CONEXIO Corporation

9422 Tokyo Stock Exchange First Section

19-Aug.-16

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FISCO Ltd. Analyst
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Five Straight Years of Record-High Operating Income due to Increasing Profitability of Carrier-Certified Shops

CONEXIO Corporation (9422) ("the Company"), a subsidiary of ITOCHU Corporation (8001), is the largest sales agency of mobile phones for NTT DOCOMO (9437) in Japan. In the fiscal year ended March 31, 2016, i.e., in FY3/16, the Company was the second-largest sales agency of mobile phones in Japan in terms of unit sales, and was the largest agency in terms of the number of operating docomo Shops and unit sales for NTT DOCOMO. In addition to selling mobile phones, the Company provides solution services using smartphones to corporate customers and sells prepaid cards at convenience stores.

On May 2, 2016, the Company announced the business results for FY3/16. Non-consolidated net sales decreased 0.6% year on year ("YoY") to ¥281,307mn, but operating income grew 7.1% to ¥9,203mn, for the fifth straight year of record highs. Sales declined slightly, mainly because unit sales of mobile phones decreased 3.2% YoY to 2.88mn units and commission income from telecom carriers fell YoY. Operating income rose despite sales decline because the Company enhanced the profitability of the consumer business by increasing sales of smartphone accessories, contents and optical-fiber broadband services at the carrier-certified shops in addition to making ongoing cost-reduction efforts.

For FY3/17, the Company projects a 4.0% YoY drop in non-consolidated net sales to ¥270,000mn and a 0.1% rise in operating income to ¥9,210mn. The Company forecasts that unit sales decrease to 2.75mn units in FY3/17 from 2.88mn units in FY3/16 because of changes in the market environment, for example, an increase in effective selling prices of mobile phones due to developments such as new guidelines from the Ministry of Internal Affairs and Communications to rectify excessive discounts on smartphone purchases. However, the Company aims to offset these adverse effects in two ways: 1) to raise profit per customer by promoting proposal-based and experience-based customer services, and 2) to streamline the management structure to reduce inefficiency.

For FY3/16, the Company had originally planned to pay dividends of ¥45.0 per share (interim dividends of ¥22.5 per share and term-end dividends of ¥22.5 per share), which would have been ¥5.0 per share more than dividends for FY3/15. However, reflecting the profit growth in FY3/16, the Company paid term-end dividends of ¥25.5 per share, for full-year dividends of ¥48.0 per share. The Company's basic policy is to maintain a dividend payout ratio of 40%. Based on this policy, the Company plans to pay dividends of ¥52.0 per share for FY3/17, increasing ¥4.0 per share for full-year (¥26.0 at the interim and ¥26.0 at the term-end, for a dividend payout ratio of 40.8%). Thus, the Company plans to increase dividends per share for the fourth consecutive year in FY3/17.

In FY3/16, the Company implemented policies to increase the profitability of its existing businesses and invested in promising new business. Therefore, we believe that the Company could achieve the ¥10.0bn of operating income it is targeting for FY3/18, and thus, we shall focus on the outcome in improvement of the profitability of the existing businesses and the development of new businesses in corporate business.

Check Point

- FY3/16 net sales fell slightly, but operating income grew to a record high for the fifth straight year
- Despite harsh climate, the Company should be able to achieve the ¥10.0bn of operating income it targets for FY3/18, mainly by improving the profitability of the existing businesses
- The Company plans to raise the dividends to ¥52.0 per share (a dividend payout ratio of 40.8%) for FY3/17, marking the fourth straight year of dividends increases

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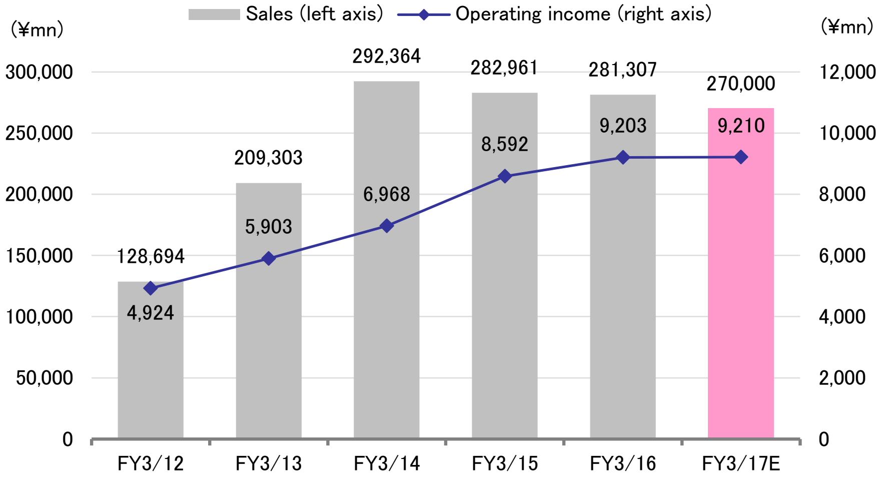
Non-consolidated Sales and Operating Income



Company Outline and History

A subsidiary of ITOCHU Corporation, a leading sales agency of mobile phones, and the top sales agency for NTT DOCOMO

