eREX
9517 Tokyo Stock Exchange First Section

5-Jul.-16

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FISCO Ltd. Analyst
Hiroyuki Asakawa

Has announced Dash 1000, the new medium-term management plan

eREX <9517> (hereafter, also "the Company") is an independent electricity provider known as a power producer and supplier, or PPS, and it operates an electricity retail business. Leveraging its strengths of a competitive base load power supply and a flexible sales strategy, the Company is targeting high growth from the full liberalization of the electricity market from 2016 onward.

The Company has formulated Dash 1000, its 3 year medium-term management plan for the period FY3/17 to FY3/19. It has positioned this 3 year period as in order to steadily advance preparations to achieve net sales of ¥100bn from FY3/20, by securing competitive power sources and strengthening its retail business. The targets for the final fiscal year of the plan, FY3/19, are net sales of ¥67,339mn and operating income of ¥7,354mn.

To secure power sources, the Company is extremely busy with the construction plans for its own power plants. In addition to the Saiki power plant that is currently being constructed in Oita Prefecture and that is scheduled to start operations in the fall of 2016, the discussions for a project to build a biomass power plant in Buzen City, Fukuoka Prefecture, have entered their final stage. The Buzen project is a joint venture with the Kyushu Electric Power <9508> Group, and it is scheduled to have a power generation capacity 1.5 times that of Saiki. Following on from the Buzen project, the Company is expected to make a fully-fledged start for a project to build a biomass power plant of the same scale in the Tohoku region, and it is also planning a further two projects after that.

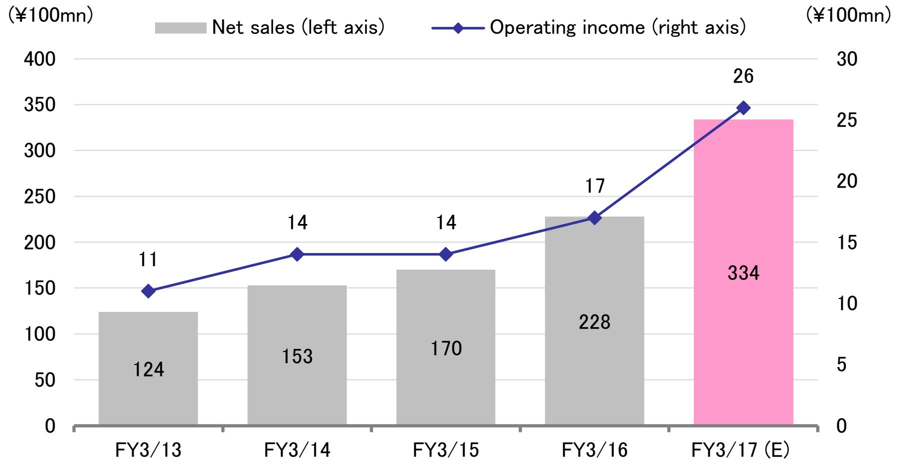
The acquisition of customers for electricity retail sales is also going well. The Company has acquired more than 8,000 large customers in the high voltage sector through its 1,200 sales agencies. It is pursuing an alliance strategy in the low voltage sector, in which sales to general households are allowed since the liberalization of this sector in March 2016. Up to the present time, it has formed alliances with 39 companies, including LP gas sales companies, and acquired more than 11,000 customers. Currently, the majority of the total amount of retail electricity sold is in the high voltage sector, but the Company expects that sales in the low voltage sector to slowly but surely increase, and by the point in time that net sales reach ¥100bn, the low voltage sector to provide 50% of sales.

In the electricity business, due to the nature of electricity of that it cannot be stored, the task of adjusting demand and supply is essential. The Company is aiming to commercialize this task and to make it a source of revenue by establishing the Energy Trading Department by this fall and starting a trading business.

