COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Holdings Corporation

3167

Tokyo Stock Exchange First Section

19-Jan.-2018

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Summary

Made a smooth start toward achieving the targets in the medium-term management plan

Based in Shizuoka Prefecture, Japan, TOKAI Holdings Corporation <3167> (hereinafter, "Tokai Holdings" or "the Company") is expanding its two main businesses, "energy and lifestyle-related services", primarily the provision of liquefied petroleum gas (LP gas), and "information and communications services". The Company aims to become a "Total Life Concierge*" (TLC), a company offering a complete range of services for everyday life. In its medium-term management plan, "Innovation Plan 2020 'JUMP'" (hereafter, "IP20"), which started in FY3/18, TOKAI Holdings targets sales of ¥339.3bn, an increase of 1.9 times from FY3/17, and operating profit of ¥22.5bn, an increase of 1.8 times. The Company intends to employ M&A and alliances to promote the growth strategy.

* The Total Life Concierge concept indicates the Company's aim to provide every type of lifestyle support service under a one contract, one stop, and one call-center model. While deepening its connection with customers, their local communities, society, and the global environment, the Company aims to enrich people's lives, assist in the development of local communities, and contribute to protecting the global environment.

1. Profits declined YoY in the FY3/18 1H results, but still exceeded the forecast

In the FY3/18 1H (April to September, 2017) consolidated results, net sales increased 3.3% year-on-year (YoY) to ¥84,911mn, but operating profit decreased 29.3% to ¥3,114mn. In the CATV business, sales increased for the first time in three years, including from the effects of Tokyo Bay Network Co., Ltd., being made a subsidiary. Conversely, operating profit declined due to investment of approximately ¥2bn, including for the costs to acquire customers and for the launches of new services, but it still exceeded the initial Company forecast (¥2,710mn). At the end FY3/18 2Q, the number of Group customers had increased to 2,827,000, up 263,000 on the end of the previous fiscal year. Financially also, the improvements continued, including that the equity ratio rose from 34.5% at the end of the previous fiscal year to 36.0%, and as a whole, it can be said that the Company made a smooth start.

2. Profits are also set to decline in FY3/18 due to upfront-investment costs, but the forecasts are for double-digit increases in profits from FY3/19

For the FY3/18 consolidated results, the initial forecasts have been left unchanged, of net sales to increase 6.0% YoY to ¥189,400mn and operating profit to decline 10.5% to ¥11,410mn. Operating profit will temporarily decline, mainly due to the increase in upfront-investment costs, including to expand the sales area of the LP gas business, to strengthen sales promotions for LIBMO, which is a new service in the information and communications services business, and to prevent the cancellation of contracts by retail customers. However, the current round of upfront investment will have been completed by FY3/19, and from then on, the forecast is for double-digit increases in profits. As its M&A measures, the Company announced that it had acquired the shares of TV Tsuyama Inc. (Okayama Prefecture, equity stake, 96.0%, approximately 10,000 customers) and will make it a subsidiary from January 2018. Group company KCT, Co., Ltd., is located in Okayama, and in addition, since September 2017 the Company has newly entered into the gas business in this area, so synergies are expected in the future.

3. In the new medium-term management plan (IP20), is actively pursuing M&A and will strategically invest ¥100bn over four years

In the new medium-term management plan IP20, the Company plans to strategically invest ¥100bn over the next four years and is working to expand its earnings base (customer numbers) in the mainstay businesses of gas, CATV, and information and communications services. Also, at the same time it is working to strengthen cross-sales of Group services. Currently, among the Company Group's customers, only 7% of them have a contract for more than one service, and it is aiming to raise this to 20% over the next four years, thereby further increasing net sales per customer and profits. The Company is also working on developing new business that will become the next generation earnings pillars over the next four years. For the "Total Life Concierge" concept, it is envisaging new services in the healthcare, education, and mobility fields, and it is considering M&A and related measures in these fields.

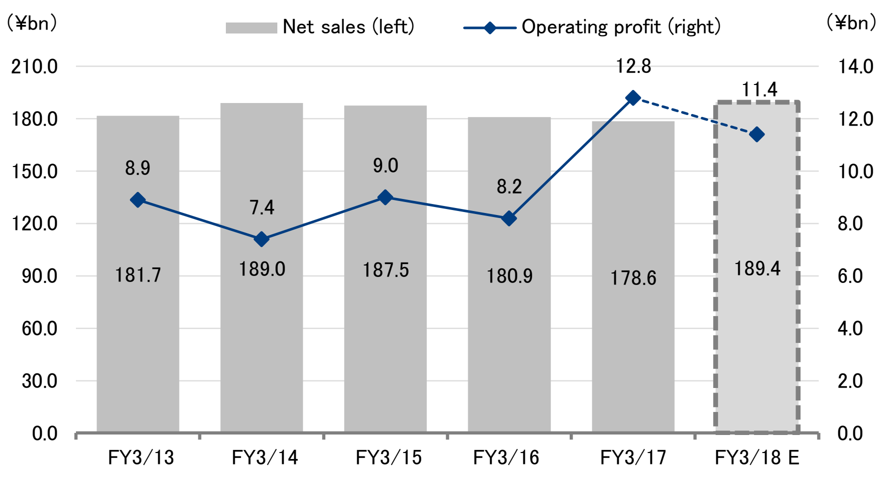
4. Continues to actively return profits to shareholders

There has been no change to the policy of continuously and stably returning profits to shareholders. The forecast dividend per share for FY3/18 is ¥28.0 (dividend payout ratio, 55.0%), which is unchanged from the previous fiscal year. Going forward, the Company intends to pay dividends while observing profit trends, with a benchmark dividend payout ratio of 40% to 50%. Also, at the end of March and the end of September, it presents one gift to shareholders from choices such as an Aqua product, a QUO card, points for a TLC member service worth ¥1,000, one-year free of charge course for inexpensive SIM service LIBMO. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (closing price of ¥875 on November 13), it is in the range of 4% to 8% (depending on the selection of either a QUO card or an Aqua product as the gift).

