SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange First Section

31-Aug.-2021

FISCO Ltd. Analyst
Noboru Terashima

FISCO Ltd.
https://www.fisco.co.jp

Index

Summary

A manufacturer specializing in road rollers for road paving and other road construction equipment. Its domestic market share is the highest in the industry at 70.4%, and it aims to grow by expanding its overseas market share

Sakai Heavy Industries, Ltd. <6358> (herein after also referred to as “the Company,” is a manufacturer specializing in road rollers for road paving and other road construction equipment, and has a long history in this field. It has the industry’s highest market share in Japan at 70.4%. In recent years, the Company has been focusing on developing overseas markets, especially in North America and Southeast Asia.

1. Outline of results for FY3/21

In the consolidated results for FY3/21, net sales declined 4.9% year on year (YoY) to ¥21,624mn, operating profit fell 26.9% YoY to ¥701mn, ordinary profit dropped 20.6% to ¥659mn, and profit attributable to owners of parent declined 99.1% to ¥4mn. The factor for the large drop in profit attributable to owners of parent was the reversal of ¥384mn in deferred tax assets at a North American operating subsidiary.

Net sales in Japan were on par with the previous fiscal year, but overall net sales declined due to the large drop in sales in North America and other regions due to the impact of the COVID-19 pandemic. Selling, general and administrative (“SG&A”) expenses declined YoY due to the reduction in general expenses as well as the decline in travel and networking/entertainment expenses in association with the COVID-19 pandemic. However, this was not enough to offset the 10.2% YoY decline in gross profit due to the decline in sales, ultimately leading to a YoY decline in operating profit. However, after 1H operating profit of ¥191mn, 2H operating profit increased to ¥509mn, so the recovery trend in 2H was clear.

2. Outlook for FY3/22

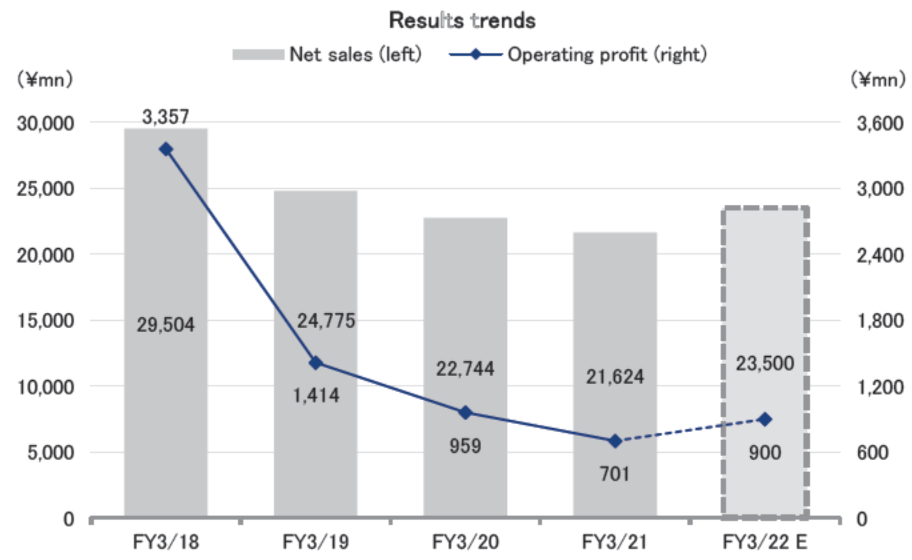
For FY3/22 consolidated results, the Company is forecasting net sales of ¥23,500mn (+8.7% YoY), operating profit of ¥900mn (+28.3%), ordinary profit of ¥800mn (+21.4%) and profit attributable to owners of parent of ¥520mn (versus ¥4mn in FY3/21). While the impacts of the COVID-19 pandemic remain uncertain, in Japan the Company expects demand related to civil engineering and roads to remain firm due to disaster prevention and mitigation efforts as well as the national resilience plan, among other factors. In the U.S., massive infrastructure upgrades under the American Jobs Act are being discussed, and a recovery is expected. In Asia, demand is recovering due to economic measures in China and ASEAN nations, and in Indonesia, where demand had been weak, a bottoming out is expected. As a result, despite expecting an increase YoY in SG&A expenses, the Company is forecasting an increase in operating profit in conjunction with higher sales.

3. Medium- to long-term growth strategy

In June 2021, the Company released its "Medium-Term Management Policy" which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this the Company will promote a "business growth strategy" and an "efficient capital strategy." In terms of numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, ROE of 8% in FY3/26, and will aim to maintain a stable dividend payout ratio of 50% (DOE of 4%). In line with this policy, the Company plans to pay an annual dividend of ¥120 (payout ratio = 99.5%) in FY3/22. In this way, it is commendable that the Company has released a clear capital policy targeting an improvement in ROE, and is carrying out shareholder returns in line with this policy.

