food processing plants, and pharmaceutical plants; special air-conditioning systems and appurtenances for manufacturers of chemicals and medical systems, and the like; and environmental control systems and so forth to automobile manufacturers.

c) Electrical systems

The electrical systems business provides electrical systems, communications-related systems, electrical civil works, and so forth.

d) Facility systems

The facility systems business offers project management and other services for the construction or relocation of the offices and dealing rooms of financial institutions and other industries. It also provides central monitoring and automatic control systems, Internet protocol (IP) solutions, network solutions, business continuity plan (BCP) solutions and other services for large-scale buildings.

(2) Machinery Systems Business

The machinery systems business supplies materials handling systems, including various transportation equipment (conveyors, sorting systems, etc.), and conveyance systems for factories and automated warehouses.

(3) Environmental Systems Business

The environmental systems business provides facilities such as water treatment facilities (including facilities to treat drinking water and dispose of sewage, facilities for the disposal of industrial wastewater, and facilities for the treatment or incineration of sludge), facilities for the treatment of waste (including waste incineration facilities, landfill wastewater treatment facilities), and others.

(4) Real Estate Business

The real estate business utilizes vacant land, such as former factory sites, and manages real estate lease business and building management business.

Sanki Engineering's main business is the provision of the facilities and solutions as described above. The Company obtains about half of its orders directly from facility owner clients and half indirectly through general contractors.

Just as the size of the orders varies widely from a few million yen to a few billion yen, the order completion time varies from a few weeks to a few years for longer orders. The profitability of an order varies and may differ from the originally planned profitability depending on factors such as labor and material costs and the management construction schedule. Some orders end up more profitable than originally planned, and some are less profitable.

2. Strengths, distinguishing traits, and competitors

(1) Broad business domain and one-stop shop solutions

It's no exaggeration to say that there are countless companies in Japan providing the same kind of construction and facilities as Sanki Engineering. The Company's strength lies in the wide range of its businesses, which includes HVAC for building, plumbing, industrial HVAC, electrical systems, facility systems, automated control systems for buildings, transportation systems, and water treatment facilities. The Company can provide services for many types of facilities and solutions covering all phases from planning and design, to installation, maintenance, repair, and replacement, depending on the life cycle of the building. This capability allows its customers to place one-stop shop orders to resolve their problems. By making optimal use of "total engineering" and "life-cycle engineering," which combines a wide variety of businesses horizontally, the Company can provide optimal systems with high added value, and this comprises the Company's strength.

(2) Top-class technology and high-quality customer base

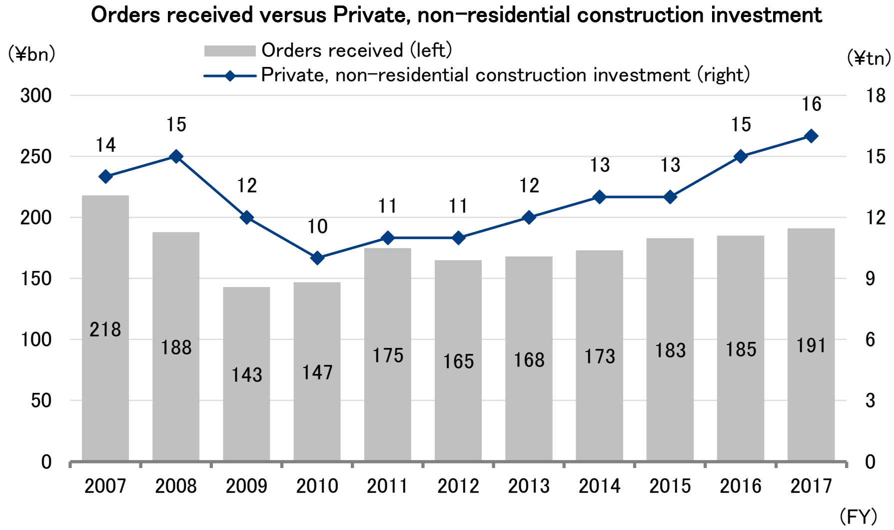
One of the Company's main strengths is the advanced technology it has accumulated since before World War II. Moreover, this top-class technology spans a wide range of fields. Furthermore, Sanki Engineering has earned a reputation for reliability over decades of business, which underpins its extensive, high-quality customer base. This can also be considered a strength of the Company. In addition to its prewar achievements, the Company's involvement in numerous post-war projects, including the construction of facilities for the Tokyo Olympic Games of 1964, have enabled it to obtain orders for recent large projects, such as the ABENO HARUKAS in Osaka.