Key Points

- Sales increased but profits decreased due to upfront-investment costs, but the forecasts were still exceeded on a profits basis
- By FY3/21, is aiming for more than 4.32 million Group customers and consolidated operating profit of ¥22.5bn
- Finances are improving and the equity ratio is continuing to rise

Result trends



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

Result trends

Sales increased but profits decreased due to upfront-investment costs, but the forecasts were still exceeded on a profits basis

1. Overview of the FY3/18 1H results

In the FY3/18 1H consolidated results announced on October 31, 2017, net sales increased 3.3% YoY to ¥84,911mn, operating profit decreased 29.3% to ¥3,114mn, recurring profit fell 29.0% to ¥3,143mn, and net income attributable to the owners of the parent declined 47.7% to ¥1,246mn. At the end of September, the number of Group customers had steadily increased by 273,000 YoY to 2,827,000, including due to the effects of M&A, and sales increased for the first time in three years. Conversely, the reasons for the decline in operating profit was spending of approximately ¥2bn on upfront-investment costs, including to acquire new customers, to prevent contract cancellations, and on sales promotion on the launch of LIBMO, which is a new service in the information and communications services business. However, this result still exceeded the initial forecast by 14.9%, mainly due to the strong performances of the CATV business and the corporate communication services business.

FY3/18 1H consolidated results

(¥mn)

	FY3/17 1H		FY3/18 1H				
	Results	% of sales	Target	Results	% of sales	YoY	vs. target
Net sales	82,201	-	86,000	84,911	-	3.3%	-1.3%
Cost of sales	48,577	59.1%	-	50,436	59.4%	3.8%	-
SG&A expenses	29,218	35.5%	-	31,360	36.9%	7.3%	-
Operating profit	4,406	5.4%	2,710	3,114	3.7%	-29.3%	14.9%
Recurring profit	4,428	5.4%	2,650	3,143	3.7%	-29.0%	18.6%
Extraordinary income (loss)	-208	-	-	-553	-	-	-
Net income attributable to owners of the parent	2,384	2.9%	1,080	1,246	1.5%	-47.7%	15.4%

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

Looking at the breakdown of the changes in the number of customers, they increased steadily YoY in the LP gas, CATV, and Aqua businesses, by 14,000, 273,000, and 6,000 respectively. They only declined in the information and communication services business, down by 21,000. This was because while they continued to increase for the Hikari Collaboration service, up by 43,000, this increase was exceeded by the pace of the reduction for the previous ISP service and other services. The intensification of competition with the major mobile carriers is considered to be a factor behind the outflow of some customers. Therefore, in February 2017, the Company newly entered the MNVO* business and launched LIBMO, an inexpensive SIM service. By offering an inexpensive mobile service, it is aiming to create a sense of low cost for its sales of sets with the Hikari Collaboration service and thereby prevent the outflow of customers. At the end of September, the number of contracts for LIBMO was 13,000, which was basically as planned. In the increase of customers in the CATV business, the addition of 250,000 was from Tokyo Bay Network Co., Ltd., being made a subsidiary in July 2017, so the actual increase on excluding them was 23,000.

* MVNO (Mobile Virtual Network Operator): Operators who provide services by borrowing other companies' wireless communication infrastructure, such as for mobile phones.

What is noteworthy in the FY3/18 1H period is the acceleration of the pace of the net increase in the number of customers, which has been sluggish in the last few years. Looking at the trend in this net increase by fiscal year, we see that recently it peaked at 73,000 customers in FY3/14, and then slowed to 19,000 customers in FY3/15, 20,000 customers in FY3/16 and 6,000 customers in FY3/17. However, in the FY3/18 1H period, it increased by 13,000 customers even after excluding the effects of the M&A in the CATV business. Looking on a monthly basis also, we see that the increase actually accelerated by a pace of more than four times. This is considered to be from the appearance of the effects from the Company investing in measures to acquire customers and to prevent contract cancellations.

