

KYOKUTO KOWA CORPORATION

*Financial Statements
for the Year Ended March 31, 2020,
and Independent Auditor's Report*

KYOKUTO KOWA CORPORATION
Balance Sheet
March 31, 2020

ASSETS	Millions of Yen	Thousands of U.S. Dollars (Note 1)	LIABILITIES AND EQUITY	Millions of Yen	Thousands of U.S. Dollars (Note 1)
	2020	2020		2020	2020
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash and cash equivalents (Note 7)	¥ 137	\$ 1,263	Short-term borrowings from parent company (Note 7)	¥ 5,835	\$ 53,614
Receivables (Note 7):			Payables (Note 7):		
Trade notes (Note 3.b and 3.d)	133	1,218	Trade notes	404	3,712
Electronically recorded monetary claims	454	4,173	Electronically recorded obligations	2,403	22,084
Trade accounts	10,572	97,140	Trade accounts	3,424	31,465
Parent company and affiliated companies (Note 8)	306	2,811	Parent company and affiliated companies (Note 8)	314	2,885
Other	379	3,484	Other	80	733
Inventories (Notes 3.a and 3.c)	2,724	25,033	Income taxes payable (Note 7)	112	1,030
Prepaid expenses and other current assets	29	261	Advances received on uncompleted construction contracts (Note 7)	511	4,692
			Provision for warranties for completed construction	36	328
Total current assets	14,734	135,383	Other current liabilities	841	7,734
			Total current liabilities	13,960	128,277
PROPERTY, PLANT AND EQUIPMENT:			LONG-TERM LIABILITIES:		
Land	926	8,509	Other	97	890
Buildings and structures	2,519	23,146	Total long-term liabilities	97	890
Machinery and equipment	2,400	22,050			
Tools, furniture and fixtures	1,054	9,691	Total liabilities	14,057	129,167
Total	6,899	63,396	CONTINGENT LIABILITIES (Note 3.b)		
Accumulated depreciation	(4,765)	(43,786)	EQUITY (Notes 4, 5, and 9):		
Net property, plant and equipment	2,134	19,610	Common stock—authorized, 30,000,000 shares; issued, 8,620,000 shares in 2020	100	919
INVESTMENTS AND OTHER ASSETS:			Capital surplus:		
Investment securities (Note 7)	91	840	Additional paid-in capital	195	1,792
Deferred tax assets (Note 6)	107	986	Other capital surplus	812	7,466
Other assets (Note 8)	200	1,831	Retained earnings:		
Allowance for doubtful accounts	(26)	(235)	Legal reserve	118	1,082
Total investments and other assets	372	3,422	Unappropriated	1,951	17,930
			Unrealized gain on available-for-sale securities	7	59
			Total equity	3,183	29,248
TOTAL	¥ 17,240	\$ 158,415	TOTAL	¥ 17,240	\$ 158,415

See notes to financial statements.

KYOKUTO KOWA CORPORATION
Statement of Income
Year Ended March 31, 2020

	Millions of Yen	Thousands of U.S. Dollars (Note 1)
	2020	2020
NET SALES (Note 8)	¥ 25,910	\$ 238,080
COST OF SALES (Note 8)	23,202	213,195
Gross profit	2,708	24,885
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (Note 8)	1,590	14,606
Operating income	1,118	10,279
OTHER INCOME (EXPENSES) (Note 8):		
Interest and dividend income	2	21
Interest expense	(42)	(382)
Financing expenses	(20)	(186)
Other—net	(10)	(106)
Other income (expenses)—net	(70)	(653)
INCOME BEFORE INCOME TAXES	1,048	9,626
INCOME TAXES		
Current	369	3,387
Deferred	(2)	(22)
Total income taxes	367	3,365
NET INCOME	¥ 681	\$ 6,261
	Yen	U.S. Dollars
PER SHARE OF COMMON STOCK (Notes 4 and 9):		
Basic net income	¥ 79.05	\$ 0.73
Cash dividends applicable to the year	17.00	0.16

See notes to financial statements.

KYOKUTO KOWA CORPORATION
Statement of Changes in Equity
Year Ended March 31, 2020

	Thousands	Millions of Yen						
	Outstanding Number of Shares of Common Stock	Common Stock	Capital Surplus		Retained Earnings		Unrealized Gain on Available- for-Sale Securities	Total Equity
			Additional	Other	Legal	Unappropri		
			Paid-in Capital	Capital Surplus	Reserve	-ated		
BALANCE, MARCH 31, 2019	8,620	¥ 100	¥ 195	¥ 812	¥ 118	¥ 1,416	¥ 6	¥ 2,647
Net income						681		681
Cash dividends, ¥17 per share						(146)		(146)
Net change in the year							1	1
BALANCE, MARCH 31, 2020	<u>8,620</u>	<u>¥ 100</u>	<u>¥ 195</u>	<u>¥ 812</u>	<u>¥ 118</u>	<u>¥ 1,951</u>	<u>¥ 7</u>	<u>¥ 3,183</u>

