Ongoing Growth through the Execution of E-Plan 2019 and Measures that Address Material ESG Issues

Since its founding, the EBARA Group has continued to expand the scope of its operations, maintaining its focus on pumps and other rotating machinery while branching out to environmental plants and semiconductor manufacturing equipment and devices. Today, the Group has grown into a conglomerate—comprised of 90 subsidiaries around the world (60 consolidated) and six affiliates—that generates consolidated net sales of around ¥500 billion a year, more than 50% of which comes from outside of Japan.

We are committed to advancing E-Plan 2019 and implementing initiatives for addressing the EBARA Group’s material environmental, social, and governance (ESG) issues in order to achieve the growth objectives of our management policy and further increase corporate value.
**The EBARA Group’s Views on Materiality**

To guide the EBARA Group in its quest to continue growing with society and improving corporate value, we have identified eight ESG issues material to our sustainable development and determined six action policies for initiatives pertaining to these issues. In addition, we have set KPIs and targets to monitor and confirm the progress of these policies. Initiatives pertaining to these issues will be revised based on their progress as we endeavor to increase corporate value.

**REFERENCE**

**Eight Material ESG Issues and Six Action Policies**

The six action policies tackle the eight material ESG issues in a comprehensive manner. We have established KPIs and targets leading up to 2019 for each action policy.

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**Identification of Material ESG Issues**

<table>
<thead>
<tr>
<th>Material ESG Issues</th>
<th>Relevance to Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innovation in the areas of water, air, and the environment</td>
<td>High</td>
</tr>
<tr>
<td>Improvement of social infrastructure</td>
<td>High</td>
</tr>
<tr>
<td>Consideration for the environment</td>
<td>High</td>
</tr>
<tr>
<td>Continuous improvement of governance</td>
<td>High</td>
</tr>
<tr>
<td>Reliable product quality and responsible customer engagement</td>
<td>Medium</td>
</tr>
<tr>
<td>Responsible supply chain</td>
<td>Medium</td>
</tr>
<tr>
<td>Secure talented human resources, foster their capabilities, and maximize value</td>
<td>Medium</td>
</tr>
<tr>
<td>Risk management</td>
<td>High</td>
</tr>
</tbody>
</table>

**Relationship between Eight Material Issues and Six Action Policies**

<table>
<thead>
<tr>
<th>Six Action Policies</th>
<th>SDG Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action Policy 1: Provide products and services that minimize the use of energy and resources</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 2: Expand the service and support (E&amp;S)/business, maximize product life, and minimize any product downtime</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 3: Minimize the amount of energy and resources used in business activities</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 4: Fulfill social responsibilities to supply chains, deliver reliable product quality throughout the product’s life cycle, and achieve responsible customer engagement</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 5: Continuously improve governance structures, headed by the Board of Directors, practice thorough compliance, and strengthen risk management</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 6: Enhance diversity, improve work environments to empower employees to develop to their full potential, and provide opportunities to develop necessary skills</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
</tbody>
</table>

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**Relationship with the SDGs**

<table>
<thead>
<tr>
<th>Action Policy</th>
<th>SDG Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action Policy 1</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 2</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 3</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 4</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 5</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
<tr>
<td>Action Policy 6</td>
<td>1, 2, 3, 6, 16, 17, 13, 14</td>
</tr>
</tbody>
</table>
Overview of KPIs and Progress toward Targets

KPIs and targets have been set with regard to addressing climate change by creating energy-efficient products and conserving resources by reducing equipment weight, and steady progress is being made toward the accomplishment of these targets.

**Major KPIs and Results (Progress toward Target)**

<table>
<thead>
<tr>
<th>Fluid Machinery &amp; Systems Business</th>
<th>Environmental Plants Business</th>
<th>Precision Machinery Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Applicable, delivered standard pump products in-use energy reduction (86%)</td>
<td>• Waste-to-energy generation at Company-operated waste incineration plants (100%)</td>
<td>• Chemical mechanical polishing systems and dry vacuum pumps in-use energy reduction (81%)</td>
</tr>
</tbody>
</table>

**Material ESG Issues Addressed**

- Innovation in the areas of water, air, and the environment / Improvement of social infrastructure / Consideration for the environment

