COMPANY RESEARCH AND ANALYSIS REPORT

Sanki Engineering Co., Ltd.

1961

Tokyo Stock Exchange Prime Market

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Index

Summary

In FY3/23, profit declined 40.6% due to projects being delayed, but orders received increased 13.0% and balance carried forward to the next period increased 25.0%, maintaining high levels

Sanki Engineering Co., Ltd. <1961> (hereafter, "the Company") is an engineering company whose main business is the planning, design, manufacture, supervision, installation, sale and consultation of systems and equipment for construction facilities (mainly HVAC systems) and plant facilities (mainly water and sewage treatment and disposal plants, etc.) in office buildings, schools, hospitals, shopping centers, industrial plants, R&D centers and other facilities. The Company's strengths include comprehensive engineering capabilities across a diverse range of business operations, combined with advanced technology and credibility accumulated over a history of nearly 100 years.

1. FY3/23 results: Posted an operating loss due to construction project delays in 1H, etc., but orders received and balance carried forward to the next period were at high levels

The Company reported FY3/23 results, with net sales of ¥190,865mn (down 1.2% YoY), operating profit of ¥5,409mn (down 40.6%), ordinary profit of ¥6,247mn (down 36.4%) and profit attributable to owners of parent of ¥4,750mn (down 26.8%). Net sales decreased because the Company was unable to adequately make up for delays that occurred in certain projects due to schedule revisions and because there were few projects in machinery systems carried forward from the previous period. Operating profit decreased due to a decline in the gross profit margin caused by fewer projects than planned being completed by the end of FY3/23 and other factors. Orders received were buoyant, increasing 13.0%. In particular, orders received for industrial HVAC, a strength of the Company, rose 23.7%. As a result, balance carried forward to the next period at the end of FY3/23 was ¥188,426mn (up 25.0%), maintaining a high level.

2. FY3/24 results outlook: Operating profit is forecast to recover and increase 38.6% YoY

For FY3/24, the Company is forecasting ¥190,000mn in orders received (down 16.9% YoY), ¥210,000mn in net sales (up 10.0%), ¥7,500mn in operating profit (up 38.6%), ¥8,000mn in ordinary profit (up 28.1%), and ¥5,300mn in profit attributable to owners of parent (up 11.6%). The forecast gross profit margin is 14.3% (up 0.1 ppt), while SG&A expenses are projected to rise by 4.2%. The decline in the gross profit margin that occurred in FY3/23 was due to temporary factors, including projects being delayed due to schedules being revised by customers and delays in the delivery of materials, so FISCO believes that the Company's forecast for its gross profit margin is fairly conservative. For this reason, if completed projects are recorded as planned, there is a strong likelihood that current forecasts for net sales and profits will be upwardly revised.

3. “Century 2025” moves on to the Phase 3 medium-term management plan

The Company has announced “Century 2025” as its long-term vision for the 10-year period from FY3/17 to FY3/26, the 100th anniversary of its foundation. To achieve the targets of the vision, the Company has divided the 10-year period into three phases and promoted business strategies based on its medium-term management plans. The ultimate goal of the long-term vision (Phase 3 target), is to be “The Company of Choice” for even more stakeholders. The Company’s quantitative targets for the final year, FY3/26, are ¥220.0bn in net sales, gross profit margin of 16.5%, ¥12.0bn in ordinary profit, dividend payout ratio of 50% or higher, and ROE of 8.0% or above. These quantitative targets are by no means easy to achieve, but we at FISCO believe the important point is not merely how the Company will achieve quantitative targets, but also how it will change qualitatively in areas that can’t be seen, such as improvements in construction quality and productivity, work style reforms and growth investment. The further changes made by the Company going forward will be important to monitor.

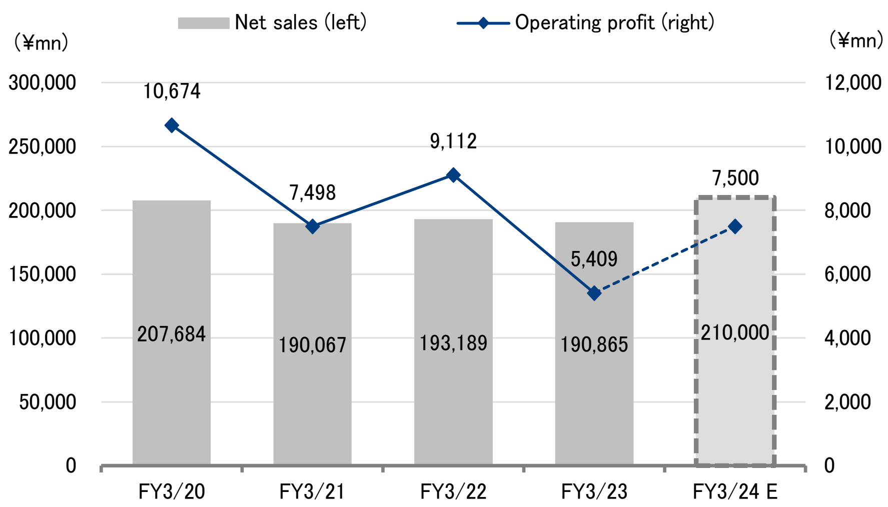
4. Actively returns profit to shareholders: Plans on dividend ratio of 71.9% in FY3/24

The Company has proactively conducted shareholder returns with stable dividends up to now, dividend hikes in recent years, and acquisition of treasury stock. The annual dividend (including extra dividends) was ¥80 in FY3/21, ¥85 in FY3/22, and ¥75 in FY3/23. With regard to treasury stock, the Company acquired 1,000,000 shares in FY3/22 and acquired another 1,500,000 shares in FY3/23. As a result, the Company forecasts a dividend ratio of 87.4% and a total return ratio of 136.4% in FY3/23. The total return ratio over the past ten years (FY3/14 to FY3/23) on a weighted average basis reached 91.6%. For FY3/24, the Company is planning a regular dividend of ¥70 (dividend ratio of 71.9%). As such, we at FISCO believe the Company is deserving of high marks for its proactive shareholder returns policy, rather than simply aiming to increase operating results.