Check Point

- Achieved record highs, with net sales increasing 34.0% and net income 20.6%
- Aiming for net sales of ¥100bn in FY3/19
- Plans to establish the Energy Trading Department by this fall and to start a trading business

Business Trends



Overview of the FY3/16 results

Achieved record highs, with net sales increasing 34.0% and net income 20.6%

The Company achieved increases in both sales and profits in FY3/16, with net sales of ¥22,877mn (up 34.0% y-o-y), operating income of ¥1,723mn (up 16.8%), ordinary income of ¥1,614mn (up 42.5%), and net income attributable to the owners of the parent of ¥1,112mn (up 20.6%) for record highs in both sales and profits.

In operations, the Tosa power plant, which is the Company's own power source, achieved an operating rate above target, and it supports its business as a requirement for the procurement of power. In sales, the number of sales agencies (over 1,200 at the end of the fiscal period) and the number of customers (over 8,000 facilities at the end of the fiscal period) both increased steadily.

FY3/16 Results Overview

(¥mn)

	FY3/15	FY3/16			
	Result	Target	Result	y-o-y	vs. target
Net sales	17,074	24,086	22,877	34.0%	-5.0%
Operating income	1,475	1,510	1,723	16.8%	14.1%
Operating income margin	8.6%	6.3%	7.5%	-12.8%	20.1%
Ordinary income	1,132	1,405	1,614	42.5%	14.9%
Net income attributable to the owners of the parent	922	936	1,112	20.6%	18.8%

Source: prepared by FISCO from the Company's financial results summary

Net sales were 5.0% below the initial target. This was due to the reduction in the amount of wholesale electricity sold in response to the major decline in wholesale electricity prices from the fall in the price of crude oil. But this reduction was covered from the increase in the amount of retail electricity sold from the acquisition of high-profit customers.

Profits exceeded the targets. The increase in purchases from the wholesale electricity market in which prices had fallen lead to cost reductions, and the gross margin increased 5.1% compared to the target (up 39.3% y-o-y), for a major increase in profits. SG&A expenses were kept down to ¥2,006mn, which was as targeted, and as a result, operating income rose 14.1% compared to the target.

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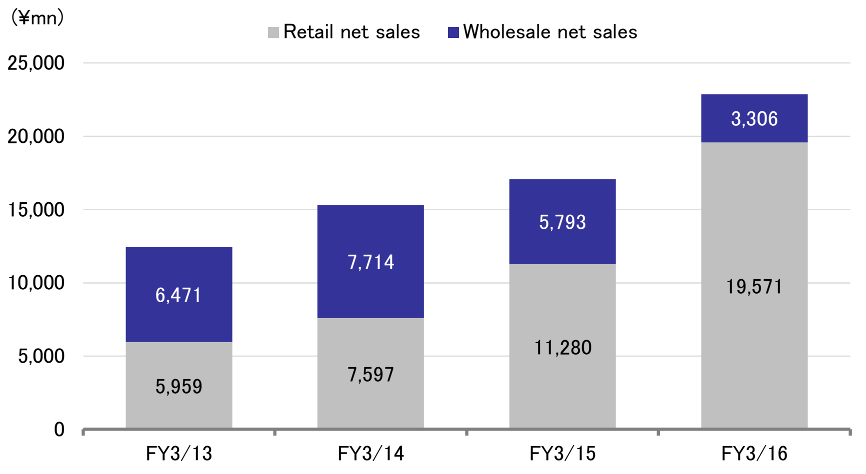
Net Sales by Customer



Source: prepared by FISCO from Company materials

Details of Dash 1000, the new medium-term management plan

Aiming for net sales of ¥100bn in FY3/19

(1) Background to its formulation, and its management targets and results target

The Company has formulated Dash 1000, its new 3 year medium-term management plan for the period FY3/17 to FY3/19. Only 1year previously it had formulated Challenge 500 as its 3 year medium-term management plan for the period FY3/16 to FY3/18, but based on the FY3/16 results, it decided to incorporate into a new plan management targets that had been raised-up to a higher level.

As indicated by the title of this medium-term management plan, the biggest difference between it and the previous plan is that within the management targets, the net sales target has been raised-up from ¥50bn to ¥100bn. Also, an operating income margin of 10% has been newly set as a profit target in this plan. There has been no change compared to the previous medium-term management plan of ROE of 20% as a financial target and a dividend payout ratio of 20% as a dividend target.