**Action Policy 1**

Provide products and services that minimize the use of energy and resources

Progress

- Applicable, delivered standard pump products in-use energy reduction (86%)
- Applicable, delivered custom pump products weight reduction (80%)
- Waste-to-energy generation at Company-operated waste incineration plants (100%)
- Chemical mechanical polishing systems and dry vacuum pumps in-use energy reduction (81%)

**Action Policy 2**

Expand the service and support (S&S) business, maximize product life, and minimize any product downtime

Progress

- S&S sales (93%)
- Standard pump on-call processing time* (87%)
- Number of countries with custom pump and chillers S&S bases (86%)
- Operation & Maintenance (O&M) contracting facilities (80%)
- S&S sales (96%)
- Number of overhauls* performed (89%)
- Companywide average on-time overhaul shipments (81%)

**Action Policy 3**

Minimize the amount of energy and resources used in business activities

Progress

- Scope of Global data collection: 88% of consolidated net sales
- Greenhouse gas emissions: Down 6.0% from the period January 1 to December 31, 2017
- Material recycling rate: 16.5%

The scope of environmental performance data collection was expanded on a Groupwide and global basis to facilitate the formulation of targets for the fiscal year ending December 31, 2030.

**Action Policy 4**

Fulfill social responsibilities to supply chain, deliver reliable product quality throughout the product’s life cycle, and achieve responsible customer engagement

Progress

- CSR procurement survey response rate: 72%
- Rate of CSR Procurement Guidelines awareness among tier 1 top 200 domestic suppliers: 98%

**Action Policy 5**

Continuously improve governance structures, headed by the Board of Directors, practice thorough compliance, and strengthen risk management

Progress

- Number of Independent Directors: 7 of 11 directors (as of March 28, 2019)
- Rate of participation in training sessions conducted on the “EBARA Way” and the EBARA Group Code of Conduct: 10%
- Number of companies administering compliance surveys: 15 in Japan, 10 overseas
- Number of companies with compliance whistleblowing helplines enabling consultation with outside venues: 17 in Japan, 15 overseas
- Number of companies that conducted compliance (anti-corruption) training: All 4 applicable companies

**Action Policy 6**

Enhance diversity, improve work environments to empower employees to develop to their full potential, and provide opportunities to develop necessary skills

Progress

- Life cycle average on-time overhaul shipments: 81%
- Human resource development (100%)

Steadfast progress has been made in promoting diversity, reducing work hours, preventing occupational accidents, and investing in human resource development.
Progress of E-Plan 2019 Medium-Term Management Plan

E-Plan 2019 is focused on profit, and it targets profitability improvements in all businesses. Particular emphasis in E-Plan 2019 is placed on improving the profit margin of the pumps business, the business on which EBARA was founded and which generates the largest amount of sales.

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Framework of Basic Group Policies

- **Basic Policy 1:** Solidify the profit foundation of the Group so that it is not influenced by market fluctuations, and aim for further growth.
- **Basic Policy 2:** Strengthen product competitiveness and improve profitability by introducing innovative production processes and business processes with the help of automated plants at the core.
- **Basic Policy 3:** Expand service & support (S&S) operations to improve and stabilize profitability.
- **Basic Policy 4:** Utilize M&A as effective means for the purpose of increasing the Group’s share in overseas markets and enhancing its product lineup in businesses that are highly susceptible to market fluctuations.
- **Basic Policy 5:** Reinforce corporate headquarters’ strategic functions and at the same time make Groupwide efforts to consolidate ongoing operations and enhance their efficiency in order to shore up the global expansion of each business.

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**Measures Approaching Final Year of E-Plan 2019**

The accomplishment of targets will be delayed, but initiatives for improving ROIC will continue to be implemented to drive growth in the fiscal year ending December 31, 2020, and beyond.