Key Points

- A facilities construction company affiliated with Mitsui and a domestic leader. Is currently implementing measures to improve its profit margin
- In FY3/23, operating profit declined by 40.6% YoY, but an increase of 38.6% is forecast for FY3/24; the targets of the medium-term management plan remain unchanged
- Actively returns profits to shareholders. Forecasts a dividend ratio of 71.9% in FY3/24

Results trends



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

Company outline

A comprehensive engineering company conducting the Facilities Construction Business and the Plants & Machinery Systems Business with strengths in advanced technology and credibility cultivated over a long history

Sanki Engineering is a facilities company that was established in 1925 as a spin-off of the machinery division of the former Mitsui & Co., Ltd. The first large projects for the Company started with the Shiga manufacturing plant of Toyo Rayon Co., Ltd. (currently, Toray Industries, Inc. <3402>), and a refrigerated warehouse for Aomori Seihyo Co., Ltd. Initially, the Company engaged in heating, plumbing, 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 the war, the Company steadily grew on robust construction demand and surpassed ¥1.0bn in capital in 1958. 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 comprehensive facilities construction company. The Company's shares were listed on the Tokyo Stock Exchange (TSE) in 1950. Currently it is listed on the TSE Prime market.

Prior to the 90th anniversary of its establishment in FY3/16, the Company announced the "Century 2025" long-term vision headed toward its 100th anniversary in 2025. It completed Phase 1 in FY3/19, and since April 2020, it has been promoting Phase 2, and in FY3/22, it can be said to have mainly achieved the targets. The Company has entered Phase 3, the final phase of "Century 2025," in FY3/23. The Company's activities going forward to its 100th anniversary in 2025 when this plan ends will be a focus point.

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
2016	Announced its long-term vision "Century 2025"
2018	Opened Sanki Techno Center, a comprehensive training and research facility (Yamato City, Kanagawa Prefecture)
2019	Opened the Yamato Product Center, and completed the STeP (Sanki Techno Park) project

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

Business description

Three main segments, particularly strong in industrial HVAC

1. Outline of business by segment

The Company's main businesses come under three segments – Facilities Construction Business, Plants & Machinery Systems Business, and Real Estate Business. Its main activities are design and construction management of various facilities. 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 depending on factors such as labor and material costs and the management construction schedule, and some orders end up more or less profitable than originally planned.

(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. The scope of activities handled by this business is extensive and can be further divided into the following sub-segments.

a) HVAC and plumbing for buildings

The HVAC and plumbing for buildings business provides HVAC, water supply and wastewater systems, plumbing, 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 for factories and research facilities of all industries, especially clean room systems for semiconductor plants and pharmaceutical and food processing plants, which are areas of strength for the Company, as well as special air-conditioning systems and appurtenances for manufacturers of medical equipment and the like, in addition to environmental control systems and so forth for automobile manufacturers. This is a strong field for the Company, partly because of its historical background.

c) Electrical systems

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

d) Facility systems

The facility systems business offers project management and consulting services for the construction or relocation of 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) Plants & Machinery Systems Business

The Plants & Machinery Systems Business encompasses machinery systems and environmental systems as two sub-segments.

a) Machinery systems

The machinery systems business supplies materials handling systems, including various transportation equipment (conveyors, sorting systems, etc.), and conveyance systems for factories and automated warehouses. Demand is centered on private-sector companies and is affected by capital investment trends.

b) Environmental systems

The environmental systems business provides facilities such as for water treatment (including water and sewage treatment and disposal, industrial wastewater disposal, and sludge treatment and incineration), waste treatment (including waste incineration and landfill wastewater treatment), and others. Customers are mainly local government entities and so forth.

(3) 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.

2. Strengths, distinguishing traits, and competitors

(1) Broad business domain and one-stop solutions

Many companies in Japan provide similar facilities construction services, but 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 orders to resolve their problems. Making use of "total engineering" and "life-cycle engineering," which combines a wide variety of businesses horizontally, enables the Company to provide optimal systems with high added value, which is its notable feature and 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, and this top-class technology spans a wide range of fields. 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 in 1964, has enabled it to obtain orders for recent large projects, such as the ABENO HARUKAS in Osaka and Tokyo Midtown Hibiya.

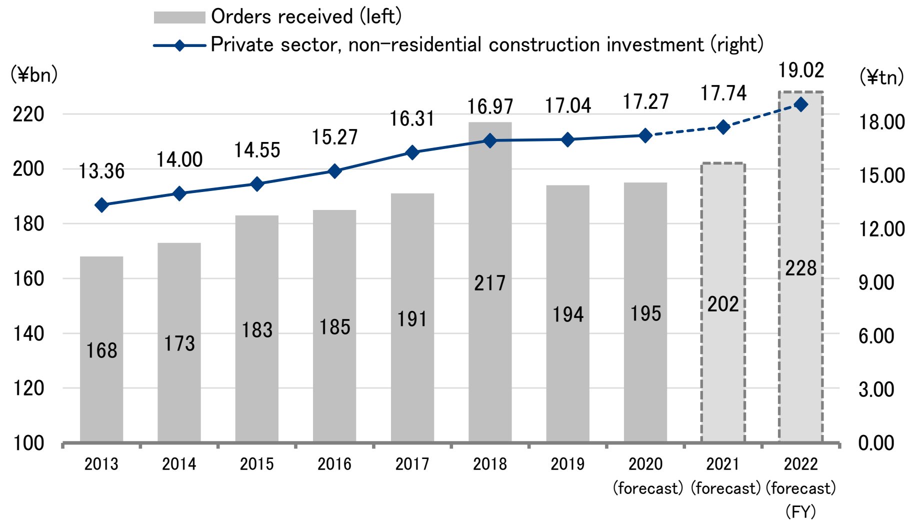
3. Main competitors

Sanki Engineering's competitors vary by project, but its main competitors among the comprehensive facilities construction companies 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 and other factory air conditioning.