The Company has significantly raised-up the results target in Dash 1000, the new medium-term management plan, compared to those in the previous medium-term management plan. For FY3/19, which is the plan's final fiscal year, it is targeting net sales of ¥67,339mn, operating income of ¥7,354mn, and an operating income margin of 10%. With FY3/16 as the starting point, the compound annual growth rates (CAGR) for the 3 years up to FY3/19 are extremely high, of net sales of 43.3% and operating income of 62.2%.

Dash 1000 Results Target

(¥mn)

	FY3/16	FY3/17		FY3/18		FY3/19		FY3/16-FY3/19
	Result	Target	y-o-y	Target	y-o-y	Target	y-o-y	CAGR
Net sales	22,877	33,466	46.3%	51,280	53.2%	67,339	31.3%	43.3%
Operating income	1,723	2,664	54.6%	5,311	99.4%	7,354	38.5%	62.2%
Operating income margin	7.5%	8.0%	-	10.4%	-	10.9%	-	-
Ordinary income	1,614	2,451	51.9%	5,076	107.1%	7,085	39.6%	63.7%
Net income	1,112	1,426	28.2%	3,336	133.9%	4,754	42.5%	62.3%

Source: prepared by FISCO from the Company's briefing materials

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(2) Overall image of Dash 1000

The Company is a power producer and supplier (PPS), and there has been no change to its business model, of selling to external parties (retail and wholesale) the power that it produces itself and that it procures externally. There are five priority measures in the new medium-term management plan, including “Securing competitive power sources and developing a profit-driven retail business.”

Priority Measures in Dash 1000, the New Medium-Term Plan

	Priority measures	Specific developments, targets, etc.
1	Secure competitive power sources and develop a profit-driven retail business	Aim to be the largest domestic producer of power from biomass as a non-fossil fuel power source, and to achieve a middle-ranking position among the top 10 PPSs for the amount of electricity sold
2	Optimize the power production business, the wholesale business, and the retail business	Newly establish and commercialize a trading department with appropriate risk management
3	Implement vertical development from the fuels business to customer services	With increasing and strengthening the biomass power plant facilities as the core, implement vertical development from the upstream sector, including the fuels business, to the downstream sector, of customer services
4	Implement a horizontal development as the alliance strategy (With eREX)	Co-creation with many business partners
5	Establish a management structure	Strengthen sales agencies, increase the probability of realizing an efficient management system, activate the organization and personnel, and enhance the governance system

Source: prepared by FISCO from the Company’s press releases

We think that on extracting the essence of these five priority measures, there are three particularly important points; securing power sources, the sales strategy, and the new establishment of the Trading Department located between power production and sales. Needless to say, these three points are elements that will have a direct impact on the Company’s profits.

Looking at “eREX at a Glance,” which provides an overview of the Company’s current situation, from the upstream (power production business) to the downstream (retail business), the current situation is that it secures power sources by procuring it from three routes; in-house power production using the biomass method, purchases using relative transactions with IPP (independent power producer) companies, and purchases from the Japan Electric Power Exchange (JEPX).

In terms of sales, in addition to its 1,200 sales agencies, the Company has formed alliances with LPG sales companies, the Tanita Group, and communications companies, and is conducting retail sales to both the high voltage sector (such as plants, supermarkets, and offices) and the low voltage sector (including general households and small stores). Its customer numbers in these sectors are more than 8,000 and more than 11,000, respectively.

Optimizing demand and supply and securing profitability will be the areas of responsibility of the newly established Trading Department. The task of adjusting electricity supply and demand is an indispensable one due to a quality of electricity of that it cannot be stored, and it is thought that the Company intends to evolve this from a “task” to “a business” and make it a source of profits.

