06

FY 2022 Business Summary and FY 2023 Outlook

FY 2022 Construction investment overview

Steady investment by the private sector, while public investment continues to stagnate

In FY 2022 (fiscal year ended March 2023), construction investment in Japan (nominal value) is expected to have increased 1.5% compared with the previous fiscal year to 68.79 trillion yen. While it is 82% of the record 84 trillion yen of FY 1992, there has been a steady expansion from the bottom of 42 trillion yen recorded in FY 2010. Breakdown of the investment shows that private construction investment, which accounts for 65% of the investment, is expected to have risen 1.8% to 44.54 trillion yen, while government investment, which accounts for the remaining 35%, is expected to have increased 0.9% to 24.25 trillion yen.

By region, investment in Hokkaido is expected to have risen 11.4%, Hokuriku 3.6%, Chubu 3.8%, Kinki 5.6%, Chugoku 6.9%, and Kyushu 2.8%, while that in Tohoku probably fell 3.9%, Kanto 1.0%, Shikoku 6.2%, and Okinawa 15.3%. Construction investment in Hokkaido turned positive for the first time in two years and that in regions from Hokuriku to Chubu, Kinki, and Shikoku are on a stable expansion track. By contrast, there appears to be a lull in Tohoku and Kanto, which had led construction investment in the past. In recent years, some construction projects are being delayed or postponed citing soaring prices of various construction materials, labor shortage, and heat waves in summer.

Labor shortage in construction industry and workstyle reform bill bolster investment in automation and manpower saving

While construction investments grew on one hand, the number of workers in the construction industry decreased on the other by 1.2% from a year earlier to 4.79 million people in 2022, falling to 70% of the 1997 peak of 6.85 million. Of that, those above 55 years in age accounted for a record 35.9% (in comparison, it was 24% in 2001 and 33% in 2010). With construction investment expected to remain steady, the decline in the number of workers in the industry coupled with their aging is becoming a structural issue in the medium- to long- term. On top of this, the workstyle reform bill for the construction industry will take effect in April 2024. It is expected to facilitate the introduction of five-day workweek in the industry and the evolution of i-Construction for productivity improvement while expanding the need for automation and labor-saving of mobile plants and other construction machinery as well as asphalt plants and concrete plants.

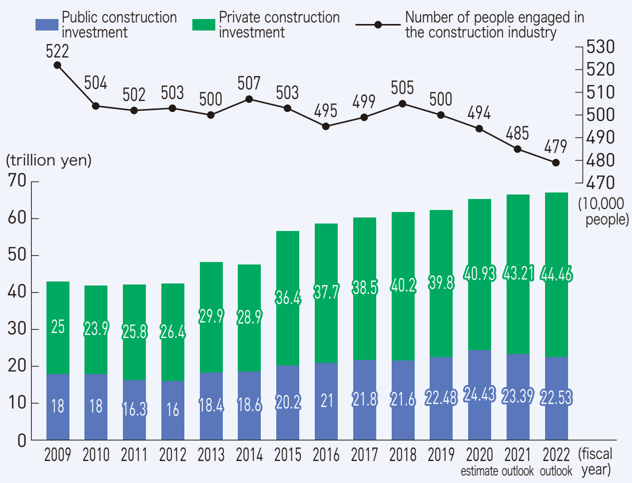
Business performance in FY 2022

The results for the first fiscal year of the Medium-Term Management Plan fell short of the plan

In FY 2022, new orders and net sales at Nikko Group were steady, with the former increasing 2.5% to 40,849 million yen compared with a year earlier and the latter rising 2.1% to 39,665 million yen, and BB ratio (new orders received / net sales) came to 1.03 times. As a result, order backlog at the end of the fiscal year increased 7.1% to 17,656 million yen (about 5.3 months' worth of the annual sales). Despite increased revenues, operating income decreased 49.9% year on year to 1,028 million yen, and operating margin also fell 2.7 pp to 2.6%. The main factors for the profit decline are an increase in expenses intended to enhance human capital, loss on valuation of inventory at Nikko Nilkhosol Co., Ltd., a Thai consolidated subsidiary, an increase in selling, general and administrative expenses including R&D expenses and costs of holding Nikko Messe, and a decline in net sales of maintenance service. Ordinary income fell 44.8% from a year earlier to 1,255 million yen partly due to recording of foreign exchange gains. Net income attributable to owners of parent declined 38.1% from a year earlier to 1,020 million yen, partly reflecting the 564 million yen in proceeds from sale of investment securities recorded as an extraordinary income.