	Thousands of U.S. Dollars (Note 1)							
	Common Stock	Capital Surplus		Retained Earnings		Unrealized Gain on Available- for-Sale Securities	Total Equity	
		Additional	Other	Legal	Unappropri			
		Paid-in Capital	Capital Surplus	Reserve	-ated			
BALANCE, MARCH 31, 2019	\$ 919	\$ 1,792	\$ 7,466	\$ 1,082	\$ 13,015	\$ 56	\$ 24,330	
Net income					6,261		6,261	
Cash dividends, \$0.16 per share					(1,346)		(1,346)	
Net change in the year						3	3	
BALANCE, MARCH 31, 2020	<u>\$ 919</u>	<u>\$ 1,792</u>	<u>\$ 7,466</u>	<u>\$ 1,082</u>	<u>\$ 17,930</u>	<u>\$ 59</u>	<u>\$ 29,248</u>	

See notes to financial statements.

KYOKUTO KOWA CORPORATION
Notes to Financial Statements
Year Ended March 31, 2020

1. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The accompanying financial statements have been prepared from the accounts maintained by KYOKUTO KOWA CORPORATION (the "Company"), in accordance with the provisions set forth in the Companies Act of Japan and applicable regulations and in accordance with accounting principles generally accepted in Japan. The information provided in the notes to the financial statements is limited to that required by the Companies Act of Japan and applicable regulations. Statements of comprehensive income and cash flows are not required as a part of the basic financial statements under the Companies Act of Japan and applicable regulations and, accordingly, are not presented herein.

In preparing these financial statements, certain reclassifications and rearrangements have been made to the Company's financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan.

The financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts are included for the convenience of readers outside Japan and have been made at the rate of ¥108.83 to \$1, the approximate rate of exchange at March 31, 2020. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. Inventories*—Construction projects in progress, finished products, and work in process are stated at cost as determined by the specific identification method. Raw materials and supplies are stated at cost as determined by the moving-average method. The write-downs of inventories due to decreased profitability are reflected in the valuation of raw materials and supplies and the accompanying loss is recognized as cost of goods sold, in principle.
- b. Property, Plant and Equipment*—Property, plant and equipment are stated at cost. Depreciation is computed by the declining-balance method based on the estimated useful lives of the assets, while the straight-line method is applied to buildings, excluding building fixtures, acquired on or after April 1, 1998. The range of useful lives is principally from 12 to 38 years for buildings and structures and from 3 to 9 years for machinery and equipment and tools, furniture and fixtures.
- c. Long-Lived Assets*—The Company reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.
- d. Investment Securities*—Investment securities are classified and accounted for, depending on management's intent, as available-for-sale securities. They are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of equity.

Nonmarketable available-for-sale securities are stated at cost determined by the moving-average method. For other-than-temporary declines in fair value, investment securities are reduced to net realizable value by an impairment charge to income.

- e. Allowance for Doubtful Accounts*—The allowance for doubtful accounts is provided for at an

amount sufficient to cover possible losses on collection. It consists of the estimated uncollectible amount with respect to identified doubtful receivables and an amount calculated by applying the percentage of actual losses on collection experienced in the past to the remaining receivables.

- f. Allowance for Losses on Construction Contracts*—To cover losses which have a high probability of occurring in the future upon work completion, an allowance for estimated losses is provided based on the amount of orders received and the estimated cost.
- g. Provision for Warranties for Completed Construction* —Provision for warranties for completed construction is provided for anticipated future costs within the warranty period arising from warranties on completed construction.
- h. Construction Contracts*— In December 2007, the Accounting Standards Board of Japan (ASBJ) issued ASBJ Statement No. 15, "Accounting Standard for Construction Contracts," and ASBJ Guidance No. 18, "Guidance on Accounting Standard for Construction Contracts." Under this accounting standard, construction revenue and construction costs should be recognized by the percentage-of-completion method if the outcome of a construction contract can be estimated reliably. When total construction revenue, total construction costs, and the stage of completion of the contract at the balance sheet date can be reliably measured, the outcome of a construction contract is deemed to be estimated reliably. If the outcome of a construction contract cannot be reliably estimated, the completed-contract method should be applied. When it is probable that the total construction costs will exceed total construction revenue, an estimated loss on the contract should be immediately recognized by providing for a loss on construction contracts.

The revenues recognized by the percentage-of-completion method for the year ended March 31, 2020, were ¥18,268 million (\$167,859 thousand).

- i. Income Tax*—The provision for income taxes is computed based on the pretax income included in the statement of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted income tax rates to the temporary differences.