(1) Company Outline

A subsidiary of ITOCHU Corporation, the Company is a leading sales agency of mobile phones in Japan and has been the top sales agency for NTT DOCOMO, the largest telecom carrier in Japan. The main business is wholesale and retail sales of mobile phones and tablet devices, but the Company also offers solution services using smartphones to corporate customers and sells prepaid cards at convenience stores. Based on the philosophy statement of "the Company to connect people and value", the Company holds up a 10-year vision of "create advanced services in communications and networks meeting the wishes of each customer and become the most reliable partner." According to this vision, the Company is pursuing a strategy of making all the carrier-certified shops for customers to "want to visit." In FY3/16, the Company ranked the second in Japan in terms of unit sales of mobile phones, and in the first position in terms of unit sales of DOCOMO mobile phones and the number of operating docomo Shops, with 371 shops nationwide.

(2) Company History

The Company was established in August 1997 as ITC NETWORKS CORPORATION that undertook telecommunications business as a subcontractor for ITOCHU Corporation. In April 2002, the Company became a sales agency directly from telecom carriers of mobile phones, taking over the position from ITOCHU Corporation*1, and the business foundation as a mobile phone marketer was prepared. As mobile phones were increasingly adopted in Japan, the Company grew, and in March 2006, listed the shares on the Second Section of the Tokyo Stock Exchange. And in December 2007, the Company was promoted to the First Section.

After listing the shares, the Company rapidly expanded the business base and scale through M&A. The first acquisition, in August 2006, was of Idomco Communications Co., which was fully merged in April 2007. In July 2008, ITC Mobile Co., a wholly-owned subsidiary of the Company, succeeded to the mobile communications sales business of Hitachi Mobile Co. (now Hitachi Auto Parts & Services Co.) and the Company merged ITC Mobile Co. into itself. In October 2012, the Company merged Panasonic Telecom Co., which had been a subsidiary of Panasonic Mobile Communications Co. Through these acquisitions, dramatically expanding the business base and scale, the Company became one of the top three sales agencies of mobile phones in Japan. In October 2013, the Company changed its name to CONEXIO Corporation*2.

*1 ITOCHU Corporation began selling mobile phones in 1991, before mobile phones had been adopted on a full scale in Japan. In October 1992, it opened the first docomo Shop in Japan, in Hachioji City, which is part of the Tokyo Metropolitan area.

*2 The company name, CONEXIO, is derived from the Latin word for bond and connotes a hope and passionate determination "to establish deep bonds of trust by respecting and connecting the wishes of each customer and encompassing all people in a circle of happiness."

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Company History

	Event
August 1997	Established in Kita Aoyama, Minato Ward, Tokyo, as ITC NETWORKS CORPORATION as a subcontractor for ITOCHU Corporation
October 1997	Established a wholly-owned subsidiary, Tokai Networks Co.
November 1999	Moved the head office to Kamiochiai, Shinjuku Ward, Tokyo
October 2000	United the distribution facilities of Greater Tokyo Area
April 2002	Succeeded to the position of the primary sales agency of mobile phones from ITOCHU Corporation
May 2002	Moved the head office to Kamimeguro, Meguro Ward, Tokyo
May 2002	Established ITC Networks Service Co. as a wholly-owned subsidiary
July 2002	Merged a subsidiary Tokai Network Co.
August 2004	Obtained the certification of the Conformity Assessment Scheme (Version 2.0) for rating Information Security Management Systems as the first company in the industry of distributing and selling mobile communication equipment
February 2005	Moved the head office to Ebisu, Shibuya Ward, Tokyo
March 2006	Listed shares on the Second Section of the Tokyo Stock Exchange
July 2006	Merged ITC Networks Services
August 2006	Bought Idomco Communications Co. and made it a wholly-owned subsidiary
April 2007	Merged Idomco Communications Co.
December 2007	Shares were elevated to the First Section of the Tokyo Stock Exchange
July 2008	ITC Mobile Co., a wholly-owned subsidiary of the Company, succeeded to the mobile communications business of Hitachi Mobile Co.
July 2008	Merged ITC Mobile Co.
October 2012	Merged Panasonic Telecom Co. and merged it
October 2013	Changed the company name to CONEXIO Corporation
July 2014	Moved the head office to Nishi Shinjuku, Shinjuku Ward, Tokyo

Past Business Trends

Panasonic Telecom Co. merger increased business scale and performance

The Company bought and merged Panasonic Telecom Co. in October 2012, and from FY3/13, the Company's business performance expanded notably for several reasons: 1) the merger allowed the Company to extend the services to other cities in Japan, whereas the services had been concentrated in the three main metropolitan areas of Japan before the merger, 2) by combining the information system with that of Panasonic Telecom, the Company lowered indirect costs, 3) the Company and Panasonic Telecom shared their respective areas of operational excellence, 4) by the recent efforts to change the working methodology aiming to improve the environments where the employees had been working so busy, the Company has successfully reduced overtime work at the same time lowered operational costs.