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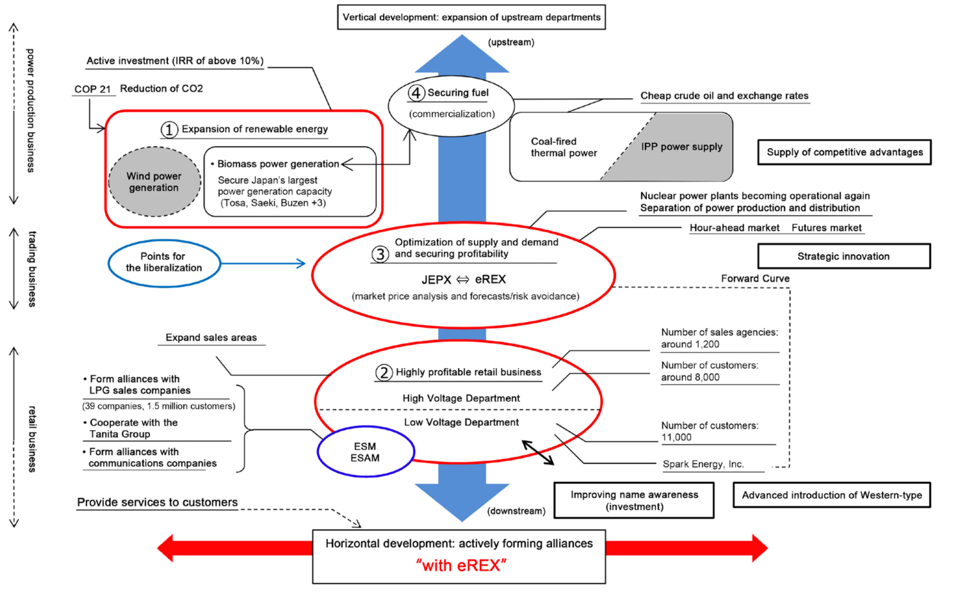
Vertical Development from the Fuels Business to Customer Services



Source: reprinted from the Company's briefing materials

The Saiki power plant is currently being constructed toward it becoming operational in the fall of 2016

(3) Securing power sources

In the initiatives to secure power sources in the current medium-term management plan, the Company is focusing on establishing its own power production facilities. The construction of the Saiki power plant is currently underway toward it becoming operational in the fall of 2016. Both the Tosa and Saiki power plants will be responsible for achieving the results targets in the new medium-term management plan.

After that, toward achieving the net sales target of ¥100bn, the Company is investigating the Buzen project, which is for a biomass power production business in Buzen City, Fukuoka Prefecture, toward starting its construction during the period of the new medium-term management plan and completing it after FY3/20. This business will be carried out by a joint venture (JV) that the Company will establish with the Kyushu Electric Power Group. To finance its construction, a new scheme will be used that it is different to that used to cover project financing up to this time. The plan is to use PKS (palm kernel shells) as the fuel to produce the power, the same as in the existing two plants. The Company has been continuously investigating the Buzen project since last year, and it seems that progress has been made in the discussions with financial institutions and that a final agreement will be reached in the near future.

After the Buzen project, the Company is planning a further three power production projects, including one in Tohoku. Among these three projects, the Tohoku project is being given the highest priority. While the details remain unclear at the present time, it will be a project to construct in the Tohoku region a biomass power production plant of the same scale as in the Buzen project. As the Buzen project can be used as a precedent, it is possible that agreements between the Company and its partner companies, such as for the investment ratio and electricity sales schemes, will be achieved smoothly. We think it is highly possible that in substantial terms, this project will be advanced at the same time and in parallel to the Buzen project.

Overview of the Biomass Power Generation Targets

	FY3/14	FY3/17	FY3/20		
	Tosa	Saiki	Under investigation 1 Buzen project	Under investigation 2 Tohoku project	Investigations will start in the future 2 projects
Power production output (MW)	20	50	75	75	50～150
Power production efficiency	31%	36%	39%	39%	Undecided
Fuel	PKS: 90% Coal: 10%	PKS: 90% Coal: 10%	Biomass: 95% Coal: 5%	Biomass: 90% Coal: 10%	Undecided
Investment amount (¥100mn)	35	167	250 E	220 (F)	Undecided
The Company's investment ratio	100%	70%	65% (F)	35% (F)	Undecided
Financing method	Corporate loan	Corporate loan	Project financing (PF)	Corporate loan	Undecided

- Will steadily implement the projects currently under investigation and maintain and expand its position as the leading biomass power producer
- The investment standard is a project IRR of 10% or above