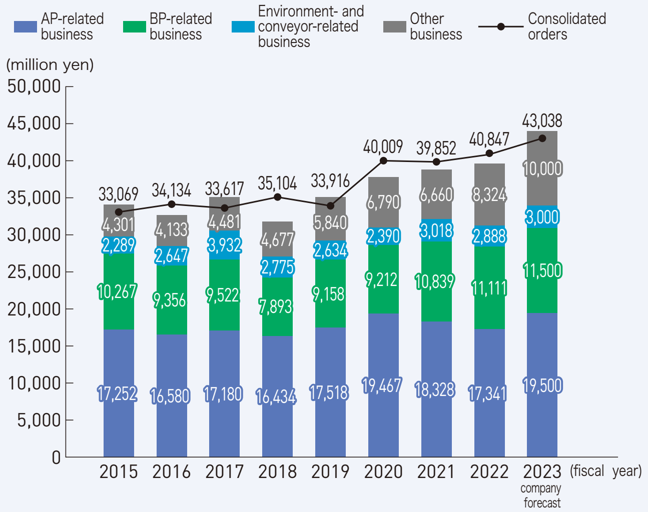
FY 2022 was the first fiscal year of the three-year Medium-Term Management Plan, and both net income and operating income results fell short of the plan (net income plan: 42.0 billion yen → result: 39.6 billion yen; operating income plan: 2.3 billion yen → result: 1.0 billion yen. Particularly, the increase in asphalt price caused by the rise in heavy oil price accelerated the deterioration in business performance of road pavement companies, which subsequently postponed asphalt plant-related capital investment, causing the downward swing in earnings at the Group.

● Amount of construction investment and number of people engaged in the construction industry



Note: The number of people engaged in the industry is on a calendar year basis and its source is the *Construction Handbook*.

● Net sales by segment and consolidated orders



Shareholder returns

Dividend payment for payout ratio of 112.5%, which exceeds pledged ratio of 60% or higher

Regarding shareholder returns, the dividend of 30 yen per share (mid-term dividend of 15 yen and year-end dividend of 15 yen), which translates to a dividend payout ratio of 112.5% given the 1,020 million yen in net income attributable to owners of parent (26.67 yen per share). The payout ratio exceeded the target of 60% or higher presented in the Medium-Term Management Plan.

Business overview by segment

Businesses other than AP-related business posted steady results in general

In the AP-related business, new orders in FY 2022 declined 3.1% from a year earlier to 17,614 million yen, net sales fell 5.4% to 17,341 million yen, while BB ratio, derived by dividing orders with net sales, came to 1.01. Some large-scale projects were postponed in Japan, while orders were stagnant in Thailand. In terms of net sales, overseas net sales grew 30.3%, but net sales of products in Japan decreased 28.8% and those of maintenance services also fell 11.4%. Order backlog at the end of fiscal year was 7,998 billion yen (5.5 months' worth of net sales for the fiscal year). In the meantime, operating income of the business decreased 91.3% year on year to 49 million yen, and operating margin fell 2.8 pp to 0.3%. The large profit decline was unavoidable given the soaring prices of supplies, investment burden in Thailand, and an increase in personnel expenses among other reasons.

The BP-related business recorded new orders of 11,461 million yen, down 5.2% year on year, and its net sales were steady at 11,111 million yen, up 2.5% year on year. The business's BB ratio came to 1.03 times, stably maintaining ratio of 1. While the volume of ready-mixed concrete shipment was weak, down 2.2% in FY 2022, the market is maintaining a high level and users' appetite for investment continues to be high. Order backlog at the end of the fiscal year increased 6.1% to 6,105 million yen (6.5 months' worth of net sales for fiscal year). However, operating income of the business decreased 9.4% year on year to 1,017 million yen, and operating margin also fell 1.2 pp to 9.2%. Low profitability of some unit products reflecting soaring raw material prices temporarily pushed down profits.