Customer numbers by key services

(thousand)

	End of FY3/15 2Q	End of FY3/16 2Q	End of FY3/17 2Q	End of FY3/18 2Q	YoY
Gas (LP gas, city gas)	626	627	634	648	14
LP gas	573	573	580	594	14
City gas	53	53	54	54	0
Information and communications	1,093	1,093	1,071	1,050	-21
Previous ISP, etc.	861	742	565	504	-61
Hikari Collaboration	-	117	272	315	43
Mobile	231	234	234	231	-3
CATV	690	698	722	995	273
CATV broadcasting	496	494	503	748	245
CATV communications	194	203	218	247	29
Aqua	132	132	135	141	6
Security	18	18	17	17	0
Total	2,535	2,543	2,554	2,827	273
(Number of TLC members)	356	439	535	642	107

* The number of customers below a thousand is rounded to the nearest thousand. Information and Communications and CATV both offer communications services, so total figures avoid duplication.
Source: Prepared by FISCO from the Company's results briefing materials and financial results

The number of subscribers increased from the set discounts, and the CATV business achieved higher sales and profits

2. Trends by business segment

Net sales by segment

(¥mn)

	FY3/15 1H	FY3/16 1H	FY3/17 1H	FY3/18 1H	YoY
Gas and petroleum	42,754	37,958	32,496	32,777	0.9%
Information and communications services	19,546	20,425	23,750	24,906	4.9%
CATV	12,144	12,212	12,560	13,607	8.3%
Building and real estate	8,197	9,301	8,040	8,349	3.8%
Aqua	2,423	2,746	2,929	3,055	4.3%
Other businesses	2,207	2,128	2,423	2,214	-8.6%
Total	87,274	84,773	82,201	84,911	3.3%

Operating profit by segment

(¥mn)

	FY3/15 1H	FY3/16 1H	FY3/17 1H	FY3/18 1H	YoY
Gas and petroleum	2,028	2,661	2,838	1,562	-45.0%
Information and communications services	2,389	1,086	1,910	1,541	-19.3%
CATV	843	968	1,451	1,769	21.9%
Building and real estate	143	347	324	388	19.9%
Aqua	-979	-616	201	135	-32.7%
Other businesses	-2,608	-2,590	-2,318	-2,282	-
Total	1,816	1,856	4,406	3,114	-29.3%

* Values are prior to allocating indirect costs and other expenses
Source: Prepared by FISCO from the Company's financial results

(1) Gas and petroleum business

In this business, net sales increased 0.9% YoY to ¥32,777mn and operating profit* decreased 45.0% to ¥1,562mn. Within it, in the mainstay LP gas business, the Company worked to acquire new customers and to prevent contract cancellations in its existing areas, while it also made progress in acquiring new customers in the areas it has newly entered into, of Sendai, Aichi, and Gifu. As a result, the number of customers increased by 14,000 YoY to 594,000. However, as the gas sales volume was basically at the same level YoY, net sales increased only slightly, up 0.6% to ¥27,478mn. Conversely, in the city gas business, customer numbers were unchanged YoY at 54,000, but net sales still increased 2.4% to ¥5,299mn due to the rise in sales unit prices.

* Operating profit is before the deduction of indirect costs, and the calculation method is different to that in the financial results summary report.

Looking at the factors that caused profits to change, the majority of the decrease was due to the YoY increase in costs to acquire customers of ¥500mn, for fee-related measures to acquire new customers of ¥400mn, and to prevent contract cancellations of ¥400mn. The increase in purchasing costs following the rise in the oil prices was a decrease factor of ¥1.2bn, but ¥1.1bn of this was absorbed by the higher sales prices.

(2) Information and communications services business

In this business, net sales increased 4.9% YoY to ¥24,906mn and operating profit fell 19.3% to ¥1,541mn. Within it, in the consumer business, net sales rose 0.5% to ¥15,703mn, as despite the decline in the number of customers for the previous ISP service and other services, customer numbers increased for the Hikari Collaboration service that has high monthly revenue. Operating profit declined, as although Hikari Collaboration became profitable, the Company invested ¥500mn including on sales promotion costs for LIBMO and on measures to prevent the cancellation of contracts for broadband services.

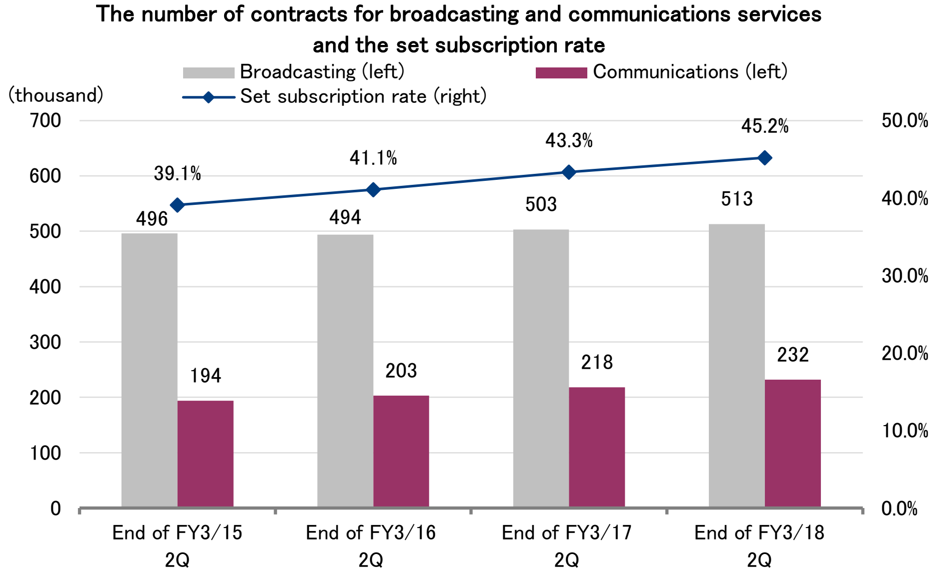
In corporate services, the stock-type business, which includes cloud services, is steadily growing, and in addition, orders for systems development projects are trending stably. As a result, net sales increased 13.2% YoY to ¥9,202mn, while profits also rose double-digit due to the effects of the higher sales.