Source: reprinted from the Company's briefing materials

(4) Sales strategy

Since it registered as a PPS in 2001, the Company has been conducting electricity retail sales. The liberalization of electricity retail sales is being carried out in stages, and up to recently, they had been liberalized for the special high voltage sector for large plants, and the high voltage sector for large customers (plants, supermarkets, and offices), and the Company had been conducting electricity retail sales for customers in the high voltage sector. As of March 2016, it had accumulated more than 8,000 customers in the high voltage sector. In April 2016, the last remaining sector to be liberalized, the low voltage sector for general households and small stores, was liberalized, and the Company has positioned it as an important market that is indispensable to it achieving its growth scenario, and it intends to actively implement measures for this market.

The Company's business strategy for electricity retail sales as is follows. Its central policy in the low voltage sector is to increase its market share by collaborating with its alliance partners. This entails increasing the number of customers by forming alliances with businesses that already have a customer base and accumulating sales to their existing customers. The Company has formed alliances with 39 LP gas sales companies (as of May 2016) through its subsidiary eREX Spark Area Marketing Co., Ltd. These 39 companies have around 1.5 million households as customers. Apart from them, the Company is also forming alliances with cable television companies, real estate companies, and communications companies (it is currently in discussions with some of these), and they are considered to have a total of 3 million households as customers.

Alliance Partners

Attributes	Number of customers
LP gas sales companies	39 companies, approximately 1.5 million customer households
Cable television companies	Customers, 200,000 to 300,000 customer households
Real-estate companies	Properties managed, about 150,000
	Brokerage properties, about 240,000
Tanita	User members, 200,000 people
Communications companies	User members,1.4 million contracts

Note: includes those currently in discussions toward an agreement
Source: prepared by FISCO from the Company's briefing materials

The policy for the high voltage sector is, the same as previously, to acquire customers through the sales agencies system. Currently, the number of sales agencies has reached 1,200, but the structure is that some of the leading sales agencies account for most of the electricity sales contracts. The Company's policy is to aim to raise-up the level of the operational sales agencies through measures such as diversifying the outsourcing form. It is also aiming for business expansion by entering into electricity retail sales areas that it has not currently entered into, of Hokkaido, Hokuriku, and Shikoku.

In the medium term, it plans to further differentiate itself from its industry peers by the creation of added value. Specifically, this will entail efforts like establishing a brand image, improving name recognition, raising customer satisfaction by enhancing customer support, and providing new services and a creative tariffs structure.

■ Details of Dash 1000, the new medium-term management plan

The eREX Retail Business Strategy

■ In anticipation of an era of mega-competition after the abolition of electric power company fees (scheduled for 2020), the Company is aiming to optimize its customer portfolio and achieve a 50%:50% sales ratio for the high voltage and low voltage sectors by the time it achieves its net sales target of ¥100bn. The strategies it will use to realize this are as follows.

Short term

Increasing market share through strong alliances with partners (with eREX)

【Low voltage】
- Increasing the number of alliance partners with close points-of-contact with customers (2 to 3 million potential customers from LPG companies, communications companies, etc.)
- Utilizing the expertise of U.S. Spark Energy, Inc.
- Increasing sales that utilize the results in the high voltage sector

【High voltage】
- Strengthening and enhancing the leading sales agencies and diversifying the outsourcing form
- Expanding the current supply areas and entering into areas that it has not yet entered into (Hokkaido, Hokuriku, and Shikoku)
- Constructing new sales channels (strengthening Internet sales, the direct sales force, etc.)

Medium-term targets

Differentiating itself from industry peers through creating added value

- Strengthening marketing (establishing a brand image, improving name recognition)
- Taking the customer's viewpoint and improving customer satisfaction (enhancing customer support, etc.)
- Developing products and a menu (environmental value, demand response, creative fee structure, etc.)
- Providing new services that anticipate customer needs (gas, communications, equipment, home services, etc.)