4. Trend in orders received and the economic environment

Orders received is the most important factor affecting results. Annual orders received are thought to be greatly affected by the Company's sales efforts, as well as the overall Japanese market, or the Japanese macro-economy. As the Company's main business is facilities construction, its orders received follows nearly the same trend as the macro indicator of private sector, non-residential construction investment. For this reason, the correlation between orders received and private sector, non-residential construction investment is arguably very high.

Orders received versus private sector, non-residential construction



Source: Prepared by FISCO from the Company's financial results and the Ministry of Land, Infrastructure, Transport and Tourism's "Estimate of Construction Investment"

Business trends

Posted an operating loss in FY3/23 due to lower sales. Solid momentum for orders, with balance carried forward to the next period rising 25.0% YoY

1. FY3/23 results overview

(1) Earnings

The Company reported FY3/23 results with ¥190,865mn in net sales (down 1.2% YoY), ¥5,409mn in operating profit (down 40.6%), ¥6,247mn in ordinary profit (down 36.4%), and ¥4,750mn in profit attributable to owners of parent (down 26.8%). Capital investment during the period was ¥2,279mn (¥1,620mn the previous period) and depreciation was ¥1,511mn (¥1,587mn).

Net sales declined due to the completion of certain projects being pushed back to FY3/24 as some project schedules were revised by customers on the impact of delays in the delivery of materials and equipment and other factors. The gross profit margin was 14.2%, a decline of 1.4 ppt YoY that was caused by a decrease in properties recorded as completed sales in FY3/23. SG&A expenses were ¥21,603mn (up 2.3%) due to factors such as an increase in personnel expenses from ongoing investment in human resources and an increase in expenses associated with IT investment and recovery from the COVID-19 pandemic. As a result, operating profit decreased by 40.6%.

FY3/23 results

(¥mn)

	FY3/22		FY3/23		YoY	
	Amount	Ratio	Amount	Ratio	YoY change	Change %
Orders received	202,250	-	228,554	-	26,303	13.0%
Balance carried forward	150,737	-	188,426	-	37,688	25.0%
Net sales	193,189	100.0%	190,865	100.0%	-2,323	-1.2%
Gross profit	30,223	15.6%	27,012	14.2%	-3,211	-10.6%
SG&A expenses	21,110	10.9%	21,603	11.3%	492	2.3%
Operating profit	9,112	4.7%	5,409	2.8%	-3,703	-40.6%
Ordinary profit	9,817	5.1%	6,247	3.3%	-3,570	-36.4%
Profit attributable to owners of parent	6,489	3.4%	4,750	2.5%	-1,738	-26.8%

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

(2) Earnings by segment

The Facilities Construction Business posted net sales of ¥155,778mn (up 0.2% YoY). By sub-segment, in HVAC and plumbing for buildings, sales declined to ¥59,392mn (down 4.4%) due to projects becoming larger (meaning a longer period of time from when the order is received to when the sale is recorded) and because sales in FY3/22 were particularly brisk. Industrial HVAC reported sales of ¥58,933mn (up 2.7%). The rate of growth YoY was low because of a rebound against sales that had been strong in the previous period, but results are being maintained and sales are at a high level. Electric systems posted sales of ¥25,668mn (up 2.9%). Similarly, sales over the past two years have been strong, especially to large data centers, but there was no significant dip and a high level is being maintained. Facility systems also recorded solid sales, of ¥11,784mn (up 6.7%).

The Plants & Machinery Systems Business reported net sales of ¥32,861mn (down 7.5% YoY). By sub-segment, machinery systems posted sales of ¥7,661mn (down 20.7%). This was primarily due to fewer orders of conveyance equipment compared to the previous period. Environmental systems posted sales of ¥25,200mn (down 2.5%), but the decline can be said to have been not necessarily a poor result considering large projects involving sewage treatment plants and industrial waste treatment plants were completed the previous period. Real Estate Business sales totaled ¥2,471mn (up 2.5%) and Others sales were ¥556mn (down 1.9%).

Regarding profit (gross profit) by segment, the Facilities Construction Business reported ¥21,291mn (down 12.8% YoY). In the sub-segments, gross profit for HVAC and plumbing for buildings, industrial HVAC, and electrical systems decreased 13.7% to ¥19,052mn accompanying a decline in sales. Facilities systems posted ¥2,239mn (down 3.6%). The Plants & Machinery Systems Business reported ¥5,143mn (up 0.2%), maintaining basically the same level as the previous year. By sub-segment, machinery systems posted ¥772mn (down 51.3%), a major decline. This was the result of lower sales as well as the impact of rising material prices for mainstay conveyors and other items. At the same time, environmental systems posted a solid result, contributing ¥4,370mn (up 23.2%). Water treatment-related projects performed well, which offset lower profit from machinery systems. In the Real Estate Business and Others, gross profit was ¥844mn (down 3.7%) and ¥51mn (down 26.3%), respectively.