ROIC Improvement Measures

- Increase operating income to sales ratio
  - **Solidify profit foundation to become more resilient to market fluctuations**
  - **Steadily implement and build upon E-Plan 2019 measures**
- **Raise capital efficiency**
  - **Appropriately manage balance sheet**
  - **Continue reducing working capital**

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  - **Appropriately manage balance sheet**
  - **Continue reducing working capital**
Financial Strategies as Explained by the Executive in Charge of Finance

To this end, our cash allocation policies for the three-year period of E-Plan 2019 will see us prioritize growth investments for improving profitability, and we have earmarked ¥300.0 billion for capital investments, ¥35.0 billion for research and development (R&D), and ¥10.0 billion for M&A. Accordingly, these investments reflect our intent to conduct capital investments and M&A totaling more than one-third of profit attributable to owners of parent plus depreciation and amortizations and to invest more than 2% or more of annual net sales in R&D. In addition, more than one-third of profit is to be retained to shareholders each year, and we are thus targeting a consolidated total return ratio of 30% or more. The remaining one-third of profit will be retained to fund human resource investments in subsequent fiscal years. Such investments will include development programs, employee education, work systems, and the creation of workplaces that support diverse workstyles, and improvements in safety levels and welfare benefits. Through these investments, we aim to cultivate a workplace environment that is conducive to innovation.

Our business is such that there is a long period of time between the receipt of an order and the payment for said order. Also, as a supplier for products and services that support social and industrial infrastructure, we have an obligation to continue our business even under extreme circumstances, such as after large-scale natural disasters or during financial crises. In recognition of these factors, we have a policy of maintaining roughly two months of sales worth of cash and deposits, securing a little safety buffer with regard to necessary working capital. The remaining funds will be allocated to the repayment of interest-bearing debt. Should funding be insufficient, necessary amount will be procured. In addition, we will keep a level of shareholders’ equity that will enable us to maintain a R&I (Credit Rating) A in order to ensure that we can procure funds even under extreme circumstances.

Q. What is the progress with regard to these efforts? A. We have made smooth progress so far based on these policies, investing a total of ¥1,779 billion over the past two years in R&D, equivalent to 2% of net sales, and deciding to invest more than ¥60.0 billion over a three-year period in capital investments such as fully automated plants. However, capital investments are slightly behind schedule and M&A have not been progressing as planned. For this reason, not cash used in investment activities was only ¥23.8 billion over the past two years, and we thus accumulated a significant amount in cash and deposits.

This situation prompted us to repurchase ¥5.0 billion worth of shares and repay ¥25.0 billion of interest-bearing debt. As a result, cash and deposits on December 31, 2018, decreased ¥27.8 billion from the previous equivalent period, to ¥110.6 billion, 2.6 months’ sales worth. In light of the high level of cash and deposits, we have chosen to move forward with the acquisition of ¥126.4 billion of cash share repurchases in the fiscal year ending December 31, 2019. We are projecting a three-year total of more than ¥36.0 billion in shareholder returns over the period of E-Plan 2019, making for a total return ratio of over 75%. Conversely, profitability is substantially less than targeted. The operating income to sales ratio was a mere 4.6% in the fiscal year ended December 31, 2019, resulting in figures of 4.9% and 4.6%, respectively, for the efficiency indicators of ROIC and ROE. Improving profitability is a pressing issue.

Q. What financial approach will be adopted toward improving profitability? A. In terms of finances, we need to place more emphasis on our balance sheet if we are to improve profitability. This is because the benefits of management initiatives for enhancing the income statement appear first on the balance sheet.

For example, the Company has annual sales of ¥900.0 billion and total assets of ¥290.0 billion. This means we are not even producing an amount of sales equivalent to the assets we use to generate those sales in a year. We need to use our assets more efficiently in order to achieve sales that are on par with the scale of assets. Total asset turnover (net sales / total assets) is one of the factors contributing to ROIC, our most important KPI. I therefore aim to realize turnover of at least 1.0 in order to prevent this indicator from dropping down ROIC.