Key Points

- Japan's leading manufacturer of road rollers with a long history. Domestic market share is 70.4%, and the Company aims to grow by expanding its overseas market share
- Domestic demand is firm, while overseas demand is recovering, so the Company is forecasting a 28.3% YoY increase in operating profit in FY3/22
- As medium-term numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26



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

Company profile

The top manufacturer of road rollers with a long history

The Company has a long history, dating back to 1918 when the Company was founded by Kinnosuke Sakai. At the time, the Company manufactured and repaired parts for automobiles, internal combustion engines, and steam locomotives. After starting to manufacture locomotives in 1927, in 1929 the Company started manufacturing road rollers for road rolling compaction. Since then, the Company has continued to develop as a specialized manufacturer of road rollers and other road construction equipment. Currently, the Company is the top manufacturer in Japan, with a 70.4% market share. In 1970, the Company established a joint venture in Indonesia, as part of the Company's effort to expand business overseas at an early stage. As of March 31, 2021, the Company has four domestic subsidiaries, and five overseas subsidiaries (U.S., China, three in Indonesia).

The Company listed its shares on the Second Section of the Tokyo Stock Exchange in 1964, and its shares were listed on the First Section of the Tokyo Stock Exchange in 1981.

History

Year	Description
1918	Founded by Kinnosuke Sakai with the aim of manufacturing and repairing parts for automobiles, internal combustion engines and steam locomotives
1927	Production of locomotives begins
1929	Starts producing road rollers for road rolling compaction
1949	Company is incorporated to establish SAKAI WORKS Co., Ltd.
1964	Listed on Second Section of Tokyo Stock Exchange
1967	Renamed SAKAI HEAVY INDUSTRIES, LTD.
1970	Joint venture, P.T. SAKAI SAKTI, established in Jakarta, Indonesia, to assemble and repair road rollers
1976	SAKAI AMERICA, INC. established in Delaware, U.S., for the purpose of importing/exporting and selling construction equipment
1981	Listed on First Section of Tokyo Stock Exchange
1996	Acquired ISO9001 certification, meeting international standards for quality assurance stipulated by the International Organization for Standardization
2004	Developed the world's first vibratory pneumatic tired roller (GW750)
2018	Celebrated its 100th anniversary
2019	Consolidated the three bases in Indonesia, including PT. SAKAI INDONESIA, and established a new factory in order to bolster the local production system targeting an expansion of overseas business domains and to build a supply platform to achieve medium- to long-term growth

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

Business overview

The top manufacturer of road rollers with a domestic market share of 70.4%. Will seek growth by offering high value-added and expanding overseas market share

1. Business description

The Company's main business is the manufacture and sale of road rollers used in road paving and other applications, and road roller-related net sales account for approximately 95% of all net sales. Also, the Company's corporate philosophy is to "Contribute to the social project of global land development through the road construction equipment business."

The term "road roller" actually covers quite a wide range of machines in terms of capabilities and size, among other features. The Company has roughly 20 platforms alone for road rollers, and when different variations are added the total number of products is in the 70-80 range. There is also a wide range in sizes, from one ton to 20 tons (for large civil engineering projects). The core price range is from ¥5mn (medium-size rollers) to ¥10mn (large rollers), but the Company also has road cutters and other machines that cost tens of millions in yen. Production is carried out on an expected production basis, and the Company does not manufacture machines based on individual orders. The useful lives of the Company's products are in the 20-30 year range, but very few customers use a machine until the end of its useful life. In most cases, they replace it after statutory depreciation (7-10 years) with a new one. Most of the depreciated equipment are resold as used machines to overseas customers (especially in developing countries).