Before this merger, in FY3/12, the Company sold 1.81mn mobile phones and tablet devices for non-consolidated sales of ¥128,694mn and operating income of ¥4,924mn. By FY3/16, the business had grown to mobile phone and tablet device sales of 2.88mn units, total non-consolidated sales of ¥281,307mn, and operating income of ¥9,203mn.

Business Description

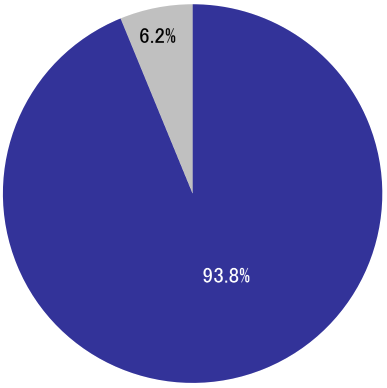
Mainly operates carrier-certified shops for individual customers and provides mobile devices and solution services to corporate customers

The Company's main business is the agency business for telecom carriers that includes selling mobile phones and tablet devices, concluding contracts of telecommunications services and providing after-sales services*. And this business consists of the consumer business and the corporate business. In FY3/16, the consumer business accounted for 93.8% of total non-consolidated sales and 83.1% of total operating income, while the corporate business provided 6.2% of sales and 16.9% of operating income.

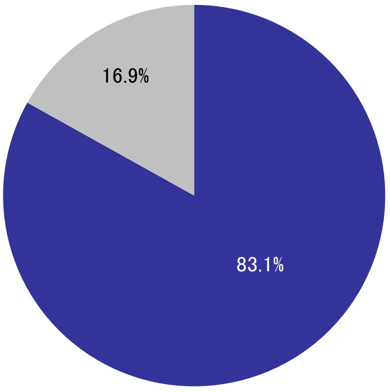
* Based on agency contracts between the Company and the telecom carriers, the Company sells the telecommunications services offered by the telecom carriers to individuals and companies. Upon concluding contracts for these services and for a fixed period thereafter, the Company receives commission income from the telecom carriers.

■ Business Description

Breakdown of FY3/16
Sales by Business



Breakdown of FY3/16
Operating Income by Business



(1) Consumer Business

The consumer business consists of operating carrier certified shops of Japan's three main telecom carriers: NTT DOCOMO, KDDI Corp. (9433) as known as "au", and SoftBank Corp. (9984) and wholesale of mobile phones to major electronics retailers and facilitating their sales. Also, the consumer business operates the "nexi", a portal site* service developed in-house. The consumer business generates revenue by selling goods, such as feature phones, smartphones, tablet devices and peripheral equipment for smartphones, and by receiving commission income for selling the products and services offered by the telecom carriers. In FY3/16, sales of goods amounted to ¥200,334mn (75.9% of total sales by the consumer business), while commission income came to ¥63,500mn (24.1% of total sales by the business).

* A portal site that facilitates the use of smartphones.

(a) Carrier-certified shops

At the end of FY3/16, the Company had 421 carrier-certified shops, and 268 of which were operated directly by the Company. Of the 421 shops, 371 were docomo Shops (241 directly operated, 130 outsourced), 45 were au shops (22 directly operated, 23 outsourced), and 5 were SoftBank shops (all operated directly). In terms of the number of shops and unit sales of mobile phones and tablet devices, the Company is the leading sales agency for NTT DOCOMO.

The Company aims to make all the shops attractive to customers. Toward this goal, the shops are making several efforts. They maintain a full line of accessories and other peripheral equipment for new models, introduce reservation system for shop services, and hold lectures about how to enjoy smartphones to senior customers. In FY3/16, this business sold 2.28mn mobile phones and tablet devices (79.2% of all the mobile phones and tablet devices sold by the Company).

(b) Wholesale to major electronics retailers and facilitating their sales

The consumer business also conducts wholesale business of mobile phones to major electronics retailers and facilitates the sale of these retailers. Furthermore, the Company operates service-corners inside of the stores of the retailers to provide after-sale services, such as repairing, receiving payments and consulting. In FY3/16, this business sold 470,000 mobile phones and tablet devices (16.3% of all the mobile phones and tablet devices sold by the Company).

The Company possesses the largest distribution center and call center in the industry, and has advanced processing capability. Specifically, the distribution center centralized reception and shipment function and able to minimize sales opportunity losses through rapid supply of popular or new models to the shops. The call center starts up the mobile phones (activates the phones and resisters/changes the service plans of them) purchased by the customers. The call center contains the largest number of computers in Japan for starting up services.

(2) Corporate Business

The corporate business includes arrangement of contracts between corporate customers and telecom carriers, the provision of after-sale services, the sale of mobile phones and tablets with various solution services. This business also handles the sale of other products such as prepaid cards at convenience stores, as well as the sales of internet of things (IoT) solutions.

The corporate business derives revenues from three sources: 1) the sale of mobile phones, tablet devices, and peripheral equipment, 2) commission income from telecom carriers or the sale of solution services 3) the sale of prepaid cards. In FY3/16, the business sold ¥6,007mn of goods (34.4% of total sales), received ¥7,552mn of commission income from telecom carriers and the sale of solution services (43.2%), and garnered ¥3,913mn (22.4%) from the sale of prepaid card. The corporate business sold 130,000 mobile phones and tablet devices in FY3/16 (4.5% of all the mobile phones and tablet devices sold by the Company)

(a) Solution services for corporate customers
The Company offers services as setting up smartphones on behalf of corporate customers and business process outsourcing services of smartphones and other devices (e.g. help desk) and the one-stop provision of solution services named “mobile biz suite” to facilitate the use of smartphones for business.