To be realized through investing in systems, developing human resources, and implementing M&As

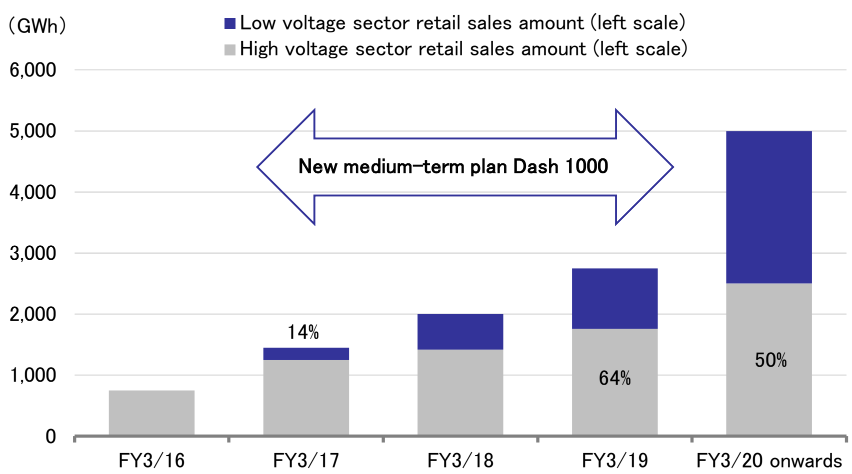
As the driving force behind growth in the medium term, the Company will also appropriately invest in the retail department and establish a strong position as a retail electricity business, thereby maintaining and improve profitability.

Source: reprinted from the Company's briefing materials

Through this series of policies, the Company is aiming to expand its customer numbers and also its business content, balancing the high voltage sector and the low voltage sector. In terms of the low voltage sector, the total amount of retail electricity sales the Company is targeting in FY3/17, which will be the first fiscal year following liberalization, is approximately 1,500GWh, and the aim is for 14% of this to be from the low voltage sector. The percentage of total sales provided by the low voltage sector is expected to rise year by year, reaching 36% by FY3/19, which is the final year of the medium-term management plan. In addition, it is anticipated that the percentages of the high voltage and low voltage sectors will be around 50% and 50% by the time the net sales target of ¥100bn is achieved.

The Company is forecasting 50,000 low voltage sector customers at the end of March 2017, 120,000 at the end of March 2018, and 150,000 at the end of March 2019.

Outlook for the Amount of Retail Electricity Sold



Source: prepared by FISCO from the Company's briefing materials

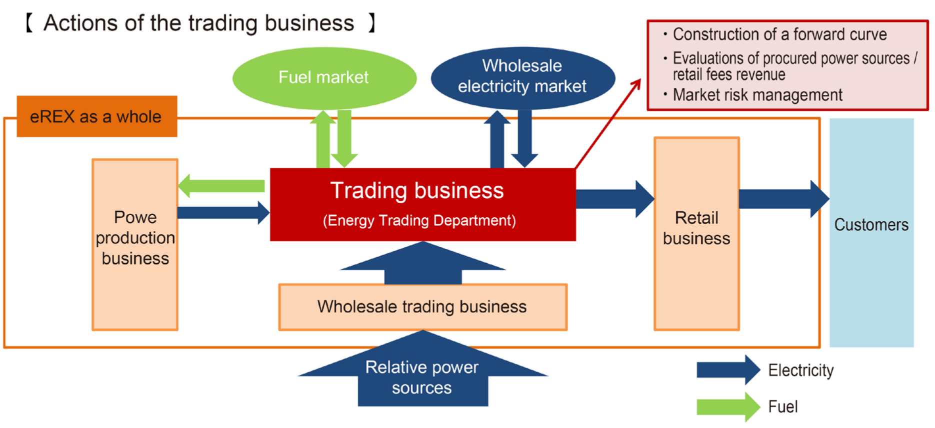
Plans to establish the Energy Trading Department by this fall and to start a trading business.