Net sales and gross profit by segment

(¥mn)

	FY3/22		FY3/23		YoY	
	Amount	Ratio	Amount	Ratio	YoY change	Change %
Net sales	193,189	100.0%	190,865	100.0%	-2,323	-1.2%
Facilities Construction Business	155,484	80.5%	155,778	81.6%	294	0.2%
HVAC and plumbing for buildings	62,146	32.2%	59,392	31.1%	-2,753	-4.4%
Industrial HVAC	57,363	29.7%	58,933	30.9%	1,569	2.7%
Electrical systems	24,933	12.9%	25,668	13.4%	734	2.9%
Facility systems	11,040	5.7%	11,784	6.2%	744	6.7%
Plants & Machinery Systems Business	35,509	18.4%	32,861	17.2%	-2,648	-7.5%
Machinery Systems	9,666	5.0%	7,661	4.0%	-2,005	-20.7%
Environmental Systems	25,842	13.4%	25,200	13.2%	-642	-2.5%
Real Estate Business	2,410	1.2%	2,471	1.3%	61	2.5%
Others	566	0.3%	556	0.3%	-10	-1.9%
Adjustments	-781	-	-802	-	-20	-
Gross profit	30,223	15.6%	27,012	14.2%	-3,211	-10.6%
Facilities Construction Business	24,409	15.7%	21,291	13.7%	-3,118	-12.8%
Building HVAC, industrial HVAC, and electrical systems	22,086	15.3%	19,052	13.2%	-3,034	-13.7%
Facility systems	2,323	21.0%	2,239	19.0%	-84	-3.6%
Plants & Machinery Systems Business	5,133	14.5%	5,143	15.7%	9	0.2%
Machinery Systems	1,586	16.4%	772	10.1%	-814	-51.3%
Environmental Systems	3,547	13.7%	4,370	17.3%	823	23.2%
Real Estate	876	36.3%	844	34.2%	-32	-3.7%
Others	69	12.2	51	9.2	-18	-26.3%
Adjustments	-266	-	-317	-	-51	-

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

Larger projects being ordered

(3) Orders received by segment

In the Facilities Construction Business, orders received increased a significant 21.4% YoY to ¥194,809mn. By sub-segment, HVAC and plumbing for buildings booked a high level of orders received at ¥74,802mn (up 27.6%). In particular, there was a significant contribution from the acquisition of large-scale projects in 2Q. Industrial HVAC saw brisk orders from the electrical machinery industry, primarily related to semiconductors, resulting in orders received of ¥78,082mn (up 23.7%). Electrical systems had orders of ¥28,542mn (up 2.5%), which is strong considering that the level in the same period of the previous fiscal year was high (¥27,856mn) and there was little YoY change, driven by orders for datacenters. Facility systems had orders received of ¥13,383mn (up 22.4%), which can also be said to be solid.

The Plants & Machinery Systems business reported orders received of ¥31,583mn (down 20.2%), which largely reflects the impact from environmental systems, so it can be said that the content basically fell in line with plan. Machinery systems was strong, with orders received of ¥11,654mn (up 30.7%). Large projects in particular have seen a recovery, contributing to the large increase. On the other hand, in environmental systems, orders received declined a significant 35.0% to ¥19,929mn. However, that is because there was a pullback from orders for large-scale projects received in the past two years, and the Company intentionally curbed orders to a certain extent due to ample existing projects. Therefore, it is fair to say that order conditions in environmental systems are not as bad as the numbers appear.

In areas other than facilities work segments, orders received in the Real Estate Business totaled ¥2,471mn (up 2.5% YoY) and in Others totaled ¥542mn (down 3.8%).

As a result, total orders received in FY3/23 (including adjusted amounts) was ¥228,554mn (up 13.0% YoY), and balance carried forward to the next period at the end of FY3/23 stayed at a high level, at ¥188,426mn (up 25.0%). By industry, all industries increased YoY except machinery, the public sector and finance and insurance, and growth was particularly high in electric machinery, automobiles and real estate.

Orders for large-scale projects (orders exceeding ¥1.0bn) included 25 projects totaling ¥63,103mn. Order volume was the same as the previous period, but order value increased 34.0% YoY and the average value per deal was ¥2,524mn (compared to ¥1,884mn the previous year), which shows that projects have gotten larger.

Orders received by segment

(¥mn)

	FY3/22		FY3/23		YoY	
	Result	Compared to orders received	Result	Compared to orders received	YoY change	Change %
Orders received	202,250	100.0%	228,554	100.0%	26,303	13.0%
Facilities Construction Business	160,504	79.4%	194,809	85.2%	34,304	21.4%
HVAC and plumbing for buildings	58,603	29.0%	74,802	32.7%	16,198	27.6%
Industrial HVAC	63,113	31.2%	78,082	34.2%	14,968	23.7%
Electrical systems	27,856	13.8%	28,542	12.5%	685	2.5%
Facility systems	10,930	5.4%	13,383	5.9%	2,452	22.4%
Plants & Machinery Systems Business	39,554	19.6%	31,583	13.8%	-7,971	-20.2%
Machinery Systems	8,914	4.4%	11,654	5.1%	2,739	30.7%
Environmental Systems	30,640	15.1%	19,929	8.7%	-10,710	-35.0%
Real Estate Business	2,410	1.2%	2,471	1.1%	61	2.5%
Others	563	0.3%	542	0.2%	-21	-3.8%
Adjustments	-782	-	-853	-	-70	-

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

Breakdown of large-scale projects with orders exceeding ¥1.0bn

(projects)

	FY3/21	FY3/22	FY3/23
Offices	4	3	6
Multipurpose building	-	1	1
Factories	6	7	6
Stores	-	1	-
Hospitals and clinics	3	1	1
Research institutes	3	2	3
Public halls and cultural halls	-	1	-
Other building interiors	3	5	2
Hotels and inns	-	-	1
Railways and airports	1	-	1
School buildings and auditoriums	1	-	2
Waste processing facilities	1	2	-
Water and sewage treatment plants	5	2	2
Total (projects)	27	25	25
Amount (¥mn)	48,483	47,103	63,103

Source: Prepared by FISCO from the Company's Summary of Financial Results

Temporary decrease in cash and deposits, but no problem in financial condition

2. Financial condition

Looking at the Company's financial condition at the end of FY3/22, current assets totaled ¥115,512mn (down ¥10,230mn compared to the end of FY3/23). This was mainly due to a decrease of ¥17,829mn in cash and deposits and an increase of ¥10,379mn in sales receivables (notes and accounts receivable, electronic record claims, notes and accounts receivable on completed construction contracts and other and contract assets). Noncurrent assets were ¥56,793mn (down ¥1,073mn). This was primarily because of a decrease of ¥467mn in property, plant and equipment due to depreciation, an increase of ¥1,047mn in intangible assets due to system development and a decrease of ¥1,653mn in investments and other assets due to a decrease in investment securities. As a result, total assets at the end of FY3/23 were ¥172,305mn (down ¥11,303mn). The large decrease in cash and deposits is temporary and resulted from shortening payment terms for partner companies from 120 days to 60 days, so it is not cause for concern.