(b) Prepaid card sales
The Company sells prepaid cards at the several convenience store chains such as FamilyMart (8028), Three F Co. (7544), Poplar Co. (7601), and the Coco Store group which has been acquired by FamilyMart. It also assists retailers and web service companies nationwide to issue prepaid cards*.

* For example, the business helped Oisix Inc. (3182), which sells healthy foods (little or no use of chemicals) through the internet, to issue the Oisix Gift Card for the purchase and exchange of foods. The business also helped OPTiM (3694), which develops and operates IoT platforms, to issue OPTiM prepaid card for the “Tabuho” service enabling the unlimited reading of popular magazines.

(c) IoT Solutions
The Company also provides solutions needed for companies to adopt the internet of things (IoT), by providing related devices, telecommunication networks, platforms and assistance in introduction of IoT that realizes accumulation of a huge amount of data remotely extracted from working machinery, vehicles, and other equipment.

Strengths and Business Risks

Nationwide network of shops certified by telecom carriers

(1) Strengths

A major strength of the Company is the nationwide network of carrier-certified shops that has been built and maintained since the beginning of popularization of the mobile phones In Japan. Furthermore, the Company mutually shares sales strategy with NTT DOCOMO, making the Company the top agency in Japan for NTT DOCOMO. This close relationship with NTT DOCOMO is one of the sources for the Company’s high profitability.

The Company also cultivates close ties with major electronics retailers, particularly with those locating stores in front of railway stations. Besides, the Company’s distribution and call center possesses the biggest scale and processing capability in the industry. In addition to this, scale of the corporate customer base of the Company includes a broad range of companies, from the small to industry leaders.

(2) Business Risks

The biggest risk to the Company is the heavy reliance on carrier-certified shop business. These shops obtain large profit from commission revenue from the telecom carriers, and the operators of the shops are strongly subject to the telecom carriers. Thus, the carrier-certified shop business can easily be affected by the sales policy or other management decisions made by the telecom carriers.

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* Mobile virtual network operators provide telecom services through the infrastructure (base stations for the transmission of radio waves to mobile phones) leased from other companies.

Carrier-certified shop business, as well as telecom carriers, can also be impacted by changes in laws and regulations such as the Telecommunications Business Act. For example, in March of this year, the Ministry of Internal Affairs and Communications issued guideline to set to rectify excessive discounts on smartphone purchases which took effect from April 1. Furthermore, from May 21, "Guidelines for Consumer Protection Rules for the Telecommunications Business Act" was amended, requiring telecom carriers to meet their obligations to fully explain the products and services, to deliver documents of explanations to customers, and to implement guidance to the agencies.

The Company's heavy reliance on NTT DOCOMO is both the strength and a business risk. If NTT DOCOMO's business foundation were to shrink significantly as a result of competition with other carriers intensifying, the Company's business could be greatly and adversely affected. In FY3/16, commission income from telecom carriers accounted for 26.1% of total sales (27.0% in FY3/15), and NTT DOCOMO supplied 76.2% of the Company's total commission income in FY3/16 (77.7% in FY3/15). In cost of purchased goods of the Company in FY3/16, that of NTT DOCOMO accounts for 90.2% (89.8% in FY3/15).

The Company's unit sales of mobile phones could be adversely affected by the recent spread of low-priced smartphones of mobile virtual network operators (MVNOs)*. Besides that smartphones and tablet devices are becoming functionally more complex, telecom carriers started to strength the loyalty services and to offer non-telecom services such as electricity and insurance. Under these conditions, high performance of sales staff is required. As a result, it is increasingly important and difficult to secure skilled sales staff.

■ Business Trends

Operating income grew YoY in FY3/16 for the fifth straight year due to increasing profitability per customer and streamlining the management structure for cost control

○FY3/16 results

(1) Summary

In FY3/16, non-consolidated sales declined 0.6% YoY to ¥281,307mn, but operating income grew 7.1% to ¥9,203mn, and net income advanced 22.6% to ¥6,149mn. In spite of sales decline, operating income rose for the fifth straight year, and all profits renewed record highs.

Financial Results, FY3/15 – FY3/16

(¥mn)

	FY3/15		FY3/16				
	Result	Ratio to Sales	Result	Ratio to sales	YoY	Initial forecast*	Result / initial forecast
Unit sales of mobile phones and tablet devices	298	-	288	-	-3.2%	300	96.0%
Sales	282,961	-	281,307	-	-0.6%	285,000	98.7%
Gross profit	46,978	16.6%	46,214	16.4%	-1.6%	-	-
SG&A costs	38,386	13.6%	37,011	13.2%	-3.6%	-	-
Operating income	8,592	3.0%	9,203	3.3%	7.1%	8,150	112.9%
Ordinary income	8,682	3.1%	9,294	3.3%	7.0%	8,250	112.7%
Pretax income	8,244	2.9%	9,390	3.3%	13.9%	-	-
Profit	5,013	1.8%	6,149	2.2%	22.6%	5,030	122.2%
EBITDA	10,771	3.8%	11,386	4.0%	5.7%	-	-

* On April 14, 2016, the Company revised the FY3/16 forecasts to sales of 281,000, operating income of 9,100, ordinary income of 9,200, and net income of 6,100.
Source: compiled by FISCO based on company materials

Sales declined slightly, mainly because unit sales mobile phones and tablet devices decreased 3.2% YoY to 2.88mn and commission income from telecom carriers fell ¥3,694mn YoY.