3. Main competitors

Sanki Engineering's competitors vary by project, but its main competitors are other large companies such as Takasago Thermal Engineering Co., Ltd. <1969>, Shinryo Corporation (unlisted), Dai-Dan Co., Ltd. <1980>, and Taikisha Ltd. <1979>. Compared to these competitors, Sanki Engineering's strengths lie in its broad business domain and its superiority in industrial HVAC systems, such as clean rooms.

4. Trend in orders received and the economic environment

Given the nature of Sanki Engineering's businesses, orders received are the most important factor affecting the Company's performance. Annual orders received are greatly affected by the overall Japanese market, or the Japanese macro-economy. As the Company's main business is facilities construction, it is influenced by the macro indicator of private sector, non-residential investment. The correlation between orders received and private sector, non-residential investment is arguably very high.



Source: Prepared by FISCO based on materials from the Ministry of Land, Infrastructure, Transport and Tourism, etc.

Business trends

In FY3/18, operating income increased 9.7% YoY
The balance of construction work carried forward rose 16.9% on the end of the previous fiscal year and maintained its high level

1. FY3/18 results overview

(1) Profits

In the FY3/18 results, orders received were ¥191,113mn (up 2.8% YoY), net sales were ¥170,157mn (up 1.0%), gross profit was ¥25,060mn (up 11.2%), operating income was ¥6,593mn (up 9.7%), and ordinary income was ¥7,434mn (up 8.1%). As a whole, net sales increased due to higher sales in the HVAC and plumbing for buildings and in the plant & machinery systems businesses. For profits also, each of gross profit, operating income, and ordinary income increased as a result of the further progress made in various measures, including to strengthen the site support system. Conversely, profit attributable to owners of parent was ¥3,906mn (down 16.9%) due to the recording of an extraordinary loss, mainly from a loss on the disposal of non-current assets in relation to the Yamato Site Redevelopment Project.

Orders received declined in HVAC and plumbing for buildings, primarily from the effects of receiving orders for large projects in the previous fiscal year. But they trended firmly for industrial HVAC and electrical systems, so for the facilities construction business as a whole, orders received rose 4.7% YoY. On the other hand, orders for environmental systems declined 20.8%, although the level was high in the previous fiscal year, while orders for machinery systems increased 48.8%, including orders for large-scale projects. As a result, in the plant & machinery systems business as a whole, orders received decreased 6.2%. The total orders amount, including in real estate and others, rose 2.8% YoY, and at the end of FY3/18, the balance carried forward had increased 16.9% on the end of the previous fiscal year and maintained its high level.

FY3/18 results

(¥mn, %)

	FY3/17		FY3/18			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	185,880	-	191,113	-	5,233	2.8
Balance carried forward	123,756	-	144,712	-	20,956	16.9
Net sales	168,512	100.0	170,157	100.0	1,644	1.0
Gross profit	22,538	13.4	25,060	14.7	2,521	11.2
SG&A expenses	16,526	9.8	18,466	10.8	1,940	11.7
Operating income	6,012	3.6	6,593	3.9	580	9.7
Ordinary income	6,880	4.1	7,434	4.4	554	8.1
Profit attributable to owners of parent	4,698	2.8	3,906	2.3	-791	-16.9

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

The Company cited the following points as the factors behind the improvement in the gross profit margin.

a) Rigorous cost management: Higher margins via significant increases in operational efficiency as a result of the measures set out below, in addition to rigorous internal cost management that the Company has hitherto promoted.

b) Reductions in negative margin factors: The environment for orders improved significantly due to an upturn in the operating environment, leading to circumstances where a balance could be struck between costs and quality. Furthermore, delays in construction progress declined as a result of rigorous process control, with profitability (margins) in large-scale projects improving in particular.

c) Establishment of site support structures: The Company has taken various steps to improve support for site engineers, including purchasing operations support through the Procurement Division and work site documentation and other clerical support via the Site-Documentation Support Center (which from April 2018 has been developing convergent operations by transferring the work of each branch office), newly established in April 2015, designing work support through the Design & Engineering Support Center newly formed in April 2016, and quality supervision via technical experts, and these efforts are paying off (in the form of improved operational efficiency).