Current liabilities were ¥69,649mn (down ¥9,560mn compared to the end of FY3/22). This was mainly due to decreases of ¥3,779mn in accounts payable (accounts payable on construction contracts, including electronic record liabilities), a decrease of ¥2,211mn in short-term loans payable, and a decrease of ¥1,820mn in income taxes payable. Noncurrent liabilities were ¥11,742mn (up ¥1,620mn), with the main factors including an increase of ¥1,080mn in long-term loans payable and an increase of ¥1,280mn in liability for retirement benefits. As a result, total liabilities at the end of FY3/23 were ¥81,392mn (down ¥7,939mn). Total net assets totaled ¥90,913mn (down ¥3,364mn), mainly due to a decrease of ¥2,046mn in retained earnings due to payment of dividends and a decrease of ¥1,533mn in unrealized gains on securities.

Balance sheet

(¥mn)

	End of FY3/22	End of FY3/23	YoY change
Cash and deposits	42,779	24,949	-17,829
Notes and accounts receivable on completed construction contracts and other, contract assets, and electronic record claims	66,761	77,141	10,379
Current assets	125,742	115,512	-10,230
Tangible noncurrent assets	13,504	13,037	-467
Intangible noncurrent assets	1,255	2,302	1,047
Investments and other assets	43,106	41,453	-1,653
Noncurrent assets	57,866	56,793	-1,073
Total assets	183,609	172,305	-11,303
Accounts payable on construction contracts, electronic record liabilities	40,520	36,741	-3,779
Short-term loans payable	8,885	6,674	-2,211
Income taxes payable	2,659	839	-1,820
Contract liabilities	14,754	15,027	273
Current liabilities	79,210	69,649	-9,560
Long-term loans payable	320	1,400	1,080
Liability for retirement benefits	2,581	3,861	1,280
Noncurrent liabilities	10,121	11,742	1,620
Total liabilities	89,331	81,392	-7,939
Total net assets	94,278	90,913	-3,364

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

3. Cash flow conditions

In FY3/23, net cash used in operating activities was ¥10,584mn. The main inflows included profit before income taxes of ¥6,935mn and depreciation of ¥1,511mn. The main outflows were an increase of ¥10,328 in trade receivables and contract assets, and a decrease of ¥3,793mn in trade payables. Net cash used in investing activities was ¥969mn. The main outflows included ¥1,007mn for the purchase of property, plant and equipment. Net cash used in financing activities was ¥8,327mn. The main outflows were ¥3,140mn in repayments of long-term borrowings, ¥2,347mn for the purchase of treasury shares, and ¥4,743mn for dividends paid.

Cash and cash equivalents hence decreased ¥19,829mn in FY3/23 to a period-end balance of ¥24,949mn.

Statement of cash flows

(¥mn)

	FY3/22	FY3/23
Cash flows from operating activities	18,529	-10,584
Profit before income taxes	9,514	6,935
Depreciation	1,587	1,511
Change in trade receivables and contract assets (- indicates increase)	5,389	-10,328
Change in notes and accounts payable on construction contracts and other (- indicates decrease)	-1,218	-3,793
Cash flows from investment activities	-3,384	-969
Purchase of property, plant and equipment	-1,010	-1,007
Cash flows from financing activities	-7,518	-8,327
Change in short- and long-term loans payable (net)	-1,390	-1,132
Outlays for acquisition of treasury stock	-1,438	-2,347
Cash dividends paid	-4,537	-4,743
Change in cash and cash equivalents (- indicates decrease)	7,692	-19,829
Cash and cash equivalents at end of period	44,779	24,949

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

Outlook

In FY3/24, operating profit is forecast to recover to increase 38.6% YoY

For FY3/24, the Company is forecasting orders received of ¥190,000mn (down 16.9% YoY), net sales of ¥210,000mn (up 10.0%), operating profit of ¥7,500mn (up 38.6%), ordinary profit of ¥8,000mn (up 28.1%), and profit attributable to owners of parent of ¥5,300mn (up 11.6%).

Uncertainties remain, including the Ukraine situation and the impact of trade friction between the U.S. and China, but the Company plans to achieve its targets by steadily accumulating sales through existing projects. Orders received have been solid the past few years and existing project volume is also at a high level, so the Company's forecasts are conservative.

In the Facilities Construction Business, the Company is forecasting net sales of ¥170,000mn (up 9.1% YoY). By sub-segment, sales from HVAC and plumbing for buildings are projected to decrease 4.0% to ¥57,000mn. There are ample existing projects, but with projects becoming larger and construction periods lengthening as a result, many will be completed after FY3/24. There is also a large order backlog in industrial HVAC, so sales are forecast to increase 25.6% to ¥74,000mn. Sales from electrical systems are expected to increase 5.2% to ¥27,000mn as a result of existing projects being steadily completed, and sales from facility systems are projected to edge up 1.8% to ¥12,000mn. Net sales in the Plants & Machinery Systems Business are forecast at ¥38,000mn (up 15.6%). By sub-segment, sales from machinery systems are expected to increase by 56.6% to ¥12,000mn, a reversal of the large decline in FY3/23. Sales from environmental systems is projected to increase 3.2% to ¥26,000mn.