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Although the Company grew new sales of tablet devices as a second handset and other products, unit sales of mobile phones dropped because of a prolongation of the replacement cycle and restrictions on cash returns for new sales started from February 2016. In the consumer business, the Company raised profit per customer by expanding the sales of accessories and other peripheral equipment for mobile phones, as well as the sales of content services and optical-fiber broadband services at carrier-certified shops.

Gross profit decreased 1.6% YoY in FY3/16 to ¥46,214mn, but SG&A costs dropped 3.6% to ¥37,011mn as a result of continued cost-control. Thus, operating income grew YoY, and operating income margin rose 0.3ppt to 3.3%. Net income rose at a higher rate than other income for two main reasons: 1) the Company earned an extraordinary profit of ¥297mn on the transfer of the housing solution business providing broadband service to condominiums, and 2) the Company received a tax credit of ¥140mn granted under the taxation rules for salary growth*.

* In FY3/16, the Japanese government amended tax law to encourage companies to increase the salary of their employees. According to the amended law, companies can receive tax credits equal to 10% of the increase in their employee compensation beyond a set proportion. The maximum tax credit for large companies was 10% of their total income tax, while the maximum credit for smaller companies was 20%.

FY3/16 sales fell short of the Company's initial forecast of ¥285,000mn primarily because unit sales of mobile phones and tablet devices were 120,000 smaller than the Company had foreseen. However, operating income exceeded the original projection mainly for two reasons: 1) the profitability of the consumer business improved as a result of increasing sales of optical-fiber broadband services and smartphone accessories and content services, and 2) the Company pared operating costs more than it had projected.

Profits from consumer business grew due to vitality of carrier-certified shops

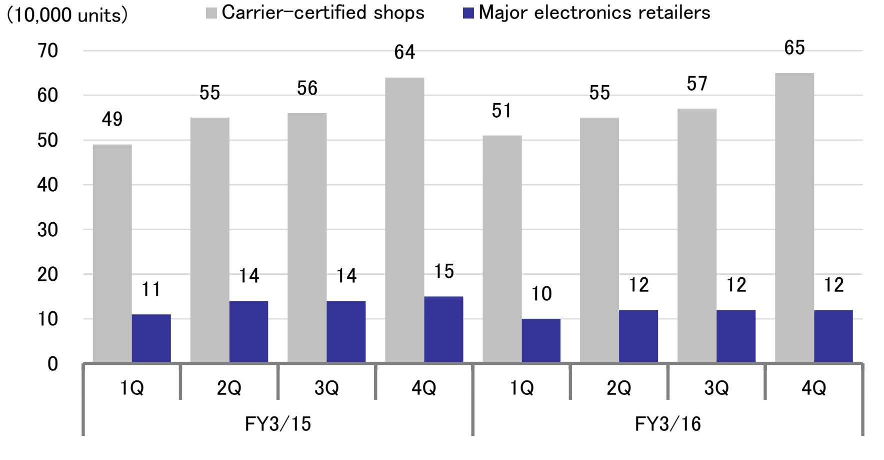
(2) Business Trend and Specific Efforts by Business

(a) Consumer business

In the consumer business, sales declined 0.1% YoY to ¥263,834mn but operating income climbed 4.6% to ¥10,598mn. Commission income received from telecom carriers decreased 3.0% YoY to ¥63,500mn, in line with the Company's expectation. However, product sales increased 0.9% to ¥200,334mn, reflecting 1) an increase in the sales ratio of smartphones, and 2) increases in sales of optical-fiber broadband services as well as content services and peripheral equipment for mobile phones. These sales-increases also supported a rise in profit per customer.

By sales channel, unit sales of mobile phones and tablet devices to major electronics retailers fell YoY in FY3/16, due mainly to the impact of mobile virtual network operators and low-priced smartphones. However, unit sales through carrier-certified shops increased YoY due to 1) improvements of shops, making them more attractive to individual customers, by introducing reservation system and by shortening the waiting time of customers in a queue with practical use of tablet devices, and 2) strengthening sales of tablet devices as a second handset.