In the environment- and conveyor-related business, new orders declined 18.5% year on year to 2,456 million yen, net sales fell 4.3% year on year to 2,888 million yen, and order backlog totaled 182 million yen. Delivery of coke drying system, for which the Group received order in the previous fiscal year, required manpower, which led to subdued order and sales activities. While operating income decreased 11.2% year on year to 522 million yen, and operating margin fell 1.4 pp to 18.1%, the business is maintaining a high profitability.

In the other business, new orders increased 41.8% year on year to 9,316 million yen and net sales rose 25.0% to 8,324 million yen. Order backlog also increased significantly by 41.7% to 3,369 billion yen (4.8 months' worth of net sales for fiscal year). Orders for and sales of mobile plants, which account for 22% of net sales, expanded steadily. By contrast, net sales of waterproof boards, which had been strong, fell 27.8% and are entering the adjustment phase. Operating income of the other business decreased 2.7% year on year to 1,044 million yen owing mainly to the sales decline of waterproof boards and operating margin fell 3.6 pp to 12.5%.

ROE and ROIC

Decline in net income had an impact despite the progress in reducing net assets

ROE in FY 2022 declined 2.0 pp to 3.2% from a year earlier, falling short of 4.9%, the plan. Net assets declined 399 million yen year on year to 31,604 million yen (average net assets for the past two fiscal year were 31,827 million yen) as the Group made progress in reducing them, while net income attributable to owners of parent remained at 1,020 million yen, falling short of the plan. Return on invested capital (ROIC) declined 2.3 pp to 1.3% from a year earlier. NOPAT (operating income subtracted by income taxes) fell 791 million yen year on year to 277 million yen, while invested capital rose 1,855 million yen to 35,760 million yen as interest-bearing debts increased.

Financial position

Net cash status maintained

Net assets as of the end of FY 2022 increased 48 million yen year on year to 52,127 million yen. Net assets as of the end of FY 2022 totaled 31,604 million yen, down 446 million yen, and equity excluding non-controlling interests of -40 million yen was 31,644 million yen, which resulted in equity ratio of 60.7, derived by dividing equity with total assets, down 0.8 pp from a year earlier. Current assets came to 33,723 million yen, and non-current assets totaled 18,404 million yen. Main items that increased include notes and accounts receivable-trade including electronically recorded monetary claims, which rose 203 million yen to 11,235 million, inventory, which increased 1,219 million yen to 10,874 million yen, and property, plant and equipment, which increased 1,170 million yen to 11,839 million yen. Main items that decreased include cash and cash equivalents, which fell 2,118 million yen to 10,317 million yen, and investment securities, which declined 848 million yen to 3,488 million yen.

Current liabilities were 15,338 million yen, and non-current liabilities were 5,184 million yen. Main items that increased include interest-bearing debts, which were up 1,949 million yen from a year earlier to 5,761 million yen. Main items that declined include contract liabilities, which fell 691 million yen year on year to 3,713 million yen, and accounts payable-factoring, which decreased 428 million yen to 2,355 million yen.

Cash and cash equivalents as of the end of FY 2022 declined 2,119 million yen from a year earlier to 10,317 million yen and net cash derived by subtracting interest-bearing debts of 5,761 million yen from cash and cash equivalents came to 4,556 million yen (8,624 million yen as of the end of FY 2021).

Cash flows

FCF became negative, while cash remained at a high level

Cash used in operating activities totaled 1,644 million yen, down 3,868 million yen. While depreciation and amortization increased 199 million yen year on year to 944 million yen, net income before income taxes declined 906 million yen to 1,693 million yen, inventories increased 1,156 million, gain on sale and valuation of investment securities came to 564 million yen, and contract liabilities declined 708 million yen.

Cash used in investing activities totaled 1,226 million yen, down 939 million yen. Main factors include expenditure of 2,174 million yen for purchase of property, plant and equipment and intangible assets and proceeds from sales and redemption of investment securities of 1,002 million yen. As a result, free cash flow derived by subtracting investing cash flow from operating cash flow came to negative 2,870 million yen, compared with 59 million yen in FY 2021.

Cash used in financing activities totaled 710 million yen. Main items included a 968 million yen increase in short-term loans payable and 1,084 million yen in proceeds from long-term loans payable as well as 1,147 million yen in cash dividends paid. The balance of cash and cash equivalents at the end of FY 2022 was 10,270 million yen, down 2,119 million yen from a year ago.