Orders received are expected to be ¥190,000mn (down 16.9%) because orders have been solid the past two years and existing projects are at a high level. In the mainstay Facilities Construction Business, orders received are expected to be ¥153,000mn (down 21.5% YoY). Sub-segment forecasts are for ¥43,000mn in HVAC and plumbing for buildings (down 42.5%), ¥73,000mn in industrial HVAC (down 6.5%), ¥25,000mn in electrical systems (down 12.4%), and ¥12,000mn in facility systems (down 10.3%). The Company expects ¥35,000mn in orders in the Plants & Machinery Systems Business (up 10.8% YoY). Sub-segment forecasts are for ¥12,000mn in machinery systems (up 3.0%), which is flat YoY. Environmental systems are forecasting orders received for ¥23,000mn (up 15.4%) as solid sales centered on water treatment are expected to continue.

The Company is forecasting a gross profit margin of 14.3%, which is flat YoY, and gross profit of ¥30,000mn (up 11.1% YoY). It projects SG&A expenses of ¥22,500mn (up 4.2%), mainly owing to growth in personnel expenses due to work style reforms. As a result, it forecasts operating profit will rise 38.6% YoY to ¥7,500mn.

The gross profit margin for FY3/23 declined significantly from the average of the previous four terms (FY3/19 to FY3/22), which was 15.3%. With projects becoming larger, the Company is taking a cautious approach to risks such as rising material and equipment costs, so it is projecting a gross profit margin for FY3/24 that is equivalent to the previous fiscal year. The decline in the gross profit margin in FY3/23 is a temporary occurrence that was due to the completion of certain projects being pushed back to FY3/24 because of delays resulting from project schedules being revised by customers. For this reason, we at FISCO believe that the forecast for the gross profit margin is fairly conservative and that it is possible it will recover to around the upper half of the 14% range. In such a case, if net sales proceed according to plan, there is a strong likelihood that profit forecasts will be upwardly revised.

FY3/24 forecast

(¥mn)

	FY3/23		FY3/24 E			
	Result	Component ratio	Amount	Component ratio	YoY change	Change %
Orders received	228,554	100.0%	190,000	100.0%	-38,554	-16.9%
Facilities Construction Business	194,809	85.2%	153,000	80.5%	-41,809	-21.5%
HVAC and plumbing for buildings	74,802	32.7%	43,000	22.6%	-31,802	-42.5%
Industrial HVAC	78,082	34.2%	73,000	38.4%	-5,082	-6.5%
Electrical systems	28,542	12.5%	25,000	13.2%	-3,542	-12.4%
Facility systems	13,383	5.9%	12,000	6.3%	-1,383	-10.3%
Plants & Machinery Systems Business	31,583	13.8%	35,000	18.4%	3,417	10.8%
Machinery Systems	11,654	5.1%	12,000	6.3%	346	3.0%
Environmental Systems	19,929	8.7%	23,000	12.1%	3,071	15.4%
Real Estate Business	2,471	1.1%	2,400	1.3%	-71	-2.9%
Others	542	0.2%	500	0.3%	-42	-7.7%
Net sales	190,865	100.0%	210,000	100.0%	19,135	10.0%
Facilities Construction Business	155,778	81.6%	170,000	81.0%	14,222	9.1%
HVAC and plumbing for buildings	59,392	31.1%	57,000	27.1%	-2,392	-4.0%
Industrial HVAC	58,933	30.9%	74,000	35.2%	15,067	25.6%
Electrical systems	25,668	13.4%	27,000	12.9%	1,332	5.2%
Facility systems	11,784	6.2%	12,000	5.7%	216	1.8%
Plants & Machinery Systems Business	32,861	17.2%	38,000	18.1%	5,139	15.6%
Machinery Systems	7,661	4.0%	12,000	5.7%	4,339	56.6%
Environmental Systems	25,200	13.2%	26,000	12.4%	800	3.2%
Real Estate Business	2,471	1.3%	2,400	1.1%	-71	-2.9%
Others	556	0.3%	500	0.2%	-56	-10.1%
Adjustments	-802	-	-900	-	-98	-
Gross profit	27,012	14.2%	30,000	14.3%	2,988	11.1%
SG&A expenses	21,603	11.3%	22,500	10.7%	897	4.2%
Operating profit	5,409	2.8%	7,500	3.6%	2,091	38.6%
Ordinary profit	6,247	3.3%	8,000	3.8%	1,753	28.1%
Profit attributable to owners of parent	4,750	2.5%	5,300	2.5%	550	11.6%

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

Medium-term management plan

"Century 2025" Phase 3, starting from FY3/23

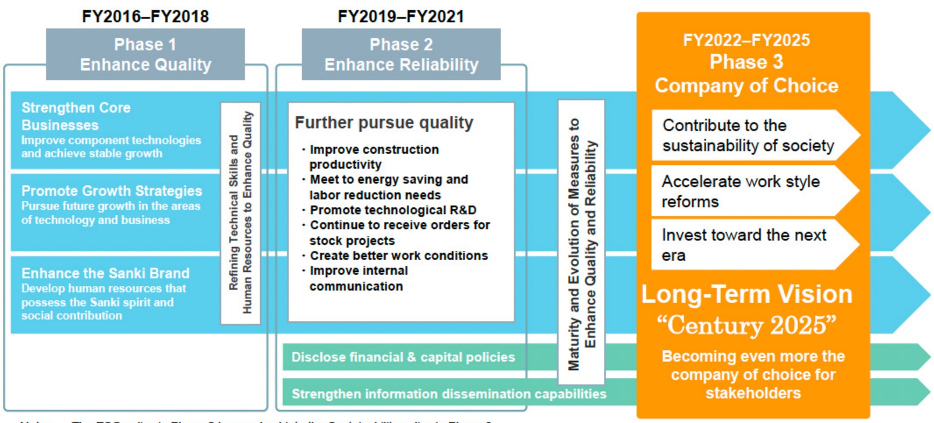
1. What is the "Century 2025" long-term vision?

In March 2016, the Company announced the long-term vision "Century 2025," which covers the 10-year period until the 100th anniversary of its establishment. The first three years of this plan (FY3/17 to FY3/19) are Phase 1, the next three years (FY3/20 to FY3/22) are Phase 2, and the final four years (FY3/23 to FY3/26) are Phase 3. In each phase, the company has set various qualitative and quantitative goals, and it has mainly achieved these up to the completed Phase 2. The Company has entered Phase 3, starting from FY3/23, which is the finishing phase of "Century 2025."

2. Basic policy of Phase 3

Phase 3 is the finishing medium-term plan for the long-term vision "Century 2025." The basic policy of the plan is to further mature and evolve its existing strategies for increasing quality and reliability, adding the three new strategies of "contribute to the sustainability of society," "accelerate work style reforms," and "invest toward the next era," aiming to be the "Company of Choice" for even more stakeholders.

Overview of Phase 3 measures



Note: The ESG policy in Phase 2 has evolved into the Sustainability policy in Phase 3

Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

3. Phase 3 results and management targets

(1) "Century 2025" final year results and management targets

The Company's quantitative targets for the final year, FY3/26, are net sales of ¥220.0bn, a gross profit margin of 16.5%, ordinary profit of ¥12.0bn, a dividend payout ratio of 50% or higher, and ROE of 8.0% or higher. While these are by no means easy targets, we at FISCO believe that what is important is not just simply attaining the quantitative targets, but also how the Company goes about making qualitative changes that are out of sight, including construction quality and productivity enhancements, work style reforms, and growth investments.

Phase 3 (FY3/26) results targets

(¥bn)

	FY3/26
Net sales	2,200
Gross profit	360
Gross profit margin	16.5%
Ordinary profit	120
Ordinary profit margin	5.5%

Source: Prepared by FISCO from the Company's "Status of Business Progress in the Medium-Term Management Plan"

Phase 3 (FY3/26) management targets

Ordinary profit margin	5.0% or above (final year)
Dividend policy	Dividend payout ratio of 50% or above Annual dividend of ¥70 or above per share
Acquisition of treasury stock	Approximately 5,000,000 shares*
ROE	8.0% or above
Growth investment	Approximately ¥20.0bn*

* Accumulative over the period of the plan

Source: Prepared by FISCO from the Company's "Status of Business Progress in the Medium-Term Management Plan"

(2) Review of the initial year (FY3/23)

Results in FY3/23, the first year of Phase 3, were all below the figures set for FY3/26, but it was still the first year of the plan, so targets have been left unchanged. FISCO thinks there is certainly the potential for the Company to meet these targets over the remaining three years.

Phase 3 targets and initial year results

	Phase 3 targets By FY2025	FY2022 Results	Difference
Net Sales	¥220.0bn	¥190.8bn	¥(29.2)bn
Gross profit [ratio]	¥36.0bn [16.5%]	¥27.0bn [14.2%]	¥(9.0)bn [(2.3)pt]
Ordinary profit [margin]	¥12.0bn [5.5%]	¥6.2bn [3.3%]	¥(5.8)bn [(2.2)pt]

	Phase 3 targets FY2022 - FY2025	FY2022 Results
Ordinary profit margin	5.0% or more	3.3%
Dividend policy	Dividend payout ratio 50% or more Annual dividend per share of ¥70 or more	Dividend payout ratio 87.4% Annual dividend per share of ¥75
Acquisition of treasury stock	About 5 million shares*	1.5 million shares (Cumulative total of 1.5 million shares during period of plan)
ROE	8.0% or more	5.1%
Growth investment	About ¥20bn*	¥3.2bn (Cumulative total of ¥3.2bn during period of plan)

*Cumulative during period of plan

Source: The Company's "Status of Business Progress in the Medium-Term Management Plan"

4. Phase 3 KPI

As KPIs for Phase 3, the Company has newly established the targets as follows.

(1) Facilities Construction Business

- Analyze the root cause of problems/complaints (within 5 years after the completion of construction): 100%, report the results of root cause analysis: 4 times/year
- Develop digital and robotic technologies related to construction: 5 projects/year, actual cases of application of developed technology: 5 projects/year

(2) Facility Systems Business

- Orders received for consulting/facility engineering: ¥400mn
- Orders received related to NeWSICT (Next Work Style with ICT): ¥500mn
- Orders received for project management and construction work stemming from consulting-related activities: ¥2.1bn

(3) Machinery Systems Business

- Net sales of robot systems: ¥5.0bn (cumulative)

(4) Environmental Systems Business

- Orders received (cumulative): AEROWING ¥3.6bn; G3 decanter centrifuge ¥2.0bn; fluidized bed incinerator 2 units

(5) E (environment)

- Scope 1 and 2: 40% reduction in CO_2 emissions from FY2020 levels
- Scope 3: 10% reduction in CO_2 emissions from FY2020 levels
- Reduce CO_2 emissions based on the SANKI YOU Eco Contribution Point system by an additional 30% compared to the 3-year average for FY2018-2020

(6) S (society)

- Rate of childcare leave taken: Men 50%, women 100%
- Ratio of women in managerial positions in April 2026: 3.0%

(7) Others

- Investments for the next era (decarbonization technology, energy-saving and labor-reduction technologies, LCE business, digital transformation (DX)): ¥20.0bn

5. Update on progress of measures

Progress on key measures is as follows.