(3) CATV business

In this business, net sales increased 8.3% YoY to ¥13,607m and operating profit rose 21.9% to ¥1,769mn. For this first time, this business earned the most operating profit among all the businesses. The contribution of Tokyo Bay Network, which entered the scope of consolidation from 2Q, was ¥700mn, and the effect of this on operating profit was negligible. The actual rate of increase in sales after excluding the effects of the M&A was about 3%.

Looking at the breakdown in the number of contracts after excluding Tokyo Bay Network, in broadcasting services, they increased 10,000 YoY to 513,000, and in communication services, they rose 14,000 to 232,000. The Company continued to offer discounted services from subscriptions to sets of broadcasting and communication services and smartphone set discounts from collaboration with a major mobile carrier, and this improved price competitiveness led to a rise in the number of subscriptions. In particular, the contract rate for sets of broadcasting and communications services is rising year by year, and at the end of FY3/18 2Q, it had risen by 1.9 percentage points YoY to 45.2%. It is considered that the increase in monthly revenue per customer from the rise in the rate of subscriptions to sets is improving profitability.

Looking at the number of contracts for Tokyo Bay Network according to service, at the end of FY3/18 2Q, it had 235,000 for broadcasting services and 15,000 for communications services, and the set contract rate was at a level of below 10%. This is considered to be due to the fact that Tokyo Bay Network's infrastructure has not yet been converted to fiber optics. Therefore, currently, the company is investing in converting it to fiber optics, and its strategy is to rapidly launch high-speed Internet services over fiber optic communication lines, thereby raising the communications services contract rate and improving profitability.



Note: the set subscription rate is calculated as the number of communications contracts ÷ the number of broadcasting contracts, excluding Tokyo Bay Network.
Source: Prepared by FISCO from the Company's financial results

(4) Building and real estate business

In this business, net sales increased 3.8% YoY to ¥8,349mn, and operating profit rose 19.9% to ¥388mn. Sales of solar power generation equipment declined, but this was covered by higher sales of homes, new store building projects, and in the building management support business.

(5) Aqua business

In this business, net sales increased 4.3% YoY to ¥3,055mn and operating profit declined 32.7% to ¥135mn. The reason for the decline in profits was that the penetration rate in Shizuoka Prefecture, which accounts for about half of the customers, has basically reached its upper limited. Therefore, the Company spent to strengthen sales promotion measures, including at commercial facilities in urban areas, in order to increase the number of customers.

(6) Other businesses and adjustments

In other businesses, net sales decreased 8.6% to ¥2,214mn. Breaking this down, in the nursing care business, sales rose 18.3% to ¥506mn following an increase in the number of facility users, while in the shipbuilding business, sales were down 10.6% to ¥686mn due to the decrease in the volume of ship repair work. In addition, sales in the wedding ceremony business fell 23.3% to ¥672mn following the closure of one of the two facilities at the end of March 2017. This segment recorded an operating loss of ¥2,282mn, including internal adjustments, (compared to an operating loss of ¥2,318mn in the same period in the previous fiscal year).

Business outlook

Profit to decline temporarily in FY3/18 on upfront investments

1. FY3/18 earnings outlook

For the FY3/18 consolidated results, the initial forecasts have been left unchanged, of net sales to increase 6.0% YoY to ¥189,400mn, operating profit to decline 10.5% to ¥11,410mn, recurring profit to decrease 11.1% to ¥11,360mn, and net income attributable to the owners of the parent to fall 12.1% to ¥6,450mn. The progress made for the full fiscal year forecasts up to 2Q appears low, of 44.8% of the net sales forecast and 27.3% of the operating profit forecast. But in the case of the Company, revenue in the gas business is mainly generated in the 2H, so the progress can be said to be basically in line with the forecasts. For example, on looking at the average rates of progress for the last 3 years, we see it was 46.5% for net sales and 26.9% for operating profit.

Looking at the factors in FY3/18 causing operating profit to increase and decrease, the increase factor is that fee revenue is expected to rise ¥1.1bn from the growth in the number of customers, while the decrease factors will be ¥1.1bn in the LP gas business, including for base costs following the area expansion, customer-acquisition costs, and the reduction in fees; ¥500mn for sales promotions costs for LIBMO; and ¥900mn for costs to prevent customers cancelling their contracts, mainly in the gas business and communications services business. However, looking only at 2H, operating profits will be basically unchanged YoY, and from FY3/19, which is when the current round of upfront investment will have been completed, the forecast is for double-digit increases in profits.