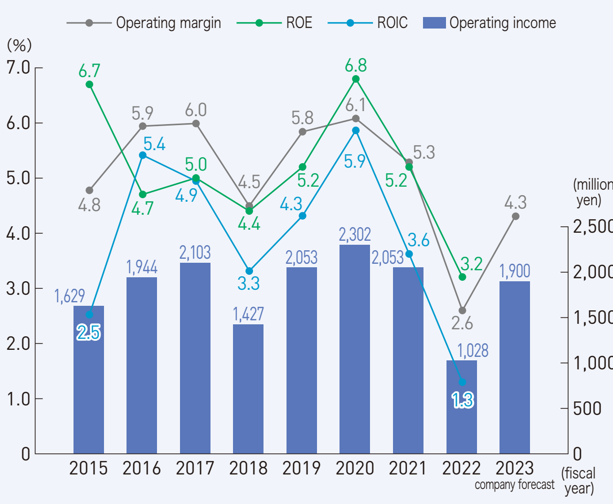
FY 2023 performance outlook

FY 2023 financial results to be dependent more on second half than usual

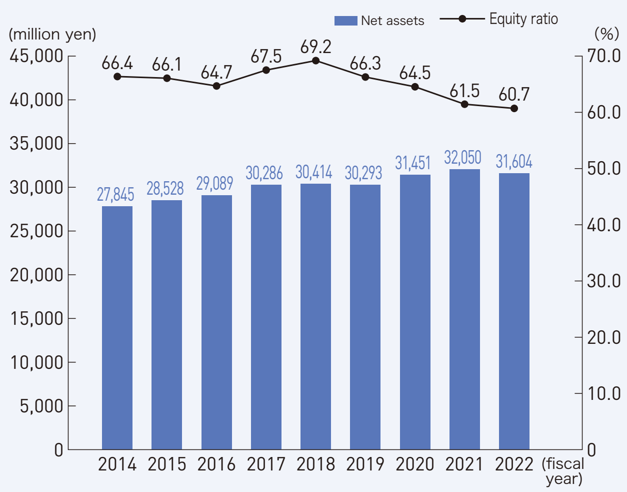
FY 2023 (fiscal year ending March 2024) is the second fiscal year of the Medium-Term Management Plan, whose final fiscal year is FY 2024 (fiscal year ending March 2025). In the final fiscal year of the plan, Nikko Group expects net sales of 50,000 million yen, operating income of 3,000 million yen, and operating margin of 6.0%. For FY 2023, it expects orders to increase 5.3% from a year earlier to 43,000 million yen and net sales to rise 10.9% to 44,000 million yen. It expects operating income to increase by 84.8% to 1,900 million yen with operating margin of 4.3%, net income per share of 31.36 yen, and dividend of 30 yen per share (payout ratio of 95.7%).

When broken down, it assumes net sales of 17,000 million yen in the first half and 27,000 million yen in the second half; operating income of 50 million yen in the first half (operating margin of 0.2%) and 1,850 million yen in the second half (operating margin of 6.8%). In the second half, the Group expects to record sales from the projects that have been delayed from the first half and it also anticipates the impact from raising product prices and a recovery in sales of highly profitable maintenance services.

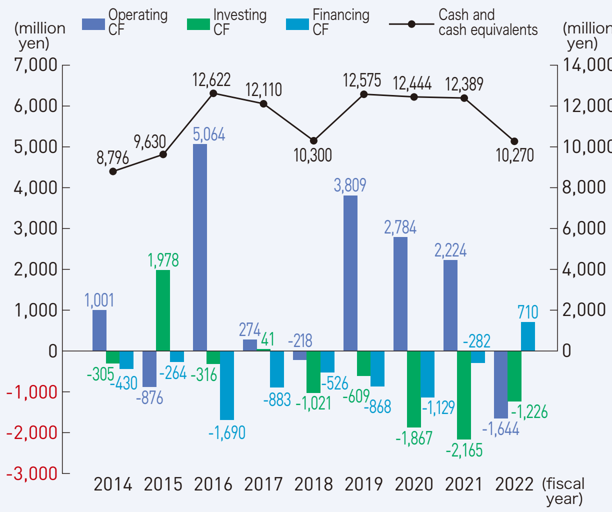
● Operating income and margin, ROE, and ROIC



● Net assets and equity ratio



● Cash flow and cash and cash equivalents



● Dividend per share, payout ratio, total return ratio