

# Operating and Financial Review

## Scope of Consolidation and Number of Employees

In fiscal 2016, the year ended March 31, 2017, the total number of consolidated subsidiaries and affiliates decreased by 3 to 55. On a consolidated basis, Daifuku Co., Ltd. and its consolidated subsidiaries and affiliates had 8,689 employees as of the fiscal year-end.

## Analysis of Operating Results

Mainstay material handling systems of the Daifuku Group (“the Group”) have growth potential, since logistics-related investments from the e-commerce sector are expanding globally, demand for automation and larger facilities is increasing, and capital investment is being used to resolve labor shortages and increase productivity. Taking note of this growth potential, entries from different industries and M&A within the industry have been increasing in recent years.

Amid these conditions, the operating results of the Daifuku Group showed steady progress. Operating income, ordinary income and net income attributable to shareholders of the parent company all reached record highs. At the same time, the Group achieved an operating margin of 7%, which was the medium-term management target.

Orders were strong in all major areas due to a worldwide increase in demand for material handling systems from manufacturers and distributors, buoyant business conditions in the flat-panel display (FPD) and semiconductor sectors, and an increase in capital investment by U.S. automakers.

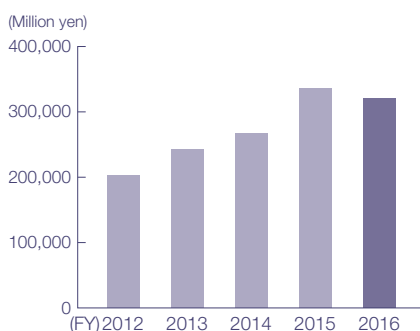
Sales made steady progress against a backdrop of an abundant order backlog but contracted with the appreciation of the yen.

Income surpassed the year-ago figure, reflecting the significantly increased profitability at U.S. subsidiaries, stable profitability by the parent company, Daifuku Co., Ltd., and the return to profitability of a European subsidiary, which sells systems used in airports.

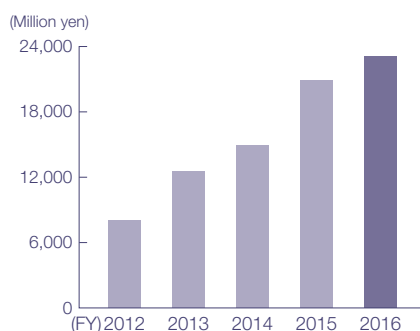
Specifically, the Group received orders of 356,518 million yen, down 0.8% from a year earlier, recorded net sales of 320,825 million yen, down 4.6%, and posted operating income of 23,099 million yen, up 10.6%. Net income attributable to shareholders of the parent company was 16,746 million yen, up 22.7%, mainly due to a decline of extraordinary loss related to subsidiaries.

The average exchange rate used for transactions within the Group during fiscal 2016 was 109.45 yen to the U.S. dollar, compared with an exchange rate of 121.04 yen for the same period of the previous fiscal year. Due to the

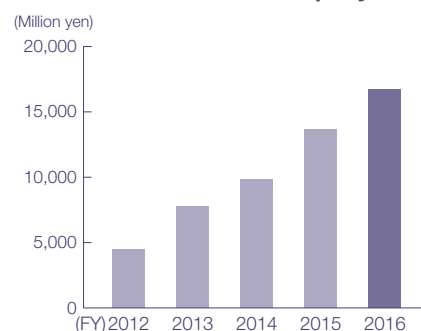
### Net Sales



### Operating Income



### Net Income Attributable to Shareholders of the Parent Company



appreciation of the yen, orders declined by about 42.8 billion yen, sales by about 18.2 billion yen, and operating income by about 1 billion yen, compared with the same period of the previous fiscal year. Of the orders, the impact on orders received during fiscal 2016 was about 21.1 billion yen, and the impact of foreign currency translation differences on the order backlog at the end of fiscal 2015 was about 21.7 billion yen.

## Operating Results by Segment

### (1) Daifuku Co., Ltd.

Orders increased, mainly due to an increase in demand for systems for semiconductor and FPD factories. In systems for manufacturers and distributors, orders for large projects remained firm in the distribution sectors, including e-commerce and co-ops, pharmaceutical wholesalers, and in the pharmaceutical and frozen-food sectors. Orders for retrofitting projects were also steady. In automobile production line systems, orders for services and small upgrade projects remained steady, bolstered by the active capital investment of automakers in Japan.

Sales also remained robust, as favorable orders continued from 2016. Income improved significantly, mainly due to an improvement in costs associated with structural reforms and a decline in extraordinary losses related to subsidiaries.