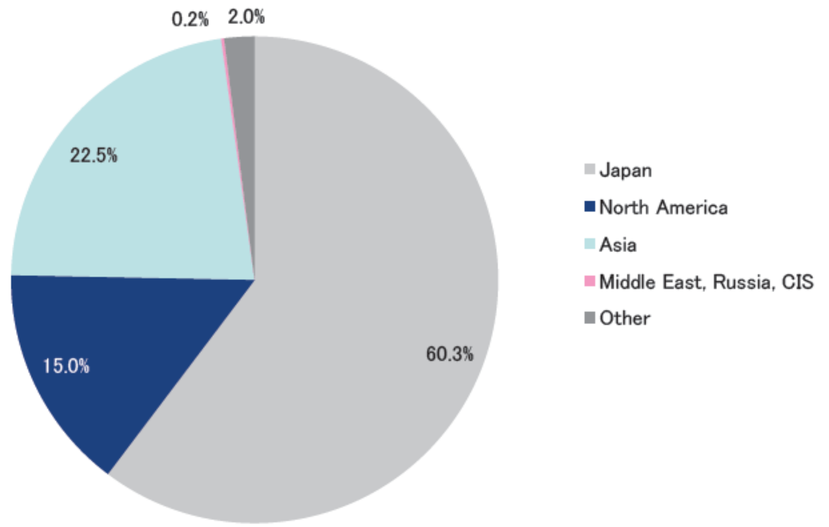
The Company's road equipment

Source: From the Company's Medium-Term Management Policy

In terms of net sales by region*, in FY3/21 net sales in Japan were ¥13,042mn (60.3% of total net sales), net sales in North America were ¥3,245mn (15.0%), net sales in Asia were ¥4,854mn (22.5%), net sales in the Middle East, Russia, and the CIS were ¥32mn (0.2%) and net sales to other markets totaled ¥449mn (2.0%).

* Net sales by region is the amount of products actually sold to customers, and differs from the reportable segment "Net Sales by Location" in the financial results.

Ratio of net sales by region in FY3/21



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

In Japan, approximately 60% of the Company's sales are to construction equipment rental companies (Kanamoto Co., Ltd. <9678>, NISHIO RENT ALL CO., LTD. <9699>, etc.), while the remaining 40% of sales are to end users (large and small- and medium-sized general contractors, roadwork companies, etc.). Sales to end users include sales via finance companies due to credit management issues. Overseas, sales are mainly to end users via distributors, but in North America some sales are through rental companies.

2. Characteristics and strengths

As mentioned above, the Company is a specialized manufacturer of road rollers and other road construction equipment, and the Company has the following special characteristics and strengths.

(1) Long history as a specialized manufacturer

The Company's greatest strength is its long history as a specialized manufacturer of road rollers and other road construction equipment. In other words, by deploying a global niche strategy through selection and concentration the Company has increased its level of expertise and accumulated its own unique technologies. Based on this long history and its experience, the Company has boosted its technological capabilities and credibility as follows.

(2) Technological capabilities

When it comes to hardening and paving roads, the necessary pressure, torque, and other variables (compaction technology) differ depending on the specific land, land quality, soil, and other conditions. Therefore, roadwork companies often require different types of road rollers to match individual worksites (ground, etc.). According to the Company, the work function of a road roller itself determines the final quality of the road or embankment (density, flatness, lifespan). Generally speaking, a 1% rise in rolling compaction density extends the life of a road by 10%. For this reason, for companies that order roadwork as well as for roadwork companies, not only the price of the road roller, but the product quality (performance) is extremely important. Because the Company has been a specialized manufacturer of road roller and other road construction equipment for many years, it boasts a high level of technological capabilities with respect to compaction technology, and it is not easy for its competitors to catch up to it.

The Company's technological capabilities can be summed up by the word “Insight.” In other words, it is the Company's engineering capabilities covering the entire roadwork process and the ability to handle a variety of materials. Specifically, combining the various technologies makes it possible to increase the quality and efficiency of roadwork. Such technologies include kneading by tires, increased rolling compaction power by vertical vibration, rubbing by horizontal vibration, thick layer compaction by vertical vibration, further high-density compaction by tire vibration, and eliminating difficult compaction issues with high-frequency vibration.

One example of the Company's strong technological capabilities is its ability to control the relationship between mechanical vibration technology and the technology to prevent this vibration. For road rollers, one important means of increasing functionality is various mechanical vibrations, but on the other hand, vibration itself can cause machine failure, and it also greatly influences operator comfort. Therefore, the ability (technology) to control the opposing relationship between enhancing vibration compaction power and machine quality is important, and this is not something that can be amassed quickly.