(5) Trading business

A major characteristic of electricity is that it cannot be stored. Due to the fact that demand for electricity varies greatly depending on the time of day and the season, it is necessary to adjust supply and demand. In the event that like the Company, an organization has its own power production facilities, it can keep its power production department operating at full capacity, and while monitoring demand, purchase power from IPP (independent power producers) using relative transactions and sell it to the retail sectors (both the high voltage and low voltage sector). Sales for power shortages arising from the time of day and of surplus power are carried out through JEPX. The aim of establishing a trading business is to monetize these demand-supply adjustment transactions as a business, rather than them being buried within overall work. In the fall of 2016, the Company plans to establish the Energy Trading Department and make a fully-fledged start to this trading business.

We think it will be worth keeping an eye on this attempt to establish a trading business as a new challenge. What should be paid attention to is the point that many of the transactions that are carried out here are eliminated in internal transactions, and pure external transactions will be transactions with JEPX, purchases from IPP, and purchases of biomass fuel, and therefore the contribution of this business to earnings is likely to be limited, particularly in the initial period. We should also pay attention to the point that as it involves trading, it is possible that it will incur losses. We will wait until it is launched in the fall of 2016 and then pay close attention to how it develops.

The trading business



Source: reprinted from the Company's briefing materials

Results outlook and consideration

Steady increase in the number of electricity retail customers

(1) FY3/17 results outlook

For FY3/17, the Company is forecasting net sales of ¥33,466mn (up 46.3% y-o-y), and operating income of ¥2,664mn (up 54.6%). We think it is highly possible that it will achieve these results forecasts. The reason why we think this is the steady increase in the number of electricity retail customers. Customer numbers in the high voltage sector exceeded 8,000 as of May, and in addition, going forward a net increase on the rate of 300 to 500 customers a month is expected. In the low voltage sector also, as of May the Company had concluded around 11,000 contracts, greatly exceeding its target, and it has made deep inroads toward achieving its target for the end of the fiscal year of 50,000 contracts. The fact that its 39 partner LP gas sales companies have around 1.5 million households as existing customers also leads us to feel confident that it will achieve its targets.

With regards to sales, it is possible that the same as in FY3/16, the net sales result will deviate from the target due to fluctuations in the amount of wholesale electricity arising from trends in the wholesale electricity price. But as profits are considered to be centered on the retail electricity business, if customer numbers trend as expected, we think it is highly possible that the Company will also achieve its profit targets.

(2) Consideration of the medium- to long-term results targets

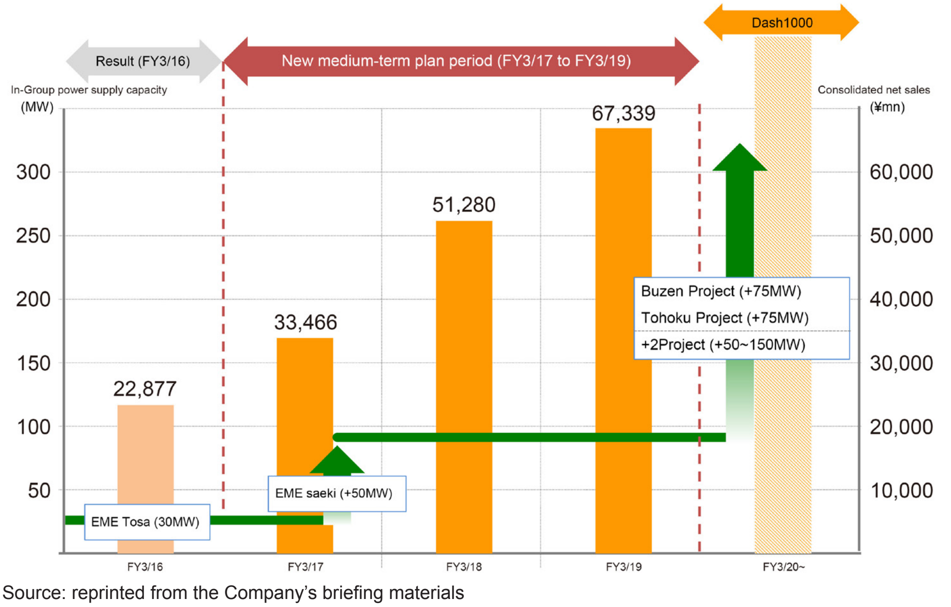
It is still difficult to judge and evaluate with any confidence the Company's long-term results targets of net sales of ¥67,339mn in FY3/19 and net sales of ¥100bn by 4 to 5 years after that.