On the other hand, the actual amount of SG&A expenses increased ¥1,940mn, and the SG&A expenses ratio rose from 9.8% in the previous fiscal year to 10.8%. The main factors included increases in personnel expenses, R&D expenses, and advertising expenses, but each was within the expected range. However, these were absorbed by the higher gross profit, and operating income increased.

(2) Profits by segment

Consolidated net sales and ordinary income by segment

(¥mn, %)

	FY3/17		FY3/18			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Net sales	168,512	100.0	170,157	100.0	1,644	1.0
HVAC and plumbing for buildings	60,376	35.8	63,782	37.5	3,405	5.6
Industrial HVAC	49,440	29.3	46,556	27.4	-2,883	-5.8
Electrical systems	21,542	12.8	20,653	12.1	-888	-4.1
Facility systems	10,208	6.1	8,695	5.1	-1,512	-14.8
Facilities construction business	141,567	84.0	139,688	82.1	-1,878	-1.3
Machinery systems	8,192	4.9	9,254	5.4	1,062	13.0
Environmental systems	18,271	10.8	19,909	11.7	1,637	9.0
Real estate business	1,592	0.9	1,755	1.0	163	10.3
Others	499	0.3	578	0.3	79	15.9
Adjustments	-1,611	-	-1,030	-	580	-
Ordinary income	6,880	4.1	7,434	4.4	554	8.1
Facilities construction business	6,404	-	6,010	-	-394	-6.2
Machinery systems	-138	-	-40	-	97	-
Environmental systems	671	-	575	-	-96	-14.3
Real estate business	189	-	476	-	287	151.7
Others	22	-	49	-	27	121.7
Adjustments	-270	-	362	-	632	-

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

In the facilities construction business, net sales were ¥139,688mn (down 1.3% YoY). By sub-segment, in HVAC and plumbing for buildings, which had a plentiful balance carried forward from the start of the fiscal period, sales increased 5.6% to ¥63,782mn. But some projects were pushed back compared to the initial plan, so it seems that sales grew at a rate a little slower than expected. Orders for industrial HVAC were strong, so although the current net sales were ¥46,556mn (down 5.8%), this result was within the expected range and not a cause for concern. Sales of electrical systems also declined 4.1% to ¥20,653mn, but this still meant that sales in the range of ¥20,000mn were maintained and it was not a poor result. Sales of facility systems declined 14.8% to ¥8,695mn, but again, this was due to the high levels achieved in the previous two fiscal years and is not a cause for concern.

Net sales were ¥9,254mn (up 13.0% YoY) in the machinery systems business and ¥19,909mn (up 9.0%) in the environmental systems business. Therefore, total net sales in the plant & machinery systems business increased 10.2% YoY, which was a strong result and basically as forecast. Other than the facilities business, in the real estate business, net sales increased 10.3% to ¥1,755mn, including due to higher rental income from the Sanki Yamato Building.

Also, in ordinary income and loss by segment, the facilities construction business recorded income of ¥6,010mn (down 6.2% from the previous fiscal year), machinery systems posted a loss of ¥40mn (a loss of ¥138mn in the previous fiscal year), and environmental systems recorded income of ¥575mn (down 14.3%). As a result, the facilities business as a whole recorded ordinary income of ¥6,545mn (down 5.7%). Also, the real estate business and other businesses recorded ordinary income of ¥476mn (up 151.7%) and ¥49mn (up 121.7%), respectively.