Consumer Business Quarterly Unit Sales by Sales Channel



Source: Compiled by FISCO based on company materials

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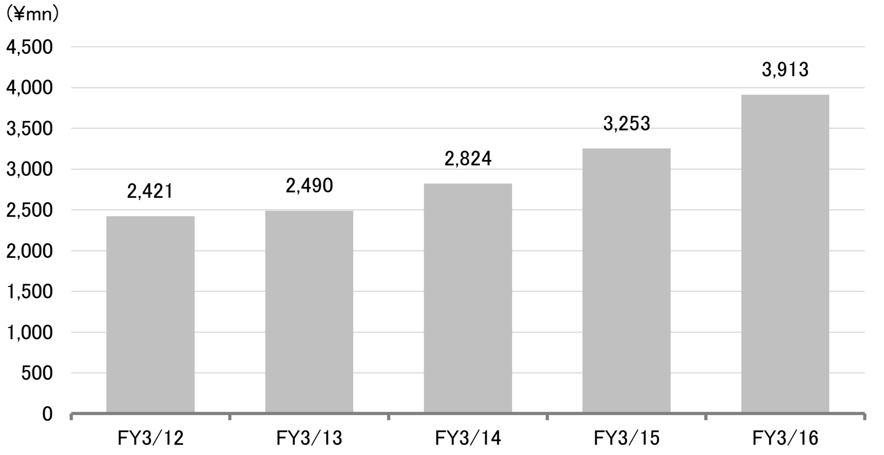
(b) Corporate business

In the corporate business, sales fell 7.9% YoY in FY3/16 to ¥17,472mn and operating income declined 3.1% to ¥2,154mn. Sales of prepaid cards, which the Company focused on, grew 20.3% YoY to ¥3,913mn. Sales promotion at FamilyMart convenience stores nationwide from October 2015, such as to display six different types of gift boxes and envelopes by the prepaid cards, contributed to this result.

However, sales of goods and services decreased 7.0% YoY to ¥6,007mn, reflecting a decline in large contracts with corporate customers. Furthermore, commission income received from telecom carriers fell 18.4% to ¥7,552mn.

Sales of Prepaid Card



Source: Compiled by FISCO based on company information

Orders received for solution services, such as setting up smartphones on behalf of corporate customers and business process outsourcing services of smartphones and other devices (e.g. help desk), grew notably in FY3/16. The corporate business also strengthened sales of other solution services, such as the sales force automation system “Salesforce” and the mobile device management (MDM) system for smartphones and tablet devices. In February 2016, the business also started selling the “E-PORTER +”, the system for the integrated management of mobile devices. These were the positive factors as well.

c) Measures to improve employee satisfaction

Believing that customers cannot be satisfied without satisfied employees, the Company has taken several measures to Increase the satisfaction of the employees, primarily those at the docomo Shops, with the aim of improving productivity. The measures were 1) promoting a movement to improve the working methodology of employees (mainly by reducing total work time through the use of flextime and variable work schedules and by encouraging the use of paid holidays) started from April 2014, also 2) supporting the Work–Life balance by encouraging male employees to take childcare holidays*1, 3) to secure skilled employees and raise their retention rate, the Company has promoted temporary workers to regular employees, provided the employees the educational opportunities as CONEXIO College*2, conducted employee satisfaction surveys every two years, and encouraged female employees to work more proactively*3. An effect of these measures directly brought a reduction of overtime pay, also indirectly contributed to the increase of employee motivation, greater shop sales effectiveness, and improved productivity.

*11 In October 2015, the Company received a special award at “Ikumen Company Award 2015” from Japan’s Ministry of Health, Labour and Welfare for encouraging the male employees to actively participate in raising their children. In February 2016, the Company was accredited as a “Work-Life balance promotion company” by the Shinjuku Ward of Tokyo.

*2One of the Company’s principles is that the growth of each employee is the source of Company growth. Consequently, the Company provides three courses of education for the employees. The “basic education” imparts a foundation to become a business person. The “sales site improvement education” teaches common skills used at all the Company’s sales sites of every sales channel. The “department-specific education” conveys knowledge and skills needed for each department.

*3As of April 2016, 54% of the Company’s employees were women. Of the female employees, 108 were shop managers or in other managerial positions (34% of all shop managers were women).

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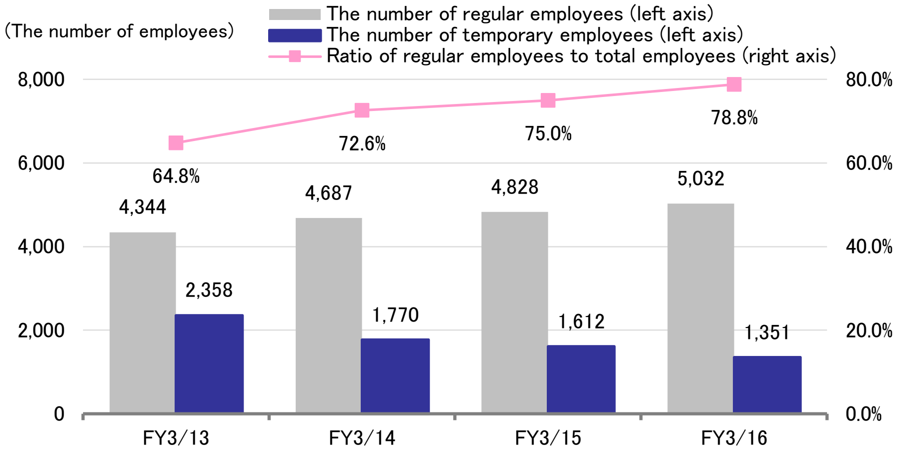
The number of Employees and Ratio of Regular Employees to Total Employees