Meanwhile, the combined total of notes and accounts receivable and inventories exceeds ¥100.0 billion, making up half of total assets. At the same time, our annual sales of ¥500.0 billion translate to daily sales of about ¥1.5 billion, and as such the ¥900.0 billion in notes and accounts receivable-trade and inventories equates to 200 days’ worth of sales. We can cut working capital by ¥30.0 billion if we reduce this amount by 20 days. The resulting funds can then be allocated to growth investments. I believe that we must realize such reductions by boosting the competitiveness of our business through improvements to contract conditions, product quality, and productivity as well. As through shorter lead times and the reinforcement of our supply chain. Going forward, I will invest in the development of cutting-edge, fully automated plants as well as the construction of global S&S bases and sales networks that will enable us to achieve these objectives. Currently, only ¥150.0 billion, or one-fourth of total assets are fixed assets. Given our equity ratio, I believe that we could have between 40% to 50% of assets represented by fixed assets without issue. For this reason, I am looking to lower the amount of notes and accounts receivable-trade and inventory assets and use the on-hand cash created by this reduction to increase fixed assets through capital investments and M&A. I am aiming to build a strong balance sheet that will make future improvements in profitability possible, resulting in greater margins on the income statement.

It is my intent to enhance our balance sheet through initiatives for improving profitability and to thereby achieve a robust corporate constitution capable of driving ongoing growth. I plan to achieve this through continuously managing KPIs such as business receivable and inventory turnover periods, making investment decisions while considering the hurdle rates based on business- and country-specific WACC introduced in the fiscal year ended December 31, 2018, augmenting our global cash management systems, and reducing cross-shareholdings.
Business Results and Operating Environment

Net sales increased ¥1.3 billion from the previous equivalent period, to ¥507.1 billion; due to higher sales in the Fluid Machinery & Systems Business and the Precision Machinery Business.

Cost of sales was ¥376.0 billion, making for a cost of sales ratio of 73.8%, and gross profit was ¥131.3 billion accordingly. Selling, general, and administrative expenses totaled ¥80.8 billion and operating income decreased ¥4.1 billion from the previous equivalent period, to ¥208.4 billion.

Non-operating income and expenses made for a net expense of ¥2.1 billion, largely due to the recording of ¥1.5 billion in interest expenses leading to ordinary income decreasing ¥4.5 billion from the previous equivalent period, to ¥31.2 billion.

Extraordinary income and expenses made for an extraordinary loss of ¥0.7 billion. The aforementioned taxes-deferred was ¥7.6 billion, resulting in profit attributable to owners of parent increasing ¥7.6 billion; up ¥17.3 billion from the previous equivalent period; to ¥128.4 billion.

In the Fluid Machinery & Systems Business, orders were ¥104.9 billion, up ¥4.1 billion from the previous equivalent period; net sales were ¥82.8 billion, down ¥7.1 billion; and operating income was ¥4.9 billion, relatively unchanged from the previous equivalent period.

In the Precision Machinery Business, orders were ¥140.6 billion, up ¥10.5 billion from the previous equivalent period; net sales were ¥62.8 billion, down ¥7.1 billion; and operating income was ¥4.9 billion, relatively unchanged from the previous equivalent period.

Ordinary income was ¥4.9 billion, down ¥6.0 billion from the previous equivalent period; to ¥32.4 billion.

Selling, general and administrative expenses totaled ¥100.6 billion, making for a cost of sales ratio of 26.1%, and gross profit was ¥406.4 billion accordingly. Operating income decreased ¥4.1 billion from the previous equivalent period, to ¥362.3 billion.

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Segment Performance

In the Fluid Machinery & Systems Business, orders were ¥226.2 billion, up ¥17.3 billion from the previous equivalent period; net sales were ¥208.9 billion, up ¥4.8 billion; and operating income was ¥8.7 billion, down ¥5.9 billion.

Recovery was seen in capital investment in the downstream areas of the oil and gas market that are the primary targets for deliveries of our compressors and turbines custom pumps. Against this backdrop, orders increased ¥19.3 billion from the previous equivalent period centered on the products of the compressors and turbines business. The full-fledged recovery of custom pumps orders is expected to be delayed until the fiscal year ending December 31, 2019, as the lead time for these items are shorter than for compressors and turbines, resulting in orders being made at later times. Net sales were favorable with regard to compressors and turbines and standard pumps. However, operating income in the Fluid Machinery & Systems Business was low as a result of several one-time detractors from profit occurring in the second half of the fiscal year. Specifically, these detractors included problems with specific models in the pumps business, intensified competition in the generators and turbines business, and delays in the integration of systems when consolidating factories in the chillers business. The aforementioned factors led profit attributable to owners of parent to decrease ¥4.5 billion from the previous equivalent period.