(3) Order conditions by segment

Orders received by segment

(¥mn, %)

	FY3/17		FY3/18			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	185,880	100.0	191,113	100.0	5,233	2.8
HVAC and plumbing for buildings	65,763	35.4	62,274	32.6	-3,488	-5.3
Industrial HVAC	49,823	26.8	58,907	30.8	9,084	18.2
Electrical systems	21,576	11.6	22,675	11.9	1,099	5.1
Facility systems	9,450	5.1	9,585	5.0	135	1.4
Facilities construction business	146,612	78.9	153,443	80.3	6,830	4.7
Machinery systems	8,130	4.4	12,100	6.3	3,969	48.8
Environmental systems	30,626	16.5	24,247	12.7	-6,378	-20.8
Real estate business	1,592	0.9	1,755	0.9	163	10.3
Others	491	0.3	587	0.3	95	19.5
Adjustments	-1,573	-	-1,020	-	552	-

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

In the facilities construction business as a whole, orders received were ¥153,443mn (up 4.7% YoY). By sub-segment, in HVAC and plumbing for buildings, due to the fact that orders for large-scale projects related to office buildings were calmed compared to in the previous fiscal year, orders received declined to ¥62,274mn (down 5.3%). In Industrial HVAC, orders were ¥58,907mn (up 18.2%), including due to orders for large-scale projects. In electrical systems, orders received were ¥22,675mn (up 5.1%), and it also received orders for large-scale projects and can be said to be performing comparatively well. In facility systems, orders trended stably to ¥9,585mn (up 1.4%).

In the plant & machinery systems business, orders received for machinery systems increased greatly to ¥12,100mn (up 48.8%), including due to the acquisition of large-scale orders in this fiscal period. On the other hand, for environmental systems, orders declined 20.8% to ¥24,247mn, but although this was a YoY decline compared to the level in FY3/17, this was because orders were higher than normal in that fiscal year due to a large-scale DBO* project, and this result was still at a level higher than FY3/16, of ¥19,610mn. Therefore, the order conditions are not a cause for concern. As a result, in the plant & machinery systems business as a whole, orders received were ¥36,347mn (down 6.2%).

* DBO (Design Build Operate) is a method for public-build, private-operations by collectively ordering design, building, and operations and maintenance management to private-sector enterprises (such as the Company).

There were a total of 20 orders for large-scale projects (¥1bn or more) worth ¥40,822mn (previous fiscal year, 15 orders worth ¥40,057mn, two fiscal years ago, 19 orders worth ¥31,476mn). By building usage, factories were the most, at six projects, which led to the significant increase in orders for industrial HVAC.

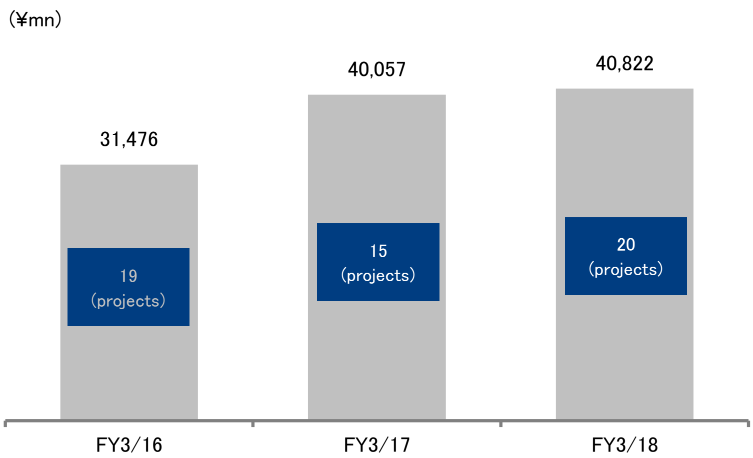
Breakdown of large-scale projects with orders exceeding ¥1,000mn

(project)

	FY3/16	FY3/17	FY3/18
Offices	3	4	2
Complex buildings	1	-	-
Commercial facilities	1	1	-
Hotels/inns	-	-	1
Factories	5	4	6
Multiple-dwelling complexes	-	-	2
Schools	1	-	-
Hospitals	2	1	1
Research institutes	1	1	1
Gymnasiums	-	-	1
Others	1	-	3
Railway and airport facilities	-	-	1
Power stations, substations	-	1	-
Waste processing facilities	3	1	2
Water and sewage treatment facilities	1	2	-
Total	19	15	20

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

Large-scale projects with orders exceeding ¥1,000mn



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

From this situation, in FY3/18, total orders received were ¥191,113mn (up 2.8% YoY) and trended stably. The balance carried forward at the end of the fiscal period was ¥144,712mn (up 16.9% on the end of the previous fiscal year) and maintained its high level.