As a result, the Company recorded orders of 171,170 million yen, up 20.4% from the previous fiscal year, sales of 145,860 million yen, up 0.6%, and segment income of 13,316 million yen, up 57.4%.

### (2) Contec Co., Ltd. and its subsidiaries

In the Japanese market, sales of industrial computers remained strong, mainly for the semiconductor production equipment sector. In the U.S. market, sales of industrial computers for the medical device sector remained firm.

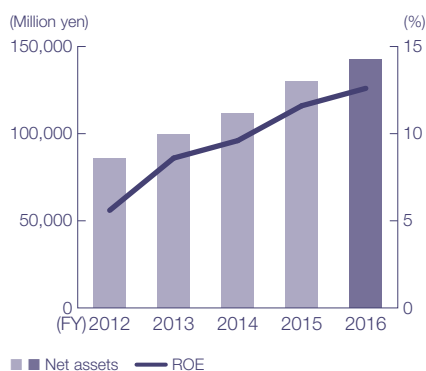
Sales of measuring and control boards for automobile production facilities were steady, along with the increased capital investment of manufacturers.

In networking products, sales of wireless LANs for semiconductor-related factories remained strong.

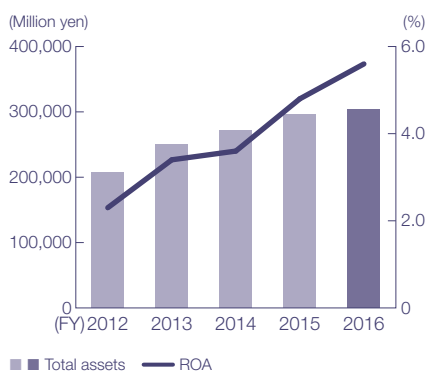
In solution products, while sales of IoT-related systems rose up, sales of photovoltaic measurement systems declined, associated with a fall in purchase prices of renewable energy.

As a result, Contec posted orders of 15,621 million yen, up 5.8% from the previous fiscal year, sales of 15,456 million yen, up 2.0%, and segment income of 722 million yen, up 22.7%.

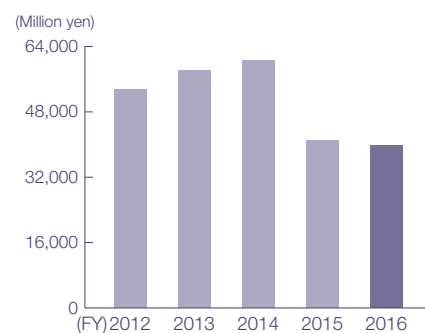
### Net Assets and ROE



### Total Assets and ROA



### Interest-Bearing Liabilities



### **(3) Daifuku North America Holding Company and its subsidiaries and affiliates**

While orders reached the 100 billion yen level, they were affected by the foreign currency translation of the order backlog. Orders for systems for semiconductor manufacturers grew significantly thanks to their brisk capital spending in line with the evolution of IoT, and large projects in systems for manufacturers and distributors also made a contribution. In automobile production line systems, orders also exceeded the initial forecast as a result of acquiring a large project from a U.S. automaker.

Sales maintained their upward trend, although slower progress in the installation of systems for automobile production lines and a delay in the time of orders for airport technologies had an impact.

Income increased with the higher sales, reflecting also the significant profitability of large projects for systems for manufacturers and distributors and automobile production line systems, in addition to the improved earnings in airport technologies.

As a result, Daifuku North America achieved orders of 88,818 million yen, down 7.2% from the previous fiscal year, sales of 79,063 million yen, up 2.6%, and segment income of 3,535 million yen, up 135.1%.

### **(4) Daifuku Plusmore Co., Ltd.**

Sales of car wash machines were the second strongest after fiscal 2015 when the sales volume reached a record high, reflecting strong sales for the automotive aftermarket such as dealers, combined with the recovery of car wash machines for the service station market that was sluggish at the beginning of the period.

Meanwhile, the Group withdrew from sales of bowling-related products and the rental business of roll box pallets on April 1, 2017, given their marketability and profitability.

As a consequence, Daifuku Plusmore reported orders of 11,324 million yen, down 8.6% from the previous fiscal year, sales of 11,466 million yen, down 6.7%, and segment income of 113 million yen, down 21.3%.

### **(5) Other**

The Daifuku Group has a total of 55 consolidated subsidiaries and affiliates worldwide. The Other segment includes all other Group companies, excluding the aforementioned Contec and its subsidiaries, Daifuku North America and its subsidiaries and affiliates, and Daifuku Plusmore.

Outside Japan, major subsidiaries include Daifuku (China) Co., Ltd. in China; Taiwan Daifuku Co., Ltd. in Taiwan; Daifuku Korea Co., Ltd. and Clean Factomation, Inc. in South Korea; and Daifuku (Thailand) Ltd. in Thailand, which primarily manufacture and sell material handling systems and equipment. Each of these companies plays a global role in optimizing the local production and procurement framework of the Group, while also increasing its exports.

In China, demand for material handling systems is rising rapidly in the food, pharmaceutical, and distribution sectors. Accordingly, the Group strengthened the production system by transferring factories in Shanghai. Sales were affected by a delay in the installation of a large food-related project. In automobile production line systems, orders exceeded the initial plan significantly, as Japanese automakers restarted capital spending, which had been put on hold.

In systems for FPD factories, while demand for OLEDs is rising, TV panels are growing in size and the segment drastically surpassed the orders target, mainly attributable to an order for systems for an FPD factory, which handles the world's largest glass substrates.

In Taiwan, orders from the FPD factory-related sector are slowing, while large projects for semiconductor factories are active.

In South Korea, orders for systems for semiconductor factories declined significantly compared with the same period of the previous fiscal year. Sales and income reflected these declines. In automobile production line systems in South Korea, orders were affected by the sluggish growth of automotive sales. Meanwhile, demand from the distribution sector is increasing, where Daifuku Korea has been focusing on marketing and obtaining orders. In

car wash machines, orders, sales, and income all reached record highs, reflecting an increase in demand for high-throughput car wash machines centering on tunnel-type car wash machines for established paid car-washing services.

Of ASEAN countries, Daifuku Thailand is focusing on reinforcing the production framework for manufacturers and distributors, to compensate for the impact from the sluggish growth in the automobile industry in Thailand. In Indonesia, demand for frozen foods and daily commodities is rising and a rally is being seen. As such, the situation is improving together with developments in local sales frameworks. In India, inquiries for systems for manufacturers and distributors are robust, and Daifuku India opened a new office in Mumbai.

BCS Group Limited, which handles systems and technologies for airports mainly in Oceania and Asia, received an order for a high-speed conveying Baggage Tray System (BTS), a promising new product, from Montreal Airport in Canada for the first time. Using this as an opportunity, the Group will work on expanding sales of BTS, which is being considered by airports in many parts of the world, in cooperation with Group companies.

As a result, the segment recorded orders of 69,584 million yen, down 26.3% from the previous fiscal year, sales of 68,785 million yen, down 15.9%, and segment income of 2,287 million yen, down 29.2%.

## Earnings

During fiscal 2016, the Group posted net sales of 320,825 million yen, down 4.6%, which declined by about 18,200 million yen reflecting the appreciation of the yen. The Group's gross profit ratio increased 1.3 percentage points, to 20.1%. In addition, the ratio of selling, general and administrative expenses increased 0.3 percentage point over the previous fiscal year, to 12.9%.

As a result, operating income rose 10.6%, to 23,099 million yen. Net income attributable to shareholders of the parent company amounted to 16,746 million yen, a significant increase of 22.7% year on year, mainly attributable to a decrease in some extraordinary losses related to subsidiaries. The effective income tax rate for fiscal 2016 was 28.8%.

As a consequence, net income per share rose from 118.72 yen per share in the previous fiscal year, to 137.58 yen in fiscal 2016.

## Financial Position

### *Assets, liabilities, and net assets*

Total assets at the end of fiscal 2016 stood at 303,540 million yen, an increase of 7,484 million yen from the end of the previous fiscal year. The result principally reflected a decrease of 7,292 million yen in notes and accounts receivable and unbilled receivables and an increase of 15,614 million yen in cash on hand and in banks.

Total liabilities at the end of fiscal 2016 amounted to 161,199 million yen, a decrease of 4,739 million yen from the end of the previous fiscal year. Primary factors included a decrease of 4,679 million yen in income taxes payable.

Net assets at the end of fiscal 2016 were 142,340 million yen, an increase of 12,224 million yen from the end of the previous fiscal year. This was mainly attributable to an increase of 12,848 million yen in retained earnings. The ratio of shareholders' equity to total assets stood at 45.8% at fiscal year-end and the return on equity (ROE) was 12.6%.

### **Cash flows**

Cash and cash equivalents at the end of fiscal 2016 increased 15,706 million yen from the end of the previous fiscal year, to 64,790 million yen, compared with 49,084 million yen in the same period of the previous fiscal year. Individual cash flows and contributing factors were as follows:

#### **Cash flows from operating activities**

Net cash provided by operating activities totaled 26,683 million yen, compared with cash provided of 7,206 million yen in the same period of the previous fiscal year. This primarily reflects income before income taxes of 23,942 million yen, depreciation of 4,202 million yen, and an increase of 4,038 million yen in advances received on uncompleted contracts, offsetting 11,373 million yen in income taxes paid.