As one way of thinking about this, we are focusing on the procurement of power sources. Although there is a debate about "What comes first, power sources or the sales channels?" we think that in the case of the Company, the power sources are likely to come first (meaning that "they are more important"). The reason we think this is that if it does not firmly secure "competitive electricity," then, for example, even if it has sales channels, this business may not be viable.

Currently, the wholesale electricity price is very inexpensive due to the impact of cheap crude oil. Therefore, the situation is that profits will be generated if electricity is procured from JEPX and retail sales conducted, but there is no guarantee that this situation will continue forever. Also, if all the market participants try to do this, we can expect the wholesale electricity price to rise, irrespective of factors such as the price of crude oil.

As previously described, the Company is currently constructing the Saiki power plant, and in addition it is expected to make a start on the Buzen project during this fiscal year. Furthermore, it is thought that it will start the Tohoku project very soon after that. The results targets in the current medium-term management plan will be achieved through the electricity produced by both the Tosa and Saiki power plants, and also by purchased electricity. But after that, the contributions of both the Buzen and Tohoku projects will be added toward achieving the net sales target of ¥100bn. We think that at the time the Tohoku project is completed, it is fully possible that the Company will be able to achieve ¥100bn from the procurement of purchased power. Then, at the points in time that the 2 projects after the Tohoku project become operational, we forecast that the percentage of power produced within the Group will rise substantially and so it will be able to realize net sales of ¥100bn in a more stable form. In terms of profits also, this will result in profitability rising to the next level.

Biomass Power Production Business and Retail Business



Source: reprinted from the Company's briefing materials

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Income Statement

(¥mn)

	FY3/15	FY3/16	FY3/17E
Net sales	17,074	22,877	33,466
y-o-y	11.5%	34.0%	46.3%
Gross profits	2,676	3,730	-
y-o-y	-0.3%	39.3%	-
Gross margin	15.7%	16.3%	-
SG&A expenses	1,201	2,006	-
y-o-y	-5.9%	67.1%	-
Operating expenses ratio	7.0%	8.8%	-
Operating income	1,475	1,723	2,664
y-o-y	4.8%	16.8%	54.6%
Operating income margin	8.6%	7.5%	6.8%
Ordinary income	1,132	1,614	2,431
y-o-y	-18.6%	42.5%	51.9%
Net income attributable to the owners of the parent	922	1,112	1,426
y-o-y	13.1%	20.6%	-28.2%
EPS adjusted for stock split (¥)	89.33	80.35	87.61
Dividend adjusted for stock split	20.00	25.00	25.00
BPS adjusted for stock split (¥)	732.18	846.94	-

Summarized Balance Sheet

(¥mn)

	FY3/15	FY3/16
Current assets	9,787	13,406
Cash and deposits	5,187	9,525
Trade receivables	1,649	1,996
Inventories	189	244
Fixed assets	8,170	13,759
Tangible fixed assets	6,417	12,730
Intangible fixed assets	36	130
Investment, etc.	1,715	897
Deferred assets	26	36
Total assets	17,984	27,202

	FY3/15	FY3/16
Current liabilities	2,591	3,096
Accounts payable	1,432	1,650
Short-term debt, etc.	488	396
Fixed liabilities	5,042	9,373
Long-term debt	3,939	8,214
Shareholders' equity	9,980	13,784
Capital	3,465	4,947
Capital surplus	2,844	4,326
Retained earnings	3,670	4,510
Non-controlling shareholders' equity	369	947
Total net assets	10,349	14,732
Total liabilities and net assets	17,984	27,202

Cash Flow Statement

(¥mn)

	FY3/15	FY3/16
Cash flow from operating activities	1,505	818
Cash flow from investing activities	-6,514	-4,182
Cash flow from financing activities	6,794	7,502
Change in cash and deposits	1,785	4,138
Cash and deposits at the start of the fiscal year	2,481	4,267
Cash and deposits at the end of the fiscal year	4,267	8,405

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