2. Financial condition

The financial condition at the end of FY3/18 was that current assets were ¥124,759mn (up ¥9,852mn on the end of the previous fiscal year), which was mainly due to increases in cash and deposits of ¥9,679mn from long-term loans for capital investment and other purposes, and in notes and accounts receivable on completed construction contracts of ¥6,289mn. Non-current assets were ¥53,831mn (up ¥2,125mn), which was primarily because of increases in tangible non-current assets of ¥1,813mn on the fully fledged redevelopment of the Yamato site, and in intangible non-current assets of ¥270mn. As a result, total assets at the end of the fiscal period were ¥178,591mn (up ¥11,978mn).

Current liabilities were ¥73,834mn (up ¥5,058mn on the end of the previous fiscal year), mainly due to increases in notes and accounts payable on construction contracts and others of ¥1,577mn and in short-term borrowing of 1,239mn. Non-current liabilities were ¥18,565mn (up ¥6,690mn), with the main factors being increases in long-term loans of ¥6,610mn in relation to the development of the Yamato site, and in liabilities for retirement benefits of ¥610mn. As a result, total liabilities at the end of the fiscal period were ¥92,399mn (up 11,748mn). Total net assets were ¥86,191mn (up ¥229mn), which was because although in addition to the payment of dividends from surplus, shareholders' equity decreased ¥1,953mn following the acquisition and retirement of treasury shares, there were increases in the valuation difference of other securities due to a rise in market prices, and also in the cumulative adjustment amount in relation to retirement benefits.

Balance sheet

(¥mn)

	FY3/17	FY3/18	Difference
Cash and deposits	34,187	43,866	9,679
Notes and accounts receivable on completed construction contracts and other	58,168	64,458	6,289
Current assets	114,906	124,759	9,852
Tangible noncurrent assets	8,849	10,662	1,813
Intangible noncurrent assets	542	813	270
Investments and other assets	42,314	42,355	41
Noncurrent assets	51,705	53,831	2,125
Total assets	166,612	178,591	11,978
Notes and accounts payable on construction contracts and other	48,277	49,854	1,577
Short-term loans	5,654	6,894	1,239
Payments received for work in progress	5,728	3,439	-2,289
Current liabilities	68,776	73,834	5,058
Long-term loans	-	6,610	6,610
Liability for retirement benefits	2,274	2,884	610
Noncurrent liabilities	11,875	18,565	6,690
Total liabilities	80,651	92,399	11,748
Total net assets	85,961	86,191	229

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

3. Cash flow conditions

In FY3/18, cash flows from operating activities increased ¥6,306mn, mainly due to the recording of net income before taxes and other adjustments of ¥6,454mn. Cash flows from investing activities declined ¥2,510mn, which was primarily because of savings in time deposits of ¥1,500mn and acguisition of ¥2,290mn acguisition of tangible non-current assets. Cash flows from financing activities increased ¥1,814mn, as although funds decreased due to factors including the purchase of treasury stock of ¥3,679mn and the dividend-payment amount of ¥2,195mn they increased ¥8,000mn from long-term loans for capital investment and other purposes.

As a result, the balance of cash and cash equivalents at the end of FY3/18 had increased ¥5,679mn from the end of the previous fiscal year to ¥44,866mn.

Statement of cash flows

(¥mn)

	FY3/17	FY3/18
Cash flows from operating activities	10,845	6,306
Pretax profit	7,004	6,454
Change in trade notes and accounts receivable (- indicates increase)	8,808	-3,546
Change in trade notes and accounts payable (- indicates decrease)	-3,180	1,092
Cash flows from investing activities	-1,644	-2,510
Cash flows from financing activities	-2,458	1,814
Increase in long-term loans payable	-340	8,000
Purchase of treasury stock	-	-3,679
Dividend-payment amount	-1,970	-2,195
Change in cash and cash equivalents (- indicates decrease)	6,686	5,679
Cash and cash equivalents at end of period	39,187	44,866

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

Outlook

The outlook is for the gross profit margin to continue to maintain its high level and for higher profits

● FY3/19 results outlook

For FY3/19, the Company forecasts for net sales of ¥187,000mn (up 9.9% YoY), operating income of ¥7,500mn (up 13.8%), ordinary income of ¥8,000mn (up 7.6%), and profit attributable to owners of parent of ¥5,500mn (up 40.8%). Orders received are expected to be ¥175,000mn (down 8.4% YoY) and the balance carried forward to be ¥132,712mn (down 8.3% on the end of the previous fiscal year). In contrast to the previous fiscal period, orders will decline slightly, but the plentiful balance carried forward from the previous fiscal period will steadily lead to sales, and also the Company will continue to work to improve profitability. Therefore, the forecasts are for higher sales and profits.