In the year ended December 31, 2018, the Environmental Plants Business was successful in capturing several large-scale orders, contributing to an exceptionally high level of orders and an increase of ¥1.8 billion. Conversely, operating income decreased slightly as a result of a decrease in net sales centered on engineering, procurement, and construction orders, and the recording of a provision for loss on the partial withdrawal from the business of a Chinese manufacturing subsidiary, which occurred in the second half of the fiscal year. In the Precision Machinery Business, orders were ¥140.6 billion, up ¥10.3 billion from the previous equivalent period; net sales were ¥135.7 billion, up ¥6.6 billion; and operating income was ¥18.5 billion, up ¥1.1 billion.

Orders, net sales, and operating income all broke records due to the brisk capital investments seen in the semiconductor market, particularly in memory-related sectors. However, performance growth slowed heading into the second half of the fiscal year as customers began to curtail investments.

As a result, cash and cash equivalents at end of period decreased ¥2.5 billion, coming to ¥110.5 billion on December 31, 2018.

Financial Position

Total assets as of December 31, 2018, stood at ¥591.5 billion, down ¥2.1 billion from the previous fiscal-year-end. Increases of ¥6.5 billion in notes and accounts receivable-trade and ¥13.1 billion in inventories were outweighed by decreases of ¥27.8 billion in cash and deposits and ¥7.4 billion in investments and other assets.

Total liabilities amounted to ¥304.8 billion on December 31, 2018, a decrease of ¥23.2 billion from a year earlier. This decrease was primarily a result of the repayment of short-term loans payable and the redemption of current portion of bonds. Interest-bearing debt decreased ¥35.4 billion, to ¥79.1 billion, and the debt/equity ratio decreased from 0.41 times on December 31, 2017, to 0.28 times on December 31, 2018, following the repayment of interest-bearing debt.

Note: The previous fiscal period was a nine-month period beginning April 1, 2017, and ending December 31, 2017. Comparisons with the previous equivalent period compare performance between the period from January 1 to December 31, 2017, and the fiscal year ended December 31, 2018.

Consolidated Balance Sheets (Billions of yen)  

<table>
<thead>
<tr>
<th>December 31, 2018</th>
<th>December 31, 2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>447.4</td>
<td>628.5</td>
</tr>
<tr>
<td>Cash and deposits, securities</td>
<td>142.8</td>
<td>112.2</td>
</tr>
<tr>
<td>Notes and accounts receivable-trade</td>
<td>175.3</td>
<td>183.8</td>
</tr>
<tr>
<td>Inventories</td>
<td>189.5</td>
<td>222.6</td>
</tr>
<tr>
<td>Others</td>
<td>71.7</td>
<td>79.1</td>
</tr>
<tr>
<td>Total inventories</td>
<td>444.4</td>
<td>530.4</td>
</tr>
<tr>
<td>Tangible fixed assets</td>
<td>110.2</td>
<td>107.8</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>12.0</td>
<td>10.6</td>
</tr>
<tr>
<td>Investments and other assets</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Total assets</td>
<td>517.7</td>
<td>591.5</td>
</tr>
</tbody>
</table>

Cash and cash equivalents at end of period decreased ¥2.5 billion, coming to ¥110.5 billion on December 31, 2018.

Cash Flows

Year-on-year comparisons are not available as the previous fiscal period was a nine-month period beginning April 1, 2017, and ending December 31, 2017.

Net cash provided by operating activities amounted to ¥43.4 billion due to robust operating income.

Net cash used in investing activities was ¥17.7 billion as proceeds from sales and redemption of securities and investment securities of ¥5.5 billion and other inflows were outweighed by outlays such as purchase of fixed assets of ¥18.5 billion.

Free cash flow, calculated by combining net cash generated from operation and net cash used in investment, was a positive ¥18.6 billion.

Net cash used in financing activities was ¥46.3 billion due to repayment of short-term and long-term loans payable, ¥10.0 billion in redemption of bonds, ¥5.0 billion in share repurchases, and ¥4.5 billion in cash dividends paid.

As a result, cash and cash equivalents at end of period decreased ¥2.5 billion, coming to ¥110.5 billion on December 31, 2018.