Note: "Regular employees" includes contract employees, but excludes operating officers and employees on leave.
Source: Compiled by FISCO based on company materials

By repaying loans, the Company generated net cash and lifted the equity ratio to more than 30%

(3) Financial Condition

At the end of FY3/16, assets totaled ¥96,912mn, which was ¥5,491mn less than assets a year earlier, reflecting a ¥5,022mn YoY drop in current assets and a ¥468mn decline in non-current assets. The fall in current assets was due mainly to a ¥2,552mn drop in trade accounts receivable, a ¥890mn decrease in cash and deposits, a ¥828mn decline in deferred tax assets, a ¥492mn fall in other accounts receivable, and ¥316mn shrinkage of merchandise and finished goods. The main factor contributing to the decline in non-current assets was a ¥698mn fall in rights of carrier shop management.

Total liabilities declined by ¥9,610mn during FY3/16 to ¥67,062mn at the end of the fiscal year. Non-current liabilities increased by ¥739mn during FY3/16, reflecting such factors as a ¥373mn rise in provisions for retirement benefits. Current liabilities decreased by 10,349mn during FY3/16, due to factors such as a ¥5,500mn drop in loans payable (comprising a ¥3,000mn fall in the current portion of long-term loans payable and a ¥2,500mn downturn in short-term loans payable), ¥1,734mn shrinkage of income taxes payable, a ¥1,612mn decline in other accounts payable, a ¥1,525mn decrease in provisions for bonus payments, a ¥1,436mn fall in trade accounts payable, and a ¥1,112mn decline in accrued consumption taxes. Interest-bearing debt shrank by ¥2,500mn during FY3/16, contributing to a ¥458mn net cash position which was the first positive net cash position since FY3/13, when the Company borrowed funds to buy Panasonic Telecom.

Net assets grew by ¥4,118mn YoY during FY3/16 to ¥29,850mn at the end of the fiscal year, due mainly to an increase as a result of the recognition of profit of ¥6,149mn, which was more than a ¥1,990mn increase in dividends paid.

The current ratio improved YoY to 125.1% in FY3/16, and the equity ratio rose to 30.8%. Because the Company increased the profit per customer and made continual efforts to rationalize management and operation of the Company to adapt to the severe environment, the ROE, ROA and operating income margin increased YoY.

Non-consolidated Balance Sheet and Cash Flow Statement

(¥mn)

	FY3/15	FY3/16	Change	Remarks
Current assets	80,041	75,018	-5,022	Trade accounts receivable -2,552 Cash and deposits -890 Deferred tax assets -828 Other accounts receivable -492 Merchandise and finished goods -316
Non-current assets	22,362	21,894	-468	Rights of carrier shop management -698 Goodwill -93 Lease and guarantee deposits +200 Tangible fixed assets +191
Total assets	102,404	96,912	-5,491	
Current liabilities	70,339	59,990	-10,349	Current portion of long-term loans payable -3,000 Short-term loans payable -2,500 Income taxes payable -1,734 Other accounts payable -1,612 Provision for bonuses -1,525 Trade accounts payable -1,436
Non-current liabilities	6,332	7,072	739	Provision for retirement benefits +373 Deferred tax liabilities +332
Total liabilities	76,672	67,062	-9,610	
(balance of interest-bearing debt)	8,000	2,500	-5,500	
(net cash)	-4,151	458	4,609	
Net assets	25,731	29,850	4,118	FY3/16 profit +6,149 Dividends paid -1,990
Total liabilities and net assets	102,404	96,912	-5,492	

Cash flow from operations	7,266	8,392
Cash flow from investing	-1,911	-1,811
Cash flow from financing	-5,509	-7,490
Balance of cash and cash equivalents	3,997	3,088

Measures of financial stability		
Current ratio	113.8%	125.1%
Equity ratio	25.1%	30.8%
Measures of profitability		
ROE	21.3%	22.1%
ROA	8.7%	9.3%
Operating income margin	3.0%	3.3%

Source: Compiled by FISCO from company materials

Plans to offset the profit impact of drop in unit sales with greater sales based on proposal-based and experience-based customer services

(4) Company Forecasts and Management Plan for FY3/17

For FY3/17, the Company projects non-consolidated sales of ¥270,000mn (down 4.0% YoY), operating income of ¥9,210mn (up 0.1%) and profit of ¥5,700mn (down 7.3%). The Company expects profit to decline because it does not foresee an extraordinary gain comparable to the gain recorded in FY3/16.