#### **Cash flows from investing activities**

Net cash used in investing activities was 5,393 million yen, compared with cash used of 2,099 million yen in the same period of the previous fiscal year. Major factors included 6,399 million yen for payments for the purchase of property, plant and equipment, outweighing proceeds of 1,121 million yen from sales of property, plant and equipment.

As a result, free cash flow for fiscal 2016 amounted to 21,289 million yen, compared with 5,107 million yen in the previous fiscal year.

#### **Cash flows from financing activities**

Net cash used in financing activities was 4,404 million yen, compared with cash used of 8,702 million yen in the same period of the previous fiscal year, mainly attributable to payment of cash dividends of 3,896 million yen.

### **Basic policy regarding dividends for fiscal 2016 and 2017**

Daifuku regards the return of profits to shareholders as its most important management task and has adopted a performance-based policy for cash dividends based on consolidated net income (net income attributable to shareholders of the parent company), with the aim of achieving additional profit distribution to shareholders. The Company appropriates the remaining surplus to internal reserves for future growth. During fiscal 2016, the Company mainly implemented maintenance and renewal work on various factory equipment at its Shiga Works.

For fiscal 2016, Daifuku paid an interim dividend of 12 yen per share and a year-end dividend of 30 yen per share, making an annual dividend 42 yen per share. The year-end dividend included a commemorative dividend of 5 yen per share for celebrating its 80th anniversary.

With respect to dividends for fiscal 2017, the Company plans to pay an annual dividend of 47 yen per share (an interim dividend of 15 yen per share and a year-end dividend of 32 yen), taking into consideration the earnings forecast for fiscal 2017 and the basic policy described above.

### **Business-Related Risks**

The main items that the Daifuku Group recognizes as risks and responds to as such are as follows. Some of the content of this section constitutes forward-looking statements. Accordingly, please note that these statements have been made based on judgments of the Group as of Monday, June 26, 2017.

### **Risks covered by the Chief Financial Officer and Chief Risk Officer**

- (1) Major disruption to production (damage to facilities, etc.)
- (2) Impact of natural disasters and intentional threats, war, acts of terrorism, strikes, disease, etc.
- (3) Environmental problems
- (4) Labor relations issues (deterioration in the employee-management relationship, outbreak of industrial disputes, etc.)
- (5) Joint ventures (deterioration in management policy at joint venture partner(s), deterioration in management environment, etc.)
- (6) Risk related to intellectual property (IP) rights (failure to obtain the license for use of the third-party IP rights/royalty demands; third-party allegations of IP right infringement(s); lack of protection of Daifuku IP rights in certain countries and regions outside of Japan, etc.)
- (7) Securing of personnel (recruitment and retention of competent personnel; difficulties in training human resources, etc.)
- (8) Customer/Supplier credit risk (customer/supplier doubtful accounts/bad debts, etc.)
- (9) Information management (leakage of important and/or personal information to outside the Company; use for purposes other than that intended, etc.)
- (10) Risk related to global business development (changes to each country's laws and regulations; changes in the social, political, and economic situation; deterioration in public safety, disruption to transportation/electric power infrastructure; currency exchange restrictions and fluctuations; tax system changes; taxation by transfer price; trade protection regulations; customer credit risk from different commercial practices; different employment/social insurance systems; changes in the labor environment; difficulties in recruiting/retaining personnel; outbreaks of disease, etc.)

### **Risks covered by the Chief Operating Officer**

- (1) Impacts of conditions in the markets related to semi-conductors and flat-panel displays, as well as automobiles (changes in demand/capital investment trends, etc.)
- (2) Price competition (pressure on profits due to fierce price competition, etc.)
- (3) Product quality issues (product defects/failures, quality claims/complaints, etc.)
- (4) Risk related to the development of new products/technologies (mismatch between new products/technologies and market needs; rival developments from competitors; absence of IP right protection; breach of another company's IP rights; emergence of new alternative technology products from other companies, etc.)
- (5) Increase in raw material prices (sharp increase in prices for raw materials and components, product shortages, supply instability, etc.)
- (6) Increasing project scale (timing of orders recorded, along with how efficiently all aspects of projects are managed)

### **Compliance**

Compliance-related risks (trouble or losses caused by director/employee failure to observe laws, regulations, standards, internal regulations, policies, etc.)