Breaking down net sales, in the facilities construction business, they are forecast to be ¥151,200mn (up 8.2% YoY). By sub-segment, in HVAC and plumbing for buildings, sales are expected to be ¥63,300mn (down 0.8%), which is around the same as the previous fiscal year and maintaining the high level. In Industrial HVAC, the forecast is for sales of ¥58,000mn (up 24.6%), as orders in the previous fiscal year were strong, including for large-scale projects. Sales of electrical systems are forecast to be basically unchanged YoY at ¥20,000mn (down 3.2%), and those of facility systems to increase to ¥9,900mn (up 13.9%) as a reaction to their sluggish performance in the previous fiscal year. In the plant & machinery systems business, net sales are forecast to recover to ¥12,000mn (up 29.7%) for machinery systems and to ¥22,000mn (up 10.5%) for the environmental systems, including due to the effects of orders for large-scale projects.

In the mainstay facilities construction business, orders received are forecast to be ¥140,200mn (down 8.6% YoY). By sub-segment, in HVAC and plumbing for buildings, they are expected to be ¥54,400mn (down 12.6%), in industrial HVAC, ¥55,000mn (down 6.6%), in electrical systems, ¥21,000mn (down 7.4%), and in facility systems, ¥9,800mn (up 2.2%). So the forecasts are for declines in every sub-segment other than facility systems. In the plant & machinery systems business, the forecast for the machinery systems is orders of ¥12,000mn (down 0.8%), which is basically unchanged YoY, while in environmental systems, they are expected to be ¥21,000mn (down 13.4%), mainly because results were at high levels in the previous two fiscal years. As a result, as a whole, orders received are forecast to decrease 8.4% to ¥175,000mn. Therefore, as net sales are expected to increase 9.9%, the balance carried forward at the end of this fiscal period is also forecast to decrease.

FY3/19 forecast

(¥mn, %)

	FY3/18		FY3/19 E			
	Amount	Ratio	Amount	Ratio	YoY change	% change
Orders received	191,113	100.0	175,000	100.0	-16,113	-8.4
HVAC and plumbing for buildings	62,274	32.6	54,400	31.1	-7,874	-12.6
Industrial HVAC	58,907	30.8	55,000	31.4	-3,907	-6.6
Electrical systems	22,675	11.9	21,000	12.0	-1,675	-7.4
Facility systems	9,585	5.0	9,800	5.6	215	2.2
Facilities construction business	153,443	80.3	140,200	80.1	-13,243	-8.6
Machinery systems	12,100	6.3	12,000	6.9	-100	-0.8
Environmental systems	24,247	12.7	21,000	12.0	-3,247	-13.4
Real estate business	1,755	0.9	1,800	1.0	45	2.6
Others	587	0.3	200	0.1	-387	-65.9
Adjustments	-1,020	-	-200	-	-	-
Net sales	170,157	100.0	187,000	100.0	16,843	9.9
HVAC and plumbing for buildings	63,782	37.5	63,300	33.9	-482	-0.8
Industrial HVAC	46,556	27.4	58,000	31.0	11,444	24.6
Electrical systems	20,653	12.1	20,000	10.7	-653	-3.2
Facility systems	8,695	5.1	9,900	5.3	1,205	13.9
Facilities construction business	139,688	82.1	151,200	80.9	11,512	8.2
Machinery systems	9,254	5.4	12,000	6.4	2,746	29.7
Environmental systems	19,909	11.7	22,000	11.8	2,091	10.5
Real estate business	1,755	1.0	1,800	1.0	45	2.6
Others	578	0.3	200	0.1	-378	-65.4
Adjustments	-1,030	-	-200	-	-	-
Gross profit	25,060	14.7	26,800	14.3	1,740	6.9
SG&A expenses	18,466	10.9	19,300	10.3	834	4.5
Operating income	6,593	3.9	7,500	4.0	907	13.8
Ordinary income	7,434	4.4	8,000	4.3	566	7.6
Profit attributable to owners of parent	3,906	2.3	5,500	2.9	1,594	40.8