Company Forecasts for FY3/17 versus Its Results in FY3/16

(10,000 units, ¥mn)

	FY3/16		FY3/17		
	Result	Ratio to sales	Forecast	Ratio to sales	YoY
Unit sales of mobile phones and tablet devices	288	-	275	-	-4.7%
Sales	281,307	-	270,000	-	-4.0%
Operating income	9,203	3.3%	9,210	3.4%	0.1%
Ordinary income	9,294	3.3%	9,300	3.4%	0.1%
Profit	6,149	2.2%	5,700	2.1%	-7.3%

Source: Compiled by FISCO based on company materials

The Company expects the Japanese market for mobile phones and tablet devices to remain difficult in FY3/17. As explained earlier, new government rules to protect consumers from being misled in their purchases took effect from May 21. The impact of this rule change is uncertain. However, the cycle for replacing mobile phones is getting longer, the number of customers visiting stores is declining, and the effective selling prices of phones are rising. Given these market conditions, the Company foresees unit sales of mobile phones falling to 2.75mn units in FY3/17 from 2.88mn units in FY3/16. However, the Company plans to raise the profitability by increasing the profit per customer and to continually rationalize management and operation of the Company, thereby lifting the operating income slightly.

The management plan for FY3/17 has three components: 1) Seeking profit by responding to changes in the environment, 2) Aggressive investment in smart life/smart business, and 3) Securing talents and strengthening control. To seek profit, the Company aims to become a company that is trusted and chosen by customers by responding to changes in the business environment ahead of others and renewing our commitment to improving customer satisfaction. The Company will also continue to streamline the management structure and reduce inefficiency. In regards to the aggressive investment in smart life/smart business, in consumer business, the Company promotes proposal-based customer services that are customized based on the lifestyle of each customer and experience-based customer services through telephone classes. With these efforts, the Company will promote optical-fiber broadband services and strengthen the offering of content services to increase profit per customer to offset the impact of decline in unit sales of mobile phones. In the corporate business, the Company plans to promote the sales of solution services that satisfy company needs. To secure talents, the Company aims to build a consistent employee educational program of CONEXIO College, to improve the ability of each employee, and to extend the movement to improve the working methodology of employees, which centered on docomo Shops through FY3/16, to include all the shops.

The Company plans to invest ¥1,823mn in FY3/17 to relocate or renovate 47 shops, to install a computer system to handle the shop sales, and to adjust work styles.

■ Medium-Term Growth Strategy

The Company could achieve operating income target for FY3/18 of ¥10.0bn

When the Company announced the results for 4QFY3/16, the Company also announced a medium-term target to achieve operating income of ¥10.0bn in FY3/18.

The Company intends to implement two main strategies. The first is to respond proactively to the rapidly changing business environment as a leading company and to strengthen the presence in the mobile phone market. And the second is to carry out investments designed to further expand the scale of business while maintaining expenses at appropriate levels and securing profit in existing businesses and to accelerate business development in new business areas drawing on the strengths of the Company to create new growth drivers.

In FY3/16, the Company implemented policies to increase the profitability of the existing businesses and invested in promising new businesses. Therefore, we believe that the Company could achieve the ¥10.0bn of operating income it is targeting for FY3/18, and thus, we shall focus on the outcome in improvement of the profitability of the existing businesses and development of new businesses in corporate business.

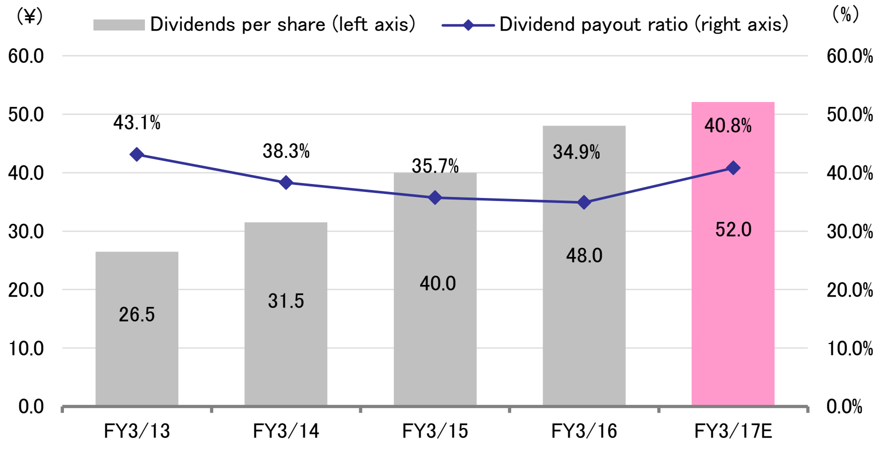
Shareholder Returns

To maintain a dividend payout ratio of 40%, the Company plans to raise the dividends per share to ¥52 for FY3/17, for the fourth straight year of increases

The Company's basic policy toward shareholder returns is to endeavor to improve financial results so that the Company can pay stable dividends at a payout ratio of 40% consistently over period.

For FY3/16, the Company had originally planned to pay dividends of ¥45.0 per share (interim dividends of ¥22.5 per share and term-end dividends of ¥22.5 per share), which would have been ¥5.0 per share more than the dividends it paid for FY3/15. However, reflecting the profit growth in FY3/16, the Company paid full-year dividends of ¥48.0 per share. The Company plans to pay dividends of ¥52.0 per share for FY3/17, half at the interim and half at the term-end, for a dividend payout ratio of 40.8%. Thus, the Company plans to increase the dividends per share for the fourth consecutive year in FY3/17.

Dividends Per Share and Dividend Payout Ratio



Source: Compiled FISCO from company materials

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