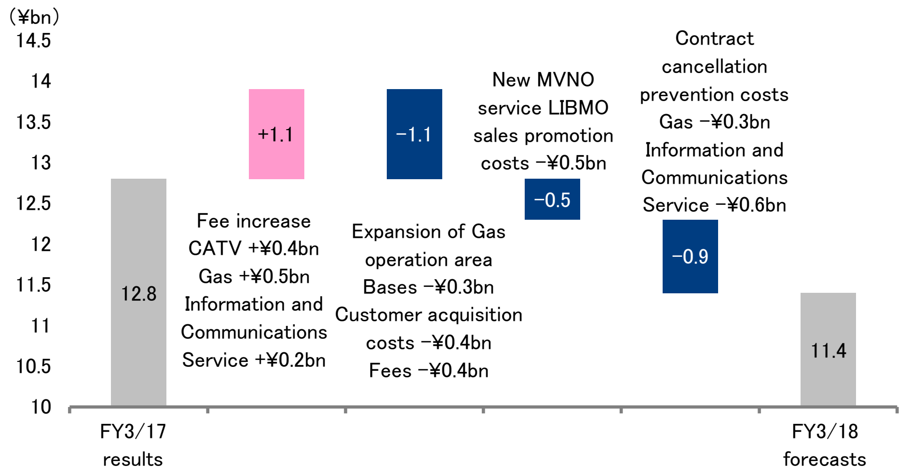
Outlook for the FY3/18 consolidated results

(¥mn)

	FY3/17		FY3/18				
	Results	% of sales	Full-year forecast	% of sales	YoY	1H results	Progress rate
Net sales	178,631	-	189,400	-	6.0%	84,911	44.8%
Operating profit	12,750	7.1%	11,410	6.0%	-10.5%	3,114	27.3%
Recurring profit	12,775	7.2%	11,360	6.0%	-11.1%	3,143	27.7%
Net income attributable to owners of the parent	7,337	4.1%	6,450	3.4%	-12.1%	1,246	19.3%

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

Factors expected to impact operating profit in FY3/18



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

At the end of FY3/18, the forecast is for the number of Group customers to have increased by 320,000 on the end of the previous fiscal year to 2.88 million. To achieve this, it will be necessary to acquire the remaining 53,000 customers in the 2H, but within this, 14,000 can be added from the customers of TV Tsuyama (approximately 10,000 customers for broadcasting services and 4,000 for communications services), which the Company announced that it will make a subsidiary in January 2018. Therefore, the remaining number to be acquired is 39,000 customers. Of this number, the plan is to obtain 16,000 from the increase in customers in the LP gas business, and the remainder from increases in the CATV, Hikari Collaboration, LIBMO, and Aqua businesses. The net increase in 1H was 13,000 customers (excluding from the M&A), so while the hurdle to achieve the forecast is somewhat high, the Company is aiming to achieve it through advancing various measures, including acquiring new customers from expanding the sales areas in the LP gas business, and increasing set sales of Hikari Collaboration and LIBMO from creating a sense of it being inexpensive and thereby preventing the outflow of customers to major mobile carriers in communications services.

In terms of the conditions on entering 3Q, it seems that results are trending favorably in all of the segments. Therefore, while there it is possible that the full fiscal year net sales will be slightly below the forecast, at FISCO we think the Company is highly likely to achieve its forecasts on a profits basis.

By FY3/21, is aiming for more than 4.32 million Group customers and consolidated operating profit of ¥22.5bn

2. Medium-term management plan

(1) Basic policy

In the new medium-term management plan (IP20) launched in FY3/18, the Company sets out its basic strategy of prioritizing topline growth and switching from defensive to proactive management. In the next four years, it will proactively conduct M&A and form alliances that will lead to the expansion of its customer base, and it plans to conduct strategic investment worth a total of ¥100bn. The candidates for M&A are companies that have a customer base in its core businesses, including gas, CATV, and information and communications services, and it is also targeting companies in areas peripheral to its existing lifestyle-related services. This is considered to be because it must provide new value and services in order to realize its “Total Life Concierge” concept and also to stably realize growth over the long term. Specifically, it seems to be looking for candidates to develop businesses in fields such as healthcare, education, mobility, and the sharing economy.

(2) Targets for management indicators

In terms of the numerical management targets, in FY03/21, it is aiming for net sales of ¥339.3bn, operating profit of ¥22.5bn, and net income attributable to owners of the parent of ¥11.5bn. Compared to FY3/17, these are increases of net sales by 1.9 times, operating profit by 1.8 times, and net income attributable to owners of the parent by 1.6 times. It is also aiming to grow the number of Group customers by 1.7 times, to 4.32 million. Financially, it is investing ¥100bn, including for M&A and alliances, so interest-bearing debt is expected to rise. Looking at the interest-bearing debt / EBITDA ratio, it will grow slightly, from 2.0 times in FY3/17 to 2.8 times in FY3/21, but this can still be said to be at a financially sound level. It is also targeting an equity ratio of 31.6% and ROE of 13.0%.

When implementing the current investment of ¥100bn, the Company is considering a ROI (operating profit before the amortization of goodwill ÷ the investment amount) at a level of around 8% as the investment criteria for candidate proposals.

Financial targets in Innovation Plan 2020

(¥bn)

	FY3/17 Results	FY3/18 Targets	FY3/19 Targets	FY3/20 Targets	FY3/21	
					Targets	Vs. FY3/17
Net sales	178.6	189.4	202.0	224.4	339.3	1.9x
Operating profit	12.8	11.4	14.0	16.2	22.5	1.8x
Net income attributable to owners of the parent	7.3	6.4	7.9	8.7	11.5	1.6x
Total assets	161.1	169.8	173.8	191.2	283.4	1.8x
Interest-bearing debt/EBITDA ratio (x)	2.0	2.4	2.2	2.0	2.8	
Equity ratio (%)	34.5	33.9	35.6	34.9	31.6	
ROE (%)	15.2	11.1	12.8	13.0	13.0	
Number of customers (million contracts)	2.56	2.88	2.99	3.72	Over 4.32	Over 1.7x

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

3. Major business initiatives

(1) LP gas business

The residential and commercial LP gas market is forecast to contract by around 7% over the next four years due to factors including the declining population and improvements in the performance of energy-efficient equipment. Therefore, small- and medium-sized businesses are expected to be eliminated or absorbed into larger corporate groups because of the intensified competition. The Company currently ranks third in the industry for the number of customers, and it has the top share of 22% in Shizuoka Prefecture, its main sales area, while it ranks second with 7% in the Kanto region. As there are many small- and medium-sized businesses in each region throughout the country, even on totaling the shares of the top 10 ranked companies, their market share would still be less than 20%. Therefore, even if the market as a whole contracts, it can still be said that it is possible to continue to grow by increasing market share.

In the medium-term management plan, in addition to increasing market shares within its existing areas, the Company is aiming for sustainable growth by expanding its sales areas and is targeting increasing the number of customers by 30% over four years, to 760,000. In terms of the new sales areas, since FY3/16, it has newly entered-into the Chubu area (Gifu Prefecture and Aichi Prefecture) and the Tohoku area (Miyagi Prefecture) and established a total of five bases in them (in Gifu, Toyokawa, Nishi Mikawa, Sendai, and Iwaki). In addition, in September 2017, it newly entered-into Okayama Prefecture (Kurashiki). Okayama is the location of Group company KCT, Co., Ltd. (number of customers; broadcasting 90,000, communications, 30,000), which is conducting a CATV business, and the Company will propose cross-selling for its customers. It is also aiming to first acquire 10,000 customers by working to acquire new sales from the approximately 260,000 households in its service areas. In addition, in November 2017, it opened a sales office in Gifu Prefecture (Tajimi), and it plans to enter into Fukuoka Prefecture (Fukuoka) by March 2018, and Mie Prefecture (Mie) and Nagano Prefecture (Suwa) by FY3/19. In Fukuoka, the Company is deploying a building management support business, and in Suwa, a CATV business by the respective Group companies and it is pursuing a cross-selling strategy.

The Company plans to increase the number of customers in these new areas by 9 times, from 8,000 at the end of FY3/17 to 70,000 in four years' time, which will give it a share of approximately 2% in these areas. Conversely, for its existing areas also, it is aiming to increase its market share from around 8% to approximately 10% through measures including cross-selling proposals and a price strategy.

Number of LP gas direct sales customers

Rank	Company	(million)	Share
1	Iwatani Corporation <8088>	0.87	3.8%
2	NIPPON GAS CO.,LTD. <8174>	0.76	3.3%
3	TOKAI CORPORATION	0.59	2.6%
4	TOHO LIQUEFIED GAS Co., Ltd.	0.35	1.5%
5	MITSUUROKO CO.,LTD.	0.35	1.5%
6	ITOCHU ENEX CO., LTD.	0.34	1.5%
7	ENEOS GLOBE ENERGY Corporation	0.32	1.4%
8	Saisan Co., Ltd.	0.29	1.3%
9	Gaspal Corporation	0.25	1.1%
10	HORIKAWA SANGYO Co., Ltd.	0.22	1.0%
10 company total		4.35	19.0%
Market total		22.82	100.0%

Note: TOKAI's value are from the end of September 2017
Source: Prepared by FISCO from the Company's results briefing materials

(2) City gas business

The city gas retail market was liberalized in April 2017, so it forecast that in the future, major corporate groups will form within it. Currently, there are 203 city gas business companies nationwide, within which, other than the 4 major companies, reorganization and consolidation are expected to occur for the many small- and medium-sized businesses.

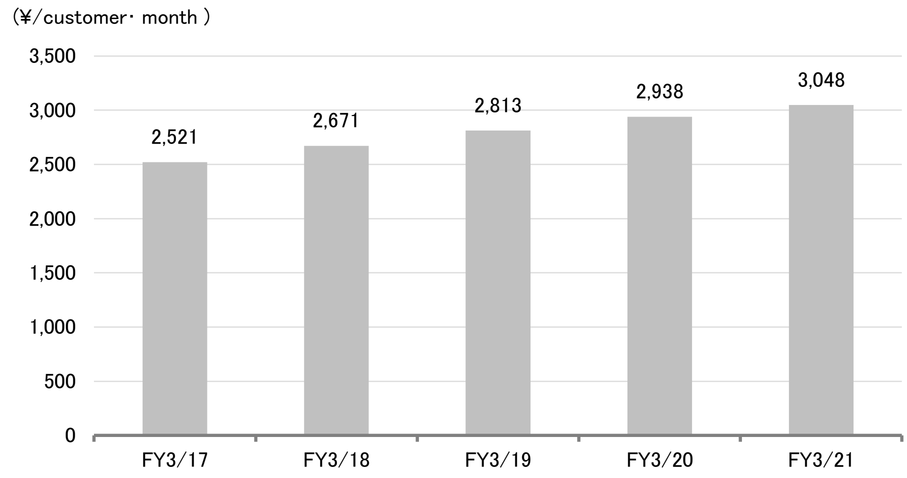
In this situation, the Company's strategy is to actively conduct M&A and form alliances. While investing in extending pipelines and capturing new industrial demand, it is aiming for 100,000 contracts, double the number at the end of FY3/17. It is targeting the entire country for the areas to newly enter into, but there has been no change for its preference for areas where the Group's other services are being provided. The Company is also developing a renovation business focused on plumbing (in the building and real estate segment), and it has strong sales capabilities compared to its industry peers. If the number of city gas customers increase, this will raise expectations for higher revenue in the renovation business. Most small- and medium-sized city gas businesses do not offer additional products and services, so if investment by the Company enables them to do so, then this will be a positive for their management also. Therefore, it is anticipated that the M&A will proceed comparatively smoothly.

(3) Information and Communications business

The Japanese broadband market is considered to be mature, but it is still expected to continue to grow by roughly 1% a year going forward. The Company ranks fourth domestically for sales in the ISP business, and it has market shares of around 23% in Shizuoka Prefecture and around 4% in its Kanto sales-bases area. It seems that it is increasing net sales and profits per customer by acquiring new customers and transferring existing customers to the Hikari Collaboration service, and also by working to maintain and expand its ISP market share. It intends to raise the Hikari Collaboration rate* from the FY3/17 rate of 55.9% to 85.1% in four years' time. This is expected to increase the monthly revenue per customer by 21%, or ¥3,048, compared to the amount in FY3/17. It is also forecasting that the number of broadband service customers will increase by 1.7 times by four years' time, to 1.34 million customers.

* Hikari Collaboration rate = number of Hikari Collaboration contracts at period end ÷ (number of Flets Hikari contracts at period end + number of Hikari Collaboration contracts at period end)

Monthly revenue per customer for FTTH



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

Owing to the proliferation of low-cost smartphones, strong growth is expected in the MVNO market and the total number of contracts is expected to grow from 8.8mn to 19.5mn in four years' time. In order to capture demand in this high-growth market, the Company launched the LIBMO service as a new business in February 2017, and it plans to increase the number of customers to 138,000 by four years' time. LIBMO is an inexpensive service that provides a data communications plus a voice plan for a monthly fee of from ¥1,180 to ¥2,980, and the Company's strategy is to increase the customer sales unit price and make it profitable through adding its own services, such as security services and insurance services. As the sales channels, in addition to those for existing ISP customers, the main channels are sales via large electronics retail stores and online. In particular, it has introduced into large electronic retail stores various discount measures, including set sales with the Hikari Collaboration service, which is contributing to the acquisition of new customers and the prevention of contract cancellations for the Hikari Collaboration.

On the other hand, for corporate information and communications services, the Company plans annual growth of 9%, with net sales increasing from ¥20.6bn in FY3/17 to ¥29.5bn in FY3/21. Within these services, it will strengthen Cloud-related services, whose market is expanding rapidly. It has built a fiber-optic cable network of around 6,000km and it owns data centers in Shizuoka and Okayama, so it already has in place the infrastructure to support growth. The corporate Cloud connection services market is forecast to realize high growth of 3.7 times, growing from ¥5.3bn in FY2016 to ¥19.5bn in four years' time. The Company is aiming to increase sales by utilizing its strengths, which include that it has full coverage for the largest AWS and other major public Clouds in the connection solutions. Also, on November 10, it announced that it had concluded a business outsourcing agreement with Educational Foundation Shingakukai (Nagano Prefecture) and that it has started providing optical Internet services under Shingakukai's own brand to the Foundation's members and to teachers. In this model, the collaborating businesses can focus on sales to their own customers, and services are provided to businesses who want to provide optical Internet services, which are a lifestyle infrastructure service, under their own brands. The Company has already had inquiries from energy businesses (city gas and LP gas), so it plans to actively develop this model in the future.

As one expansion strategy, in October 2017 the Company announced a strategic business collaboration with Cloud Ace, which has the leading track recording domestically for the introduction and technical support for the Google Cloud Platform (GCP). Going forward, both companies will collaborate for GCP sales. For the Company, it is expected that this collaboration will lead to an increase in the number of contracts for GCP connection services.

(4) CATV business

Currently, the CATV business is managed by eight Group companies in metropolitan and five prefectures (Shizuoka Prefecture, Tokyo metropolis, Kanagawa Prefecture, Chiba Prefecture, Nagano Prefecture, and Okayama Prefecture). After Tokyo Bay Network was made a subsidiary, the number of customers rose greatly, from 730,000 at the end of FY3/17 to 990,000 at the end of September 2017 (750,000 for broadcasting services and 240,000 for communications services). Also, in November 2017, the Company announced that it had newly acquired the shares of TV Tsuyama (Okayama) and made it a subsidiary (scheduled to become a consolidated subsidiary from January 2018). In terms of customer numbers, it has approximately 10,000 for its broadcasting services and 4,000 for its communications services, so it is certain that the Group's customer numbers will exceed one million by the end of by FY3/18. In the future, the plan is to increases customers at pace of 20,000 a year in the existing areas, which seems possible as it has achieved a net increase at the same pace in the past. But in the event that the increase is below this, the Company may also conduct M&A. Further, in this business, the plan is to grow operating profit from ¥2.8bn in FY3/17 to ¥4.9bn in FY3/21.

In the CATV business, the Company's strengths include that it is constructing its own optical fiber network. In advance of the Tokyo Olympic and Paralympic Games in 2020, it will start testing and commercialization for high definition 4K/8K broadcasting. But it is necessary to investment in optical fiber and related equipment to provide this high definition broadcasting. The Company plans to invest ¥6.5bn up to FY2020 and achieve practically 100% fiber optic coverage within its service areas. It is also aiming to improve the services of Tokyo Bay Network by investing in converting its network to fiber optics, and its strategy is to improve profitability by increase the number of communication services contracts, which is currently at a low level.

In addition, as a measure to increase the added value of the CATV network, the Company is working to construct a regional wireless network BWA (Broadband Wireless Access). Regional BWA refers to a wireless network system that aims to contribute to the promotion of regional and public welfare, such as by using radio waves that are secured as a dedicated band to improve public services in a region and to eliminate the digital divide (in disadvantageous areas). Specifically, it is used in collaboration with local governments for a disaster prevention network and Wi-Fi spot infrastructure. In October 2017, Tokyo Bay Network also acquired a wireless radio station license for regional BWA and it plans to provide this additional service.

Financial position

Finances are improving and the equity ratio continues to rise

Looking at the financial condition at the end of FY3/18 2Q, total assets had declined ¥614mn on the end of the previous fiscal year to ¥160,497mn. This was because the increase in property, plant and equipment of ¥1,948mn, including due to Tokyo Bay Network being made a consolidated subsidiary, was exceeded by a decrease in notes and accounts receivable-trade of ¥3,323mn, which was mainly due to seasonal factors.

Total liabilities were down ¥2,991mn on the end of the previous fiscal year to ¥101,674mn. Interest-bearing debt increased ¥882mn. In the above amount, ¥2,400mn was from converting convertible bonds with stock acquisition rights. Total net assets were up ¥58,822mn on the end of the previous fiscal year to ¥2,376mn. The main reasons for this increase were the recording of net income attributable to the owners of the parent and the conversion of convertible bonds with stock acquisition rights.

Looking at the management indicators, the equity ratio, which indicates financial soundness, increased by 1.5 percentage points on the end of the previous fiscal year to 36.0%, while the reliance on interest-bearing debt rose 0.7 of a point to 34.3%. It can be said that the Company's financial condition is continuing to improve.

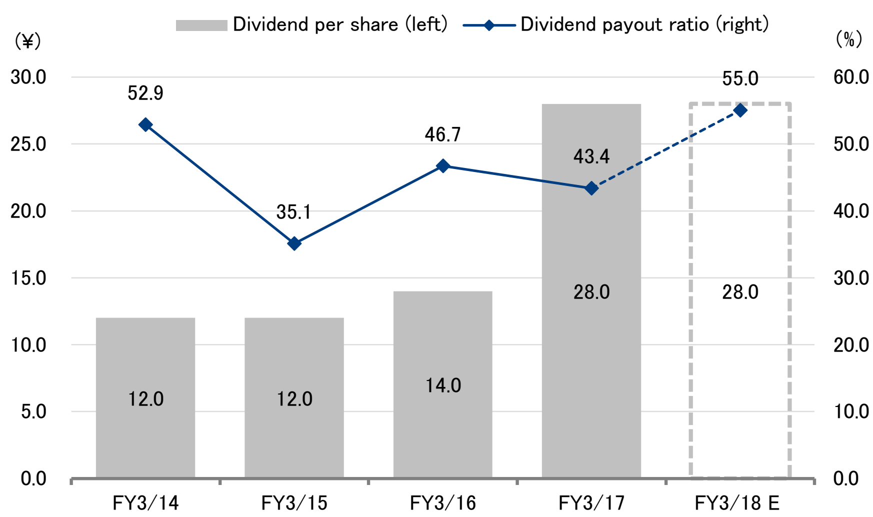
Shareholder return policy

To continue proactive shareholder return policy

The Company returns profits to shareholders by paying dividends, presenting shareholders with gifts, and also purchasing treasury shares depending on conditions. Its basic policy is to continuously pay a stable dividend and it targets a dividend payout ratio of 40% to 50%. For FY3/18, the Company plans to leave dividend distributions unchanged YoY at ¥28.0 per share (the commemorative dividend of ¥6.0 was included in FY3/17) but it will consider a dividend hike in FY3/19 if net income attributable to owners of the parent rises.

The Company presents gifts to shareholders at the end of March and September depending on the number of shares held. For each unit of shares (100 shares) held, shareholders can receive one of the following gifts: an Aqua product worth ¥1,900 (such as the Ulunom) "Fuji-no-Tennensui Sarari" (Mt. Fuji natural water), a QUO card worth ¥500, food coupons worth ¥1,000, or ¥1,000 worth of TLC Membership Service points. Further, shareholders registered at the end of September or March in FY3/17 can also select a special course for LIBMO, the inexpensive SIM service, in which the monthly fee of ¥1,880 becomes free of charge for the maximum of one year. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (¥885 on December 18, 2017), it is in the range of 4% to 8% (depending on the selection of either a QUO card or an Aqua product as the gift).

Dividend per share and dividend payout ratio



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

Information security measures

As its information security measures, since the past the Company has been managing the personal information held in each Group company and conducting measures in the event of a system failure or similar event and to defend against cyber-attacks. Moreover, since FY3/18, it has established a Group-wide expert committee in order share information between all the Group companies and at the same time, to heighten awareness of its security measures.

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