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

Overall, given that currently there is ample work in hand, we feel there is every likelihood that the Company will achieve the above targets. Going forward, the point to pay attention to is avoiding unexpectedly unprofitable projects by rigorous progress management. In respect of orders also, the environment surrounding the construction and HVAC industries is good, and given that there is expected to be an ample volume of works, it is felt that it is possible for the Company to secure their target for orders received.

The gross profit margin in the previous fiscal year was at a high level (14.7%), but the Company plans to ensure a slightly lower level (14.3%) this fiscal year. It will do so by continuing to implement measures to improve profits, including establishing and enhancing on-site support systems, particularly by strengthening negotiating capabilities for the procurement of materials, and supporting on-site purchasing operations through ongoing integrated management by the Procurement Division. As a result of the above, if net sales are as expected, the forecasts are for increases in all of the profit items, for gross profit of ¥26,800mn (up 6.9% YoY), operating income of ¥7,500mn (up 13.8%), ordinary income of ¥8,000mn (up 7.0%), and profit attributable to owners of parent of ¥5,500mn (up 40.8%).

Medium-term management plan

STeP Project to start in earnest

1. The Long-Term Vision “Century 2025”

The Company has announced a 10-year long-term vision “Century 2025” that covers from fiscal 2016 to fiscal 2025, the 100th anniversary of its establishment. The ultimate goal of this long-term vision is to be “The Company of Choice.” The Company has divided the 10 years into three phases described below in order to achieve this goal and the Company’s policy is to implement business strategies promoted in each phase of medium-term management plan.

2. Progress of the Sanki Yamato Site Redevelopment Project <STeP (Sanki Techno Park) Project>

One of the priority measures in the medium-term management plan, “Century 2025” Phase 1, is the “Redevelopment of the Yamato Site.” The Company announced the overview of this redevelopment project, which it has named the “STeP (Sanki Techno Park) Project.” First, it divided the project into three plans: 1) building the Sanki Techno Center, 2) reorganizing manufacturing plants in the machinery systems business, and 3) making effective use of existing assets. The progress made in each plan and the schedule for the future are described below.

(1) Construction of the “Sanki Techno Center”

One of the targets in “Century 2025” Phase 1 is “Improving the quality of technologies and human resources,” and the Company has already announced that it plans to build the “Sanki Techno Center” to achieve this target. In this plan, it will renovate the former A-block in the Sanki Yamato Buildings and utilize it for the Sanki Techno Center (six above-ground floors and one below-ground floor, with a total area of approximately 45,000 square meters) as a comprehensive research and training facility. The new Technical Research & Development Institute has already started operations in March 2018, and the entire complex is scheduled to commence full operation around October 2018.

(2) Reorganizing manufacturing plants in the machinery systems business

Toward “reorganizing manufacturing plants in the machinery systems business,” the Company has announced it will rebuild a new machinery systems manufacturing plant (a site area of approximately 11,000 square meters, and a building area of around 5,500 square meters) on the site of the former standard products manufacturing plant. For this rebuilding, the machinery systems plant has been temporarily relocated to the Shonan area, and the new plant is scheduled to commence construction in May 2018 and commence operations around August 2019.

(3) The completion of the dismantling of the Yamato Plant facilities

The Company progressed the dismantling of the various facilities in the Yamato Plant, which was comprised of the above-described machinery systems manufacturing plant, the Technical Research & Development Institute, and other buildings, and it completed the dismantling work in April 2018. The costs of this dismantling work and the loss on the disposal of non-current assets had already been recorded in the FY3/18 results. Following the completion of this dismantling work, the plan is to construct from the current fiscal year the above described new machinery systems plant on one part of this land, while the Company decided that the remaining land will be prepared and maintained as rental real estate from the perspective of effectively utilizing assets owned. About 41,000 square meters of this land is scheduled to be leased to Nippon Life in the near future, so going forward, sales and profits in the real estate business can be expected to further accumulate.