The Company's parent company files a tax return under the consolidated corporate tax system, which allows companies to base tax payments on the combined profits or losses of the parent company and its wholly owned domestic subsidiaries. The Company is included in the consolidated corporate tax system.

(Treatment of tax effects for transition from the consolidated corporate tax system to the group tax sharing system)

Regarding the transition from the consolidated tax system to the newly established group tax sharing system and the several changes to accounting policies of the single taxation system following the aforementioned transition under the act on partial revision of income tax act (Act No. 8, 2020), the Company calculates deferred tax assets and liabilities based on the corporate tax law before revision, notwithstanding the provisions of section 44 of the ASBJ Implementation Guidance on tax effects accounting (Guidance No. 28, February 16, 2018), pursuant to Section 3 of the ASBJ Practical Solution on the treatment of tax effects for the transition from the consolidated corporate tax system to the group tax sharing system (PITF No. 39, March 31, 2020).

- j. Per Share Information*—Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period.

Cash dividends per share presented in the accompanying statement of income are dividends applicable to the fiscal year, including dividends accrued and paid after the end of the year.

- k. New Accounting Pronouncements*—On March 31, 2020, the ASBJ issued ASBJ Statement No. 29, " Accounting Standard for Revenue Recognition," and ASBJ Guidance No. 30,

" Implementation Guidance on Accounting Standard for Revenue Recognition." The core principle of the standard and guidance is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognizes revenue in accordance with that core principle by applying the following steps:

Step 1: Identify the contracts with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognize revenue when the entity satisfies a performance obligation

The accounting standard and guidance are effective for annual periods beginning on or after April 1, 2021. Earlier application is permitted for annual periods beginning on or after April 1, 2018.

The Company expects to apply the accounting standard and guidance for annual periods beginning on or after April 1, 2021, and is in the process of measuring the effects of applying the accounting standard and guidance in future applicable periods.

3. NOTES TO BALANCE SHEET

a. Inventories

Inventories at March 31, 2020, consisted of the following:

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Construction projects in progress	¥ 1,022	\$ 9,392
Finished products	1,467	13,479
Work in process	127	1,165
Raw materials and supplies	108	997
Total	<u>¥ 2,724</u>	<u>\$ 25,033</u>

b. Contingent liabilities

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Guarantees to loans from banks of the parent company	¥ 4,850	\$ 44,565
Trade notes endorsed	168	1,541
Total	<u>¥ 5,018</u>	<u>\$ 46,106</u>

4. NOTES TO STATEMENT OF CHANGES IN EQUITY

a. Type and number of outstanding shares

For the year ended March 31, 2020	Number of Shares			
	Balance at Beginning of Year	Increase in Shares During the Year	Decrease in Shares During the Year	Balance at End of Year
Issued stock:				
Common stock	8,620,000	—	—	8,620,000

b. Dividends

(1) Dividends paid to shareholders For the year ended March 31, 2020

Resolution Approved by	Type of Shares	Amount		Amount per Share		Record Date	Effective Date
		Millions of Yen	Thousands of U.S. Dollars	Yen	U.S. Dollars		
Annual General Meeting of Shareholders (June 21, 2019)	Common stock	¥73	\$673	¥8.5	\$0.08	March 31, 2019	June 24, 2019
Board of Directors (October 18, 2019)	Common stock	¥73	\$673	¥8.5	\$0.08	September 30, 2019	November 29, 2019

(2) Dividends with a record date during the fiscal year but an effective date subsequent to the fiscal year For the year ended March 31, 2020

Resolution Approved by	Type of Shares	Amount		Amount per Share		Record Date	Effective Date
		Millions of Yen	Thousands of U.S. Dollars	Yen	U.S. Dollars		
Annual General Meeting of Shareholders (June 19, 2020)	Common stock	¥73	\$673	¥8.5	\$0.08	March 31, 2020	June 22, 2020

5. EQUITY

Japanese companies are subject to the Companies Act of Japan (the "Companies Act"). The significant provisions in the Companies Act that affect financial and accounting matters are summarized below:

a. Dividends

Under the Companies Act, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the general meeting of shareholders.

For companies that meet certain criteria including (1) having a Board of Directors, (2) having independent auditors, (3) having an Audit & Supervisory Board, and (4) the term of service of the directors being prescribed as one year rather than the normal two-year term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends-in-kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation. However, the Company does not meet all the above criteria.

Semi-annual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Companies Act provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

b. Increases/Decreases and Transfer of Common Stock, Reserve, and Surplus

The Companies Act requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus), depending on the equity account charged upon the payment of such dividends, until the aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Companies Act, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Companies Act also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts within equity under certain conditions upon resolution of the shareholders.