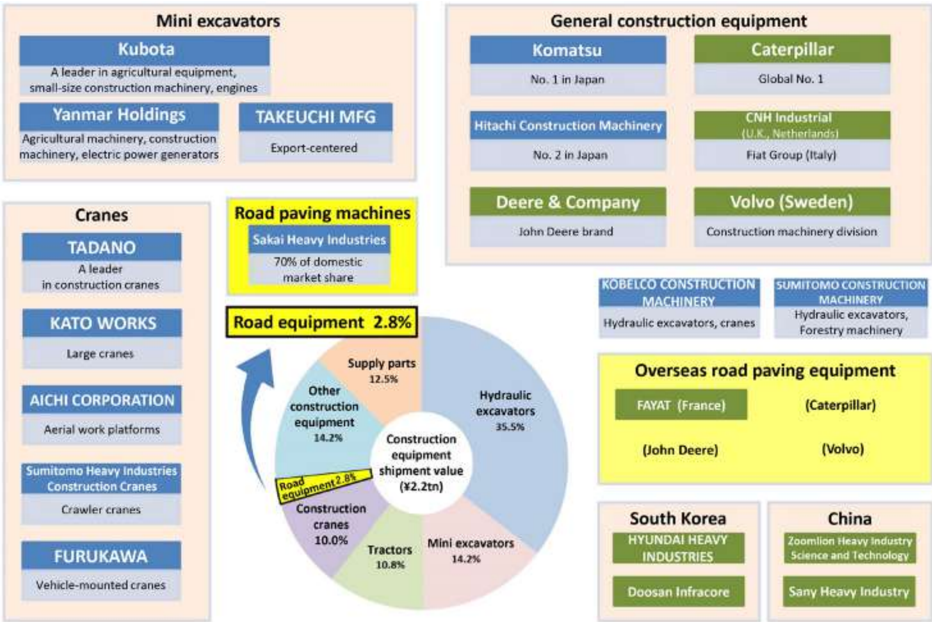
(3) Credibility

Credibility backed by experience engineering and track record is also a strength of the Company. The technology to ensure underground compaction quality is a black box, and is not something that is easy for late-arriving manufacturers and non-specialized manufacturers to copy. For example, asphalt mixture brought in at high temperatures must be worked with within a limited time, and if the work is of poor quality, it must be redone which involves a large price. Also, work quality issues for roads and embankments are slow to emerge, and the compaction quality at the time that work is completed tends to be a black box. For this type of experience engineering, the Company's brand which customers have used for many years and the long-term insight due to variety of worksite experiences are strengths, and these are points that have earned the trust of many customers.

3. Market share and competitors

According to data from the Japan Construction Equipment Manufacturers Association, in FY2020 domestic construction equipment shipment value was ¥2.2tn, and road roller and other road construction equipment (the Company's main products) account for 2.8% of this amount. The Company has a 70.4% share of this road equipment market, making it the top manufacturer in Japan. Competitors include companies such as Hitachi Construction Machinery Co., Ltd. <6305>, but none of these companies are specialized manufacturers. Some overseas manufacturers have entered the market in Japan, but none have much of a presence. In Japan, the Company's earnings rise and fall along with the ups and downs of the market.

Construction equipment industry



Note: Prepared by FISCO from Japan Construction Equipment Manufacturers Association FY2020 data
Source: The Company's results briefing materials

In the global market, although there are no accurate statistics, the Company's market share (on a units produced basis) is estimated to be in the 6-7% range. However, this is on a global basis, and if we limit the scope to the main markets that the Company operates in (Japan, ASEAN, North America), the Company's market share is around 20%. The Company's main competitors in the global market include Caterpillar <CAT>, FAYAT, Deere <DE>, and Volvo, but none of these companies are manufacturers that specialize in road rollers.

Results trends

The FY3/21 declines in sales and profits due to the impacts of the COVID-19 pandemic were within the range of what was expected, and there was a strong recovery trend from 2H

1. Outline of results for FY3/21

In the consolidated results for FY3/21, net sales declined 4.9% year on year (YoY) to ¥21,624mn, operating profit fell 26.9% YoY to ¥701mn, ordinary profit dropped 20.6% to ¥659mn, and profit attributable to owners of parent declined 99.1% to ¥4mn.

Net sales in Japan were on par with the previous fiscal year, but overall net sales declined due to the large drop in sales in North America and other regions due to the impact of the COVID-19 pandemic. The gross margin declined 1.5pp YoY to 25.0%, but this was due to the change in the product mix. SG&A expenses declined 7.1% YoY due to the reduction in general expenses as well as the decline in business travel and networking/entertainment expenses as a result of the COVID-19 pandemic. However, this was not enough to offset the 10.2% YoY decline in gross profit due to the decline in sales, ultimately leading to a YoY decline in operating profit. However, after 1H operating profit of ¥191mn, 2H operating profit increased to ¥509mn, so the recovery trend in 2H was clear. The factor for the large drop in profit attributable to owners of parent was the reversal of ¥384mn in deferred tax assets at a North American operating subsidiary.

Analyzing the change factors for ordinary income, the decline in sales had a minus ¥297mn impact, the increase in the cost of goods sold had an impact of minus ¥320mn, the decline in SG&A expenses had an in impact of plus ¥357mn, the decline in interest paid had a positive impact of ¥45mn, and the improvement in other non-operating income had a positive impact of ¥42mn.