3. The progress made in the various measures

The above-described Yamato Site Redevelopment Project is one of the priority measures in “Century 2025” Phase 1. But other than this, the Company is also implementing various other qualitative measures, and the progress made in these measures in FY2017 is described below.

(1) Development of new technology

a) Market rollout of aluminum refrigerant piping method “Aluminger”
b) Development of the world’s fastest conveyor and sorting device (cross-belt sorter)
c) Received first order for DBO style of energy-recovery waste treatment facilities including new construction work
d) Full-scale participation in the wood biomass gasification power generation facility market

(2) Work-style reforms

a) Meeting to exchange opinions between division chiefs and young employees
b) Holding the 2nd Sanki Ladies' Forum (on this occasion, the forum was held for female engineers and it was attended by the President)
c) Opening of the "Women's Hotline"
d) Continuing to hold the Sanki Super Meister and Sanki Best Partner Awards

(3) Social contributions

a) Contributions and plantingtrees through "SANKI YOU Eco Contribution Points"
b) Holding an undergrowth weeding event at Sanki no Mori
c) Participation in the "Uchimizu-Biyori" event held by Bureau of Environment of the Tokyo Metropolitan Government
d) Fundraising activities for the Japan Guide Dog Association
e) Participating in blood donation by the Japanese Red Cross Tokyo Metropolitan Blood Center

(4) Information dissemination

a) Exhibiting at various exhibitions
"HVAC & R JAPAN 2018", "4th Interphex Osaka", "ENEX2018", "Sewage Works Exhibition 2017 Tokyo", etc.
b) Disseminating information from various media
Advertising in the Nikkei newspaper, etc. Broadcasting the Company's TV programs

(5) From the perspective of ESG

The Company is also implementing the following measures from the viewpoint of ESG.

a) Environment (E)
1) Continuing donations through "SANKI YOU Eco Contribution Points"
2) Order received for DBO style of new energy-recovery waste treatment facilities, including new construction work
3) Constructed wood biomass gasification power generation facility (related to renewable energy)
4) Constructed high-level energy-saving facility in Shanghai, China, in construction with NEDO and others
5) Registration as a "ZEB Planner", which is a license system that was instituted by the Ministry of Economy, Trade, and Industry in FY2017

b) Society (S)
1) Entered the third year of the "Smile Project", the Company's unique work-style reform
2) Initiated the above projects "Smile Site Plan" subcommittee, which is focusing on working styles of construction sites
3) Established the "Women's Hotline", a women-only consultation service
4) Holding meetings to exchange opinions between division chiefs and young employees
5) Holding a meeting for female engineers to exchange opinions at the 2nd "Sanki Ladies Forum"

c) Governance (G)
1) Increased the content of self-evaluation by the Board of Directors
2) Participation in a digital voting platform
3) Conducted meetings to exchanges opinions about corporate governance
4) Engaged in revision of decision - making procedure standards for the Board of Directors
5) Increased dialogue with shareholders (strengthened the systems, increased the number of opportunities for dialogue, and held briefing sessions for individual investors)

Shareholder return policy

Actively returns profits to shareholders by increasing the dividend and acquiring and retiring treasury shares

The Company actively returns profits to shareholders. Currently, its basic policy is to pay an annual, ordinary dividend of ¥20, but as the FY3/17 results were strong, it also paid an extra period-end dividend of ¥10 for an annual dividend of ¥30 (dividend payout ratio, 40.6%). Further, in FY3/18, in addition to the regular dividend (¥20), it paid an interim extra dividend of ¥5 and period-end extra dividend of ¥10, for the third consecutive year, meaning the annual dividend increased by ¥5 YoY to ¥35 (dividend payout ratio, 55.5%). For the FY3/19 annual dividend, presently it plans to maintain the regular, annual dividend of ¥20, but it may increase the dividend, depending on results going forward.

Also, as part of its measures to return profits to shareholders, up to the present time the Company has actively acquired its treasury shares on the stock market and retired them. During FY3/18, on May 22, 2017, it retired 3 million of the treasury shares it held, so the total number of outstanding shares became 63,661,156 shares. Moreover, in FY3/18 it newly acquired 3 million treasury shares.

We feel that his positive attitude towards shareholder returns should be regarded highly.

Disclaimer