6. INCOME TAXES

The tax effects of significant temporary differences which resulted in deferred tax assets and liabilities at March 31, 2020, are as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Deferred tax assets:		
Share-based compensation expenses	¥ 27	\$ 247
Accrued enterprise tax	23	215
Retirement payments	33	305
Provision for warranties for completed construction	12	112
Impairment loss	13	119
Other	24	221
Subtotal	132	1,219
Valuation allowance	(22)	(202)
Total	110	1,017
Deferred tax liabilities:		
Unrealized gain on available-for-sale securities	(3)	(31)
Total	(3)	(31)
Net deferred tax assets	¥ 107	\$ 986

7. FINANCIAL INSTRUMENTS

a. Overview

(1) Policy for financial instruments

The Company raises funds by borrowing from the parent company and banks. Also, the Company restricts temporary excess fund management to highly secure assets such as time deposits.

(2) Types of financial instruments related risks and risk management

Receivables, such as trade note receivables, electronically recorded monetary claims, and trade account receivables, are exposed to the credit risk of customers. In order to mitigate the risk when orders are received, the Company conducts strict screening and determines project plans on the basis of internal guidelines. As investment securities are exposed to market risk, the Company monitors market prices of these securities.

Long-term loans are used for operations or capital investment.

The Company does not engage in derivative transactions.

b. Fair value of financial instruments

The following table shows the carrying values and fair values of financial instruments as of March 31, 2020, and any differences. Certain financial instruments for which it is extremely difficult to determine the fair value are not included.

At March 31, 2020	Millions of Yen			Thousands of U.S. Dollars		
	Carrying Value	Fair Value	Difference	Carrying Value	Fair Value	Difference
Assets						
Cash and cash equivalents	¥ 137	¥ 137	—	\$ 1,263	\$ 1,263	—
Receivables	11,844	11,844	—	108,826	108,826	—
Investment securities	20	20	—	184	184	—
Liabilities						
Short-term borrowings from the parent company	5,835	5,835	—	53,614	53,614	—
Payables	6,625	6,625	—	60,879	60,879	—
Income taxes payable	112	112	—	1,030	1,030	—
Advances received on uncompleted construction contracts	511	511	—	4,692	4,692	—

Assets

Cash and cash equivalents and Receivables

Since cash and cash equivalents and receivables are settled in a short period of time, the carrying value approximates fair value.

Investment securities

The fair value of stocks is determined based on quoted market prices.

Liabilities

Short-term borrowings from the parent company, Payables, Income taxes payable, and Advances received on uncompleted construction contracts

Since these accounts are settled in a short period of time, the carrying value approximates fair value.

c. Carrying amount of financial instruments whose fair value cannot be reliably determined

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Non-listed stocks	¥ 71	\$ 656

It is extremely difficult to determine the fair values for these securities since they have no quoted market prices available. Thus, they are not included in “Investment securities” above.

8. RELATED PARTY DISCLOSURES

a. Parent company

Transactions with the parent company for the year ended March 31, 2020, were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Fee for consulting and administrative services	¥ 119	\$ 1,093
Allocated amount of consolidated corporation tax	185	1,699
Rental fees for land and office buildings	118	1,083
Interest expense	42	382
Guarantees to parent company’s liabilities	4,850	44,565

The balances due to or from the parent company at March 31, 2020, were as follows:

	Millions of Yen	Thousands of U.S. Dollars
	2020	2020
Receivables	¥ 4	\$ 34
Other assets	59	542
Payables	209	1,925

Business terms:

1. Fee for consulting and administrative services are determined through negotiations with the parent company based on the amounts suggested by the parent company.
2. Rental fees for land and office buildings are determined through negotiations with the parent company on an arm’s-length basis.
3. The parent company uses a Cash Management System (CMS) for its subsidiaries to control the cash surplus and spend money efficiently at the group level. The interest rates on loans within the CMS are generally decided based on the current market interest rates available.

Because the loans within the group are made as needed, the amounts of the transactions are omitted from the table above.

4. The allocated amount of consolidated corporate tax is allocated based on the calculation of consolidated taxation by the parent company.

b. Affiliated companies

Transactions with affiliated companies for the year ended March 31, 2020, were as follows:

	<u>Millions of Yen</u>	<u>Thousands of U.S. Dollars</u>
	2020	2020
Net sales	¥ 74	\$ 682
Cost of sales	446	4,096
Selling, general and administrative expenses	31	282
Non-operating transactions	0	4

The balances due from / to affiliated companies at March 31, 2020, were as follows:

	<u>Millions of Yen</u>	<u>Thousands of U.S. Dollars</u>
	2020	2020
Receivables	¥ 302	\$ 2,777
Payables	105	960

9. PER SHARE INFORMATION

	<u>Yen</u>	<u>U.S. Dollars</u>
	2020	2020
Per share amounts:		
Net assets	¥ 369.27	\$ 3.39
Basic net income	79.05	0.73

Diluted net income per share is not presented since there are no dilutive shares of common stock issuable upon conversion of the convertible debt.