Overview of FY3/21 consolidated results

(¥mn)

	FY3/20		FY3/21		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	22,744	100.0%	21,624	100.0%	-1,120	-4.9%
Gross profit	6,025	26.5%	5,408	25.0%	-616	-10.2%
Selling, general and administrative expenses	5,065	22.3%	4,707	21.8%	-357	-7.1%
Operating profit	959	4.2%	701	3.2%	-258	-26.9%
Ordinary profit	829	3.6%	659	3.0%	-170	-20.6%
Profit attributable to owners of parent	470	2.1%	4	0.0%	-466	-99.1%

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

2. Trends by region

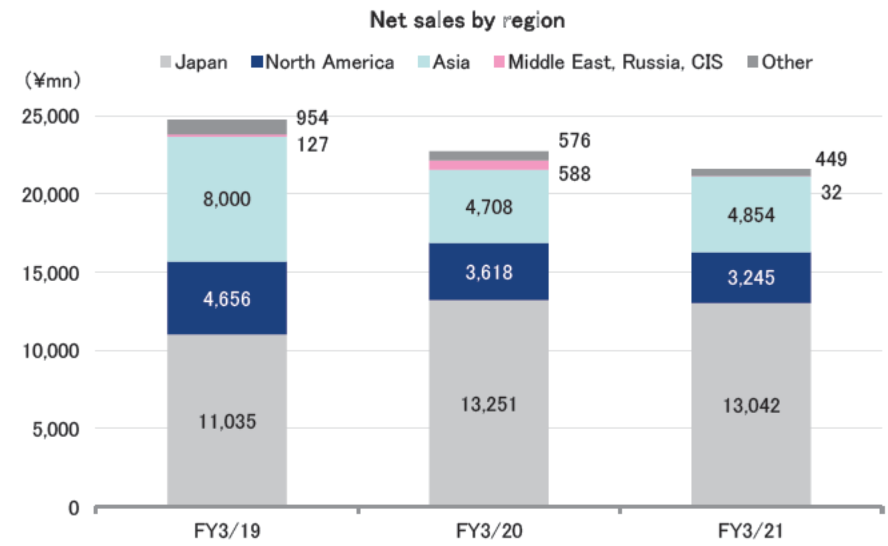
In looking at FY3/21 sales by region, on the whole, sales were greatly impacted by the COVID-19 pandemic. In Japan, net sales were ¥13,042mn (down 1.6% YoY), as a result of relatively solid execution of road and civil engineering projects, despite impacts from COVID-19. Net sales in North America were ¥3,245mn (down 10.3%), as the impact from COVID-19 was particularly large in 1H. Net sales in Asia were ¥4,854mn (up 3.1%), as despite impacts from the COVID-19 pandemic, demand recovered in Thailand, Vietnam, South Korea and China. However, the local subsidiaries and plants in Indonesia were significantly impacted by the COVID-19 pandemic (although there are signs of the dip bottoming out in 2H). Net sales in the Middle East, Russia, and the CIS dropped to ¥32mn (down 94.5%), and net sales to other markets were ¥449mn (down 22.0%).

Net sales by region

(¥mn)

	FY3/19		FY3/20		FY3/21		Change	
	Results	% of total	Results	% of total	Results	% of total	Amount	%
Japan	11,035	44.5%	13,251	58.3%	13,042	60.3%	-209	-1.6%
North America	4,656	18.8%	3,618	15.9%	3,245	15.0%	-373	-10.3%
Asia	8,000	32.3%	4,708	20.7%	4,854	22.5%	145	3.1%
Middle East, Russia, CIS	127	0.5%	588	2.6%	32	0.2%	-556	-94.5%
Other	954	3.9%	576	2.5%	449	2.0%	-126	-22.0%

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



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

Stable financial condition, ample cash and deposits of ¥6,983mn

3. Financial condition

In terms of the Company's financial condition as of March 31, 2021, current assets were ¥22,927mn (down ¥658mn from the end of the previous fiscal year). The main factors included a ¥228mn increase in cash and deposits, a ¥1,707mn increase in notes and accounts receivable – trade, and a ¥2,502mn decrease in inventory assets. Non-current assets were ¥12,173mn (up ¥311mn). The main factors included a ¥458mn increase in investments and other assets. As a result, total assets were ¥35,101mn (down ¥347mn YoY).

Meanwhile, total liabilities were ¥13,062mn (down ¥465mn YoY). The main factors among current liabilities included a ¥169mn decline in payables (notes and accounts payable – trade and electronically recorded obligations – operating) and a ¥476mn increase in short-term borrowings. Among non-current liabilities, the main factors included a ¥804mn decrease in long-term borrowings and a ¥260mn increase in deferred tax liabilities. Total net assets stood at ¥22,038mn (up ¥118mn YoY), with the main factors including a ¥339mn decline retained earnings due to dividend payments and a ¥653mn increase in valuation difference on available-for-sale securities. As a result, the equity ratio as of March 31, 2021, was 62.7% (versus 61.7% at the end of the previous fiscal year).