(1) Topics by segment

- Facilities Construction Business: Many orders received for projects defined as “lifecycle engineering” (the Company’s concept aimed at overall building lifecycles) that will be a legacy for the future. The projects are related to large-scale redevelopment in urban areas, semiconductors and automobiles.
- Facility Systems Business: New services for business line expansion under development in partnership with startup companies
- Machinery Systems Business: Developed and launched new products for the logistics market: Reverse Sorter (a compact, high-speed sorting device) and Meris Bianca (a conveyor robot)
- Environmental Systems Business: Strong global sales of AEROWING, an air diffuser for sewage treatment facilities

Development and launch of new products in the Machinery Systems Business for the logistics market

Source: The Company’s “Status of Business Progress in the Medium-Term Management Plan”

(2) Technology development

- Delivered an AI waste crane system to Clean Hill Tenzan
- Participated in the “FY2022 Demonstration Project for the Effectiveness of Decarbonized Resource Recycling Businesses Using Digital Technology” sponsored by the Ministry of the Environment
- Received an order for an energy-saving air dispersal system for a large-scale sewage treatment facility in Australia (which will also contribute to efficient protection of the marine environment)
- Selected for a feasibility study for the Breakthrough by Dynamic Approach in Sewage High Technology Project sponsored by the Ministry of Land, Infrastructure, Transport and Tourism (low-cost composting technology for ash from sewage sludge incineration)

(3) Sustainability

i) Environment

- Strengthened the SANKI YOU Eco Contribution Point system (entered into a forestation agreement with Wakayama and Shiga Prefectures)
- Selected as an A List company by the CDP*, which is a company with exceptional climate initiatives and disclosure practices
- Entered into an agreement to supply electricity from renewable energy (solar power) at the Sanki Techno Center and Yamato Product Center
- Continued to cooperate in efforts to protect the polar environment (Antarctica)
- Participated in the 30by30 Alliance for Biodiversity sponsored by the Ministry of the Environment

* The CDP is a UK-based non-governmental organization that was started in 2000. It evaluates the environmental initiatives of companies and groups based on their responses to a survey and discloses the information. Evaluations by the CDP are one of the criteria emphasized by investors when investing in companies.

ii) Society and human

- Continued to promote the “earthquake recovery project”
- Formulated and released the “Sanki Engineering Group Human Rights Policy”
- Introduced a new personnel system, extended the retirement age to 65, actively promoted young employees, and raised starting salaries
- Launched the new Career Return Program

iii) Governance

- Moved to the TSE’s Prime Market
- Reviewed officers’ compensation system and introduced restricted stock compensation
- Promoted diversity on the Board of Directors and elected Sanki Engineering’s first female Director

(4) Investments for the next era

- Conducted M&A aimed at BIM promotion
- Made the decision to build a new clean room at the Yamato Product Center for development of clean room-ready products
- Made investments in human capital, ICT and R&D. Positioned as investment for the future.
- Made capital investments for decarbonization based on Sanki’s Carbon-Neutral Declaration
- In FY3/23, invested a total of ¥3.2bn of a total four-year investment budget of ¥20.0bn
- Launched the Earth MIRAI Project to explore new technologies. Solicited ideas from employees in the second half of FY3/23 and received 122 submissions.

(5) Other topics

- Updated company uniforms and worked on creating comfortable working environments
- Aiming to boost recruitment activities through first-ever bus-wrap advertisement

Shareholder return policy

Proactive stance toward shareholder returns with dividend hikes and acquisition and retirement of treasury stock. Total return ratio of 91.6% (weighted average) over the past 10 years

The Company actively returns profits to shareholders. While its basic annual dividend was ¥15 through FY3/14, a change in profit structure prompted a dividend increase beginning in FY3/15. In FY3/20, the Company increased its dividend to ¥95 annually and then in FY3/21 it paid an annual dividend of ¥80, comprised of a regular dividend of ¥70 and an extra dividend of ¥10, in FY3/22 it paid an annual dividend of ¥85 (including an extra dividend of ¥15), and in FY3/23 it provided an annual dividend of ¥75 (payout ratio of 87.4%). For FY3/24, it is planning an annual dividend of ¥70 (payout ratio of 71.9%), but FISCO believes this could be increased if results for FY3/24 are upwardly revised.

Additionally, the Company actively acquires its own shares in the market and retires them. In FY3/20, it acquired 1,958,000 shares and retired 2,000,000 shares of treasury stock. In FY3/21, it acquired 1,000,000 shares and retired 1,000,000 shares of treasury stock. In FY3/22, it acquired 1,000,000 shares of treasury stock. In FY3/23, it acquired 1,500,000 shares and retired 1,500,000 shares of treasury stock. As a result, the Company's dividend payout ratio was 87.4% and a total return ratio of 136.4% in FY3/23. As a result, the total return ratio over the past ten years (weighed average of FY3/14 to FY3/23) was 91.6%.

Also, the Company actively responds to stakeholders other than shareholders. For the payment terms for partner companies, it had required entirely cash payments for partner companies with capital of less than ¥40.00mn from FY3/20, but recently it also shortened payment terms from 120 days to 60 days.

We at FISCO think the Company should be favorably assessed for its positive stance on shareholder returns and relationships with various stakeholders.

Shareholder returns

(¥mn)

	Acquisition of treasury stock			Total dividend amount (B)	Amount of shareholder returns (C)=(A)+(B)	Profit attributable to owners of parent
	Number of shares	Amount (A)				
FY3/23	1,500,000	2,347		4,132	6,479	4,750
FY3/22	1,000,000	1,438		4,773	6,211	6,489
FY3/21	1,000,000	1,171		4,568	5,739	5,901
FY3/20	1,958,000	2,899		5,543	8,442	7,576
FY3/19	1,000,000	1,191		3,595	4,786	9,046
FY3/18	3,000,000	3,679		2,136	5,815	3,906
FY3/17	0	0		1,906	1,906	4,698
FY3/16	0	0		1,906	1,906	5,327
FY3/15	2,000,000	1,604		1,270	2,874	2,461
FY3/14	4,000,000	2,408		983	3,391	1,763
			Total		47,549	51,917
			Total return ratio (weighed average)			91.6%

Source: Prepared by FISCO from the Company's financial results and Summary of Financial Results

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