Consolidated balance sheet

(¥mn)

	End-FY3/20	End-FY3/21	Change
Cash and deposits	6,755	6,983	228
Notes and accounts receivable – trade	6,251	7,959	1,707
Inventory assets	9,553	7,050	-2,502
Total current assets	23,586	22,927	-658
Non-current assets	6,816	6,725	-90
Property, plant and equipment	613	557	-55
Investments and other assets	4,431	4,889	458
Total non-current assets	11,861	12,173	311
Total assets	35,448	35,101	-347
Notes and accounts payable – trade (including electronically recorded obligations –operating)	4,858	4,688	-169
Short-term borrowings	4,628	5,105	476
Total current liabilities	11,455	11,488	32
Long-term borrowings	1,232	428	-804
Deferred tax liabilities	222	483	260
Total non-current liabilities	2,073	1,574	-498
Total liabilities	13,528	13,062	-465
Retained earnings	11,109	10,769	-339
Valuation difference on available-for-sale securities	1,079	1,732	653
Total net assets	21,919	22,038	118

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

4. Cash flows

In FY3/21, net cash provided by operating activities was ¥1,525mn. The main revenue factors included ¥703mn in profit before income taxes, ¥637mn in depreciation, and ¥2,456mn from decrease in inventories. The main expenditure factors included ¥1,717mn in increase in trade receivables and ¥143mn in decrease in trade payables.

Net cash used in investing activities was ¥508mn. This was mainly due to ¥546mn in expenditure from the purchase of property, plant and equipment. Net cash used in financing activities was ¥812mn. The main expenditures were ¥340mn from the decrease (net) in long-term borrowings, and ¥343mn in dividends paid. As a result, cash and cash equivalents increased ¥164mn from the end of the previous fiscal year, and the balance of cash and cash equivalents at the end of FY3/21 was ¥6,847mn.

Consolidated statements of cash flows

(¥mn)

	FY3/20	FY3/21
Net cash provided by (used in) operating activities	3,448	1,525
Profit before income taxes	850	703
Depreciation	587	637
Change in trade receivables (- denotes increase)	1,639	-1,717
Change in inventories (- denotes increase)	259	2,456
Change in trade payables (- denotes decrease)	-30	-143
Net cash provided by (used in) investing activities	-825	-508
Net cash provided by (used in) financing activities	-226	-812
Change in long-term borrowings (net)	302	-340
Dividends paid	-427	-343
Change in cash and cash equivalents	2,391	164
Cash and cash equivalents at end of FY3/21	6,682	6,847

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

Outlook

Domestic demand is firm, while overseas demand is recovering, so the Company is forecasting an 8.7% YoY increase in net sales and a 28.3% increase in operating profit in FY3/22

● Outlook for FY3/22

For FY3/22 consolidated results, the Company is forecasting net sales of ¥23,500mn (+8.7% YoY), operating profit of ¥900mn (+28.3%), ordinary profit of ¥800mn (+21.4%) and profit attributable to owners of parent of ¥520mn (versus ¥4mn in FY3/21).

While the impacts of the COVID-19 pandemic remain uncertain, in Japan the Company expects demand related to civil engineering and roads to remain firm due to factors including the government's ¥15tn national resilience plan to speed up countermeasures for disaster prevention and mitigation. In the U.S., massive infrastructure upgrades under the American Jobs Act, which will invest US$2.25tn over an eight-year period are being discussed, and a recovery is expected. In Asia, demand is recovering due to economic measures in China and ASEAN nations, and in Indonesia, where demand had been weak, a bottoming out is expected. As a result, despite expecting an increase YoY in SG&A expenses, the Company is forecasting an increase in operating profit in conjunction with higher sales.

Consolidated outlook for FY3/22

(¥mn)

	FY3/21		FY3/22		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	21,624	100.0%	23,500	100.0%	1,875	8.7%
Operating profit	701	3.2%	900	3.8%	198	28.3%
Ordinary profit	659	3.0%	800	3.4%	140	21.4%
Profit attributable to owners of parent	4	0.0%	520	2.2%	515	-

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

Medium- to long-term growth strategy

As its medium-term growth strategy, the Company will seek to create added value by growing its overseas market share, expanding overseas business domains, and developing next-generation businesses. FY3/26 targets include net sales of ¥30bn and operating profit of ¥3.1bn

In June 2021, the Company released its "Medium-Term Management Policy" which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this the Company will promote a "business growth strategy" and an "efficient capital strategy." In terms of numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, ROE of 8% in FY3/26, and will aim to maintain a stable dividend payout ratio of 50% (DOE of 4%).

1. Business strategy

(1) Domestic market: Create added value through stabilization and developing next-generation businesses

The domestic market for road rollers is already in its mature phase and the Company's market share is large. Therefore, the Company will aim to grow by adding new value to existing products (high-performance, etc.), in other words, by developing next-generation businesses. Specifically, the Company plans to do the following.

a) To enhance safety, the Company will horizontally roll out models equipped with automatic emergency brake systems. This performs an emergency stop of operating equipment if a person or obstacle is in the movement path of the equipment. This function has already been added to the main models in Japan (approximately 30% of orders are for equipment with emergency braking), and the Company is horizontally rolling out this function in more models.

b) The Company aims to improve compaction quality with a rolling compaction management system (with CCV). This system remotely links work managers with worksites, allowing compaction quality to be confirmed and managed (e.g., number of rolling compactions) in real time. With the certification of acceleration response-type compaction density management in Ministry of Land, Infrastructure, Transport and Tourism ICT roadbed work, this will contribute to the major streamlining of compaction density inspections.

c) The Company aims to improve productivity by commercializing autonomous (unmanned) driving rollers. In the autonomous driving standard equipment development project, the Company is advancing commercialization through worksite implementation testing with multiple general contractors. Specifically, through unmanned construction work, the Company aims to create safe worksites, improve productivity through efficient compaction operations, and stabilize and improve quality, independent of operator skill.

(2) Overseas markets: Increase market share and expand business domains

In overseas markets, there are many regions (countries) where demand is increasing, and there is significant room for growth given the Company's low market shares. Therefore, the Company will seek growth through the two strategies of more fully cultivating existing markets and expanding its business domains.

a) In the Southeast Asia market, the Company will aim to cultivate markets more fully and expand its product domains. Specifically, the Company will enhance its Indonesia site, where a new factory started to operate in 2019, as a core location for sales, manufacturing, and service directed at the ASEAN region.

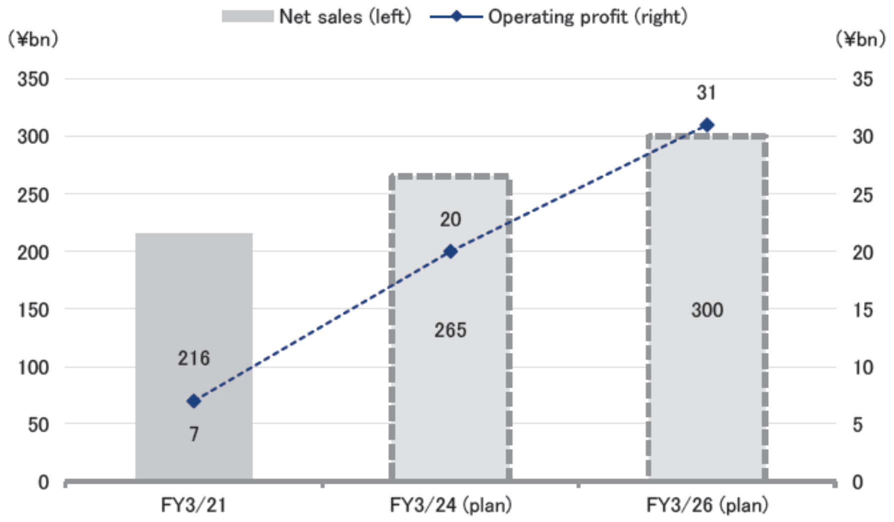
b) In North America, aiming to expand its market share, the Company will strengthen its North America logistics strategy and advance measures to increase its market share. Specifically, the Company will seek to expand its market share through the niche marketing strategy based on the Lanchester/Blue Ocean strategy and through engineering sales focused on improved pavement quality.

c) Aiming to expand overseas business domains, the Company will promote a strategy of cultivating markets for road maintenance machinery in ASEAN markets and ODA, along with other markets.

(3) Numerical targets

As medium- and long-term numerical targets, the Company aims for net sales of ¥26.5bn, operating profit of ¥2.0bn, and ROE of 5.5% in FY3/24, and net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.

Medium-and long-term targets



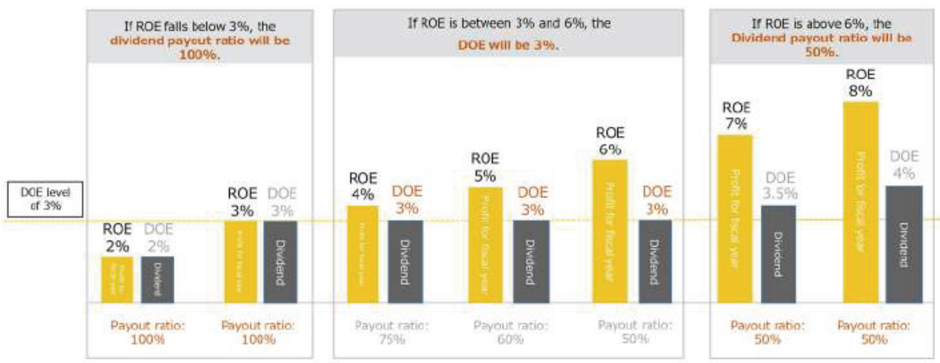
Source: Prepared by FISCO from the Company's Medium-Term Management Policy

2. Capital Strategy

As its basic policy for capital strategy, the Company will return profits to shareholders at a level that supports the Company's objective of ROE of 8%, and will increase shareholder value (improve capital efficiency). As a final target for FY3/26, the Company will strive to achieve ROE of 8% and a 50% dividend payout ratio. This would be DOE (ratio of dividends to equity) of 4%.

Generally, two things need to be improved in order to increase ROE. One is of course increasing profit attributable to owners of parent, while the other is suppressing shareholders' equity (not increasing shareholders' equity more than necessary). In order to increase operating profit, the Company plans to promote the business strategies discussed above, but at the same time, in order to keep from increasing shareholders' equity more than needed, the Company plans to execute a dividend policy in which, if ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%.

Basic capital policy approach



Source: Medium-Term Management Policy

In terms of share buybacks, through FY3/26 the Company will consider flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn. With respect to investment securities, the Company will review investment securities from the perspective of business strategy. Also, concerning growth investment, the Company will consider utilizing leverage with an emphasis on return on capital (ROIC).

Shareholder return policy

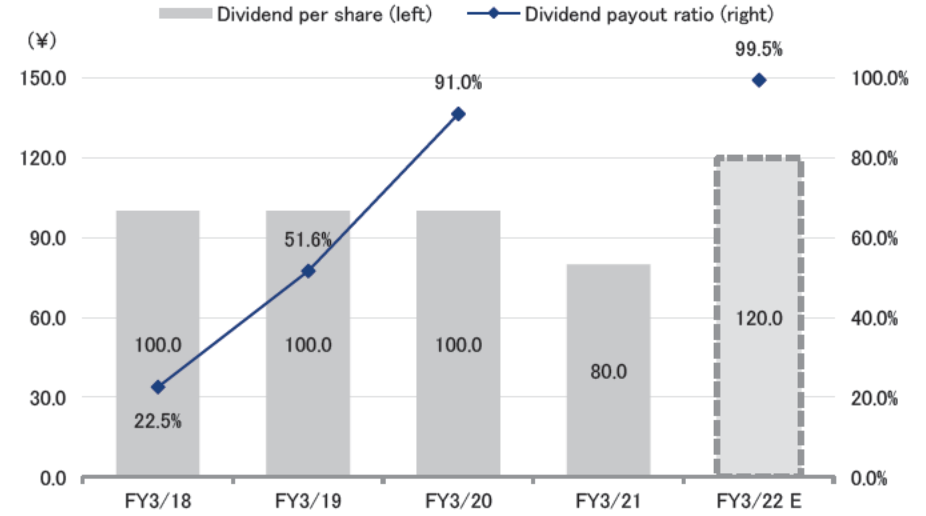
The Company plans to pay a ¥120.0 annual dividend (up ¥40.0 YoY) in FY3/22 (dividend payout ratio of 99.5%)

The Company works to secure a stable management base over the long term, and also places importance on the continuation of stable dividends, and makes it a basic policy to distribute results that are supported by business performance and a sound financial structure. Based on this basic policy, the Company decides dividends and conducts share buybacks. As discussed above, the Company's medium-term shareholder return policy is as follows. If ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%. With respect to share buybacks, the Company is considering flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn by FY3/26.

The Company paid an annual dividend of ¥100.0 in FY3/20, and an annual dividend of ¥80.0 in FY3/21. For FY3/22, the Company plans to pay a dividend of ¥120.0 (dividend payout ratio of 99.5%). Concerning share buybacks, the Company has announced that it will buy back up to a maximum of 130,000 shares (¥500mn) by December 2021.

The Company's stance of announcing a clear plan to improve ROE and carrying out shareholder return plans in line with that plan is commendable.

Dividend per share and dividend payout ratio



Note: The Company consolidated ten shares into one share effective October 1, 2017. Figures for FY3/18 have been revised retroactively.
FY3/21 dividend payout ratio is not shown due to the fact that it was 8,602.2%.
Source: Prepared by FISCO from the Company's financial results

Disclaimer

■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp