

TOKAI Holdings3167 Tokyo Stock Exchange
First Section

7-Oct.-14

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at the end of this document.FISCO Ltd. Analyst
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■ Launch of a new three-year business plan from this fiscal year

Tokai Holdings Corp., based in Shizuoka, has two main businesses: gas and oil products, which engages mainly in the sale of liquefied petroleum (LP) gas, and information and communications services. Its vision is to become “a total life concierge”, i.e., a company offering a complete range of services for everyday life. From FY3/15, it launched its new three-year business plan, “Innovation Plan 2016 ‘Growing’”, in which it has set the targets of sales of ¥209.5bn and operating profit ¥12.6bn in FY3/17, the final year of the plan.

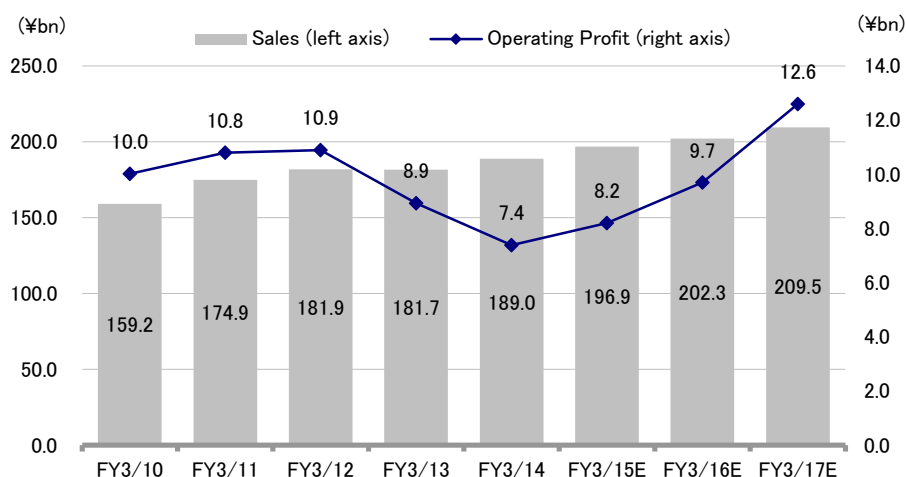
In the first quarter of the fiscal year through March 2015, i.e., in Q1 FY3/15 (April to June), Tokai Holdings’ consolidated sales grew 2.9% year-on-year (y-o-y) to ¥44,302mn, and its operating profit increased 155.7%, to ¥1,657mn. The sales growth resulted from the correction of the selling price in the LP gas business and in addition, the increase in customers from the aqua business and broadband Internet services. The main factors behind the higher profits were the progress made in reducing the costs of acquiring customers in the broadband Internet services; the effects of the rationalization, such as the price correction and the reduction of indirect costs in the LP gas business. The result surpassed the company’s initial forecast. Results in Q2 are also expected to exceed company forecasts and it highly likely that the 1H cumulative totals (the sum of the Q1 and Q2 totals) will surpass company forecasts.

The company’s basic policies in its new medium-term business plan are to “increase sales and improve profitability through accumulating customers,” “continue to improve the financial condition,” and “continuously and stably return profits to shareholders.” In this three-year plan, it is particularly focusing on increasing sales per customer by introducing set menus. The Company is currently conducting test marketing for a set menu combining LP gas and communication services and plans to start full-scale sales from November. Among the various services currently provided by the Company’s group, only 12% of all customers subscribe to multiple services, which is a low level. The introduction of set menus should have considerable effects both in terms of increasing the number of customers and reducing the costs of acquiring new customers. In addition, in August the Company upgraded its TLC Membership Service, which is also intended to encourage customers to subscribe to multiple services. It is aiming to improve convenience for members by expanding the TLC points exchange program.

The complete liberalization of electricity retail sales is expected to begin in 2016, and the Company is currently considering providing an electricity service as one of its set menus. As a total life infrastructure services provider for households in the Company’s service areas of Shizuoka Prefecture and Greater Tokyo, its strategy is to increase profits by accumulating customers and strengthening relations with customers.

■ Check Point

- Profits in Q1 greatly surpassed the 1H forecast
- The extent of the increase in profits in gas and oil products may grow over the full fiscal year
- Its dividend payout ratio has exceeded 40% in the three fiscal years since its shift to a holding company system

Consolidated Financial Results and Medium-term Plan through FY3/17


Note: Figures through FY3/11 are for Tokai Corp.

Financial Results

Profits in Q1 results greatly surpassed the 1H forecast

(1) Q1 FY3/15 results

On July 7 31, 2014, Tokai Holdings announced its consolidated results for Q1 FY3/15 (April to June). Sales grew 2.9% y-o-y, to ¥44,302mn, and operating profit increased 155.7%, to ¥1,657mn. The Company forecasts sales of ¥88,500mn, and operating profit of ¥720mn for the cumulative 1H totals, so operating profit has already greatly exceeded the forecast.

The main reasons for the increase in profits were the effects of the correction to the selling price in the LP gas business and rationalization in the indirect section, and the reduction in the costs of acquiring customers in broadband Internet services. Another factor behind the rise in profits was the reduction in the costs of acquiring new customers, which was due to a fall in new customers in broadband Internet services as a reaction to the increase in the consumption tax.

Q1 FY3/15 Consolidated Results

	Q1 FY3/14	Q1 FY3/15	y-o-y	Reason for change
Sales	43,038	44,302	2.9%	Sales grew due to the increase in customers in the aqua business and in broadband Internet services, and also as a result of the correction to the selling price in the LP gas business
Gross profit (vs. sales)	15,842 36.8%	16,513 37.3%	4.2%	
SG&A costs (vs. sales)	15,194 35.3%	14,855 33.5%	-2.2%	The cost of acquiring new customers fell in broadband Internet services The effects of rationalization due to improved productivity in the LP gas business
Operating profit (vs. sales)	648 1.5%	1,657 3.7%	155.7%	
Recurring profit	549	1,547	181.3%	
Net profit	149	713	376.0%	



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The performance by each segment is detailed below. Sales were strong in the aqua business in conjunction with its increase in customers, increasing 19.2% y-o-y. In the construction and real estate business, allotment sales of newly constructed condominiums were favorable and sales grew 9.0%. In addition, the Company's main business of gas and oil products, information and communication services, and CATV each increased their number of customers and achieved sales growth of around 2%. The number of customers for the entire group rose by 55,000, to 2,526,000 customers.

The increases in profits were predominately from gas and oil products and information and communication services. As mentioned above, the primary factors behind the higher profits were the price correction in the LP gas business, the rationalization of indirect costs, the lower costs of acquiring customers in broadband Internet services (improved deployment of staff in mass retailers of electronic goods), and the reduction in the costs of acquiring customers from the decline in the number of new customers. Elsewhere, the loss recorded by the aqua business was practically unchanged due to a rise in the costs of acquiring new customers, while in the construction and real estate business, higher SG&A costs and the impact of the decline in sales following the increase in consumption tax in the home renovation business depressed profits.

Q1 results by Segment

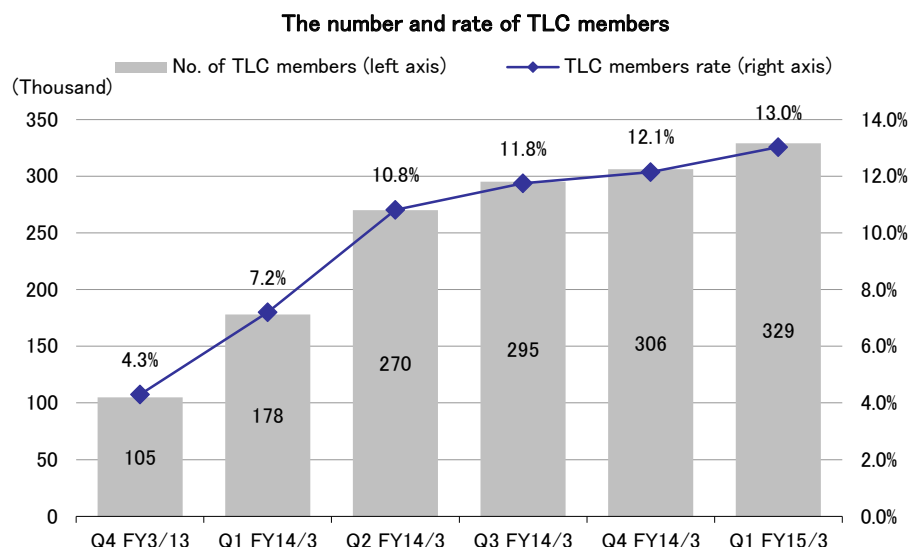
(¥mn, thousand customers)

	FY3/14 Q1	FY3/15 Q1	y-o-y	
Gas and oil products				<ul style="list-style-type: none"> Sales increased as the decrease in the quantity of LP gas sold was exceeded by the price correction (+¥300mn), while the rationalization of indirect operations (+¥200mn) contributed to the increase in profits.
sales	21,940	22,513	2.6%	
Operating profit	1,049	1,494	42.4%	
Profit margin	4.8%	6.6%	-	
No. of customers	629	627	-2	
Information and communications				<ul style="list-style-type: none"> Broadband services customers increased, while communication services to companies and systems development also performed strongly Profits rose due to the increase in broadband customers (+¥100mn), lower customer acquisition costs (+¥200mn), and an expansion of the stock business to corporate customers (+¥100mn)
sales	9,414	9,659	2.6%	
Operating profit	826	1,333	61.4%	
Profit margin	8.8%	13.8%	-	
Number of broadband customers	821	843	+23	
CATV				<ul style="list-style-type: none"> Although the number of broadcast services customers declined, communication services customers increased 4,000 y-o-y to 193,000 customers, resulting in the higher profits.
sales	5,970	6,070	1.7%	
Operating profit	377	503	33.4%	
Profit margin	6.3%	8.3%	-	
No. of customers	693	692	-1	
Construction and real estate				<ul style="list-style-type: none"> Sales increased due to strong sales of condominiums. Profits were down due to the effects of the higher consumption tax and the increase in SG&A costs in the home renovation business
sales	3,419	3,728	9.0%	
Operating profit	135	31	-76.9%	
Profit margin	3.9%	0.8%	-	
Aqua				<ul style="list-style-type: none"> Sales grew thanks to the increase in the number of customers While it continues to record an operating loss because of the increase in costs to acquire new customers, its profit margin is improving
Sales	942	1,123	19.2%	
Operating profit	-523	-511	-	
Profit margin	-55.5%	-45.5%	-	
No. of customers	105	126	+20	
Other businesses/Indirect costs				<ul style="list-style-type: none"> Sales increased because of higher user numbers in its nursing homes business Sales declined in the wedding halls business due to fewer weddings
Sales	1,350	1,207	-10.6%	
Operating profit	-1,216	-1,193	-	
Profit margin	-90.1%	-98.8%	-	
Total				
Sales	43,038	44,302	2.9%	
Operating profit	648	1,657	155.7%	
Profit margin	1.5%	3.7%	-	
No. of customers	2,471	2,526	+55	

Note: The values are before the distribution of indirect costs, while the number of customers is rounded-off to the nearest 1,000

The Company introduced the TLC Membership Service in December 2012 with the objective of increasing the user rate of services within the group and to fortify its hold on the current customer base. By the end of June, members of this service had grown to 329,000 people, equivalent to 12% of the Company's customer base. The Company is aiming to increase the number of TLC members in the future and in August it announced that it had upgraded this service. Specifically, it announced that it had enhanced the menu for the exchange into goods and services of the TLC points that members acquire when using services provided by the Company. It also announced the extension of the expiry period for the TLC points from one year to three years (from the date the points are acquired).

As of the end of June 2014, about 187,000 Aeon Group stores and other stores or businesses exchanged WAON points, but from August the points-exchange menu was expanded, as described in the following table.



Expansion of the TLC points exchange menu

Exchange to WAON points	Can be used to purchase goods at Aeon Group stores and other stores or businesses accepting WAON points
Exchange to Suica points	Can be used on railways, buses, buying products, etc.
Mutual Exchange with LuLuCa points	Shizuoka Railway trains and buses, Shizutetsu stores, Shin Shizuoka Genova, Denbill, etc.
Exchange to TLC tickets	Can be used at stores accepting TLC tickets (101 stores within Shizuoka Prefecture, including restaurants and leisure facilities (as of August 2014))
Exchange to TLC selection	Can be exchanged to gourmet foods at leading department stores, redeemable coupons, aqua services in the TOKAI Group, etc.

The extent of the increase in profits in gas and oil products may grow over the full fiscal year

(2) Company Forecasts for FY3/15

For FY3/15, Tokai Holdings has not changed its initial forecasts of a 4.2% y-o-y rise in consolidated sales to ¥196,900mn, an 11.1% increase in operating profit to ¥8,210mn, a 5.2% upturn in recurring profit to ¥7,380mn, and a 23.2% rise in net profit to ¥3,200mn.

The Company is predicting it will expand its customer base from 68,000 to 2,586,000 customers. Most of the growth is expected from the broadband communications business and the aqua business, and also from the drop in the cancellation rate for gas services, while the increase in the number of customers for communications will offset the fall in CATV broadcast service customers. In July 2014, leading TV broadcasters in Tokyo, other than TV Tokyo Corp., stopped transmitting broadcasts. Thus, the Company forecasted a 6,000 y-o-y drop in the number of customers for its CATV broadcasting service in FY3/15. But at the current time, the effect seems to be negligible.

Number of Customers

	(thousand)				
	FY3/12	FY3/13	FY3/14	FY3/15E	Absolute change
Gas (LP gas + town gas)	648	629	628	634	+6
Home security	20	19	19	19	0
Aqua business	97	102	122	143	+20
Information and communication services (broadband services)	758	816	854	876	+22
Information and communication services (mobile services)	193	213	227	238	+11
CATV	722	691	693	700	+7
Total	2,415	2,445	2,519	2,586	+68

Note: Total figures omit double counting (ascribing the same customer to more than one service)

Sales by Segment

	(¥bn)				
	FY3/12	FY3/13	FY3/14	FY3/15E	Absolute change
Gas and oil products	80.4	94.5	97.2	97.8	+0.6
Information and communication services	37.9	38.5	38.8	41.5	+2.7
CATV	24.3	23.8	24.2	24.6	+0.4
Construction and real estate	15.9	15.8	19.2	21.8	+2.6
Aqua	3.5	3.8	4.4	5.4	+1.0
Other businesses	5.5	5.4	5.1	5.8	+0.7
Total	181.9	181.7	189.0	196.9	+7.9

Operating Profit by Segment

	(¥bn)				
	FY3/12	FY3/13	FY3/14	FY3/15E	Absolute change
Gas and oil products	7.8	7.4	6.5	6.8	+0.3
Information and communication services	5.5	4.9	4.4	5.2	+0.8
CATV	2.3	1.3	1.8	1.4	-0.4
Construction and real estate	1.0	0.6	1.4	1.3	-0.1
Aqua	-0.9	-0.9	-2.0	-1.4	+0.6
Other businesses + indirect costs	-4.7	-4.3	-4.7	-5.1	-0.4
Total	10.9	8.9	7.4	8.2	+0.8

Note: All operating profits are before deducting indirect costs

The Company had forecast a y-o-y increase in operating income of ¥300mn for the gas and oil products business. As previously stated, this surpasses the target it set for Q1, and in Q2 also, the effects of rationalization, such as to keep down indirect costs, will continue, and profits should further improve. Therefore, it is highly likely that the extent of the increase in profits will further increase over the course of the full fiscal year.

In the information and communication services business, in addition to the increase in the number of broadband Internet services customers, the reduction in customer acquisition costs means the Company is forecasting an increase in profit of ¥2.7bn y-o-y. The decline in the number of new customer in Q1 was one reason why the forecast was surpassed, and from 1H onwards the results are expected to be roughly in-line with forecasts.

The growth in customer numbers in the aqua business meant the double-digit increase in sales continued and moreover the costs of advertising and acquiring customers are expected to decline over the course of the full fiscal year. Therefore, the Company forecasts a reduction in the loss recorded by this business.

However, it expects a decline in profits in both the CATV business and the construction and real estate business. The CATV business is expected to be impacted by the fact that TV broadcasters in Tokyo, other than TV Tokyo Corp., have stopped transmitting broadcasts. Also, it anticipates a decline in sales in the construction and real estate business as a reaction to the increase in the consumption tax.

Overall, the Company's sales are progressing basically in-line with its targets for the full fiscal year, while it should surpass its forecast for operating profit by the extent that its LP gas business exceeds its forecast.

■ New three-year business plan

Aiming for sales of ¥209.5bn and operating profit ¥12.6bn in FY3/17

(1) Outline of three-year plan, Innovation Plan 2016 "Growing"

In June 2014, the Company announced "Innovation Plan 2016 'Growing'" as its three-year plan with FY3/17 as its final year. Within this plan, it set the specific management targets of sales of ¥209.5bn and operating profit of ¥12.6bn in FY3/17 (please refer to the table). This represents an increase in operating profit of ¥5.2bn compared to the result of the previous fiscal year, and within this increase, it expects external growth—namely, of expanding its customer base and reducing the cost of acquiring new customers—to contribute ¥2.7bn, and internal growth—such as improved productivity via scale merits and reduced amortization costs—to contribute ¥2.5bn.

Targets in IP16 "Growing"

	FY3/14 Result	FY3/15 Forecast	FY3/16 Target	FY3/17 Target
No. of customer (mn)	2.52	2.59	2.66	2.73
Sales (¥bn)	189.0	196.9	202.3	209.5
Operating profit (¥bn)	7.4	8.2	9.7	12.6
Earnings per share (¥)	22.67	27.86	34.91	54.06
EBITDA (¥bn)	24.9	25.2	26.7	28.7
Interest bearing debt (¥bn)	85.8	81.8	74.1	64.7
Equity ratio	21.6%	23.0%	25.1%	28.6%



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Analysis of factors behind the increase in operating profit (FY3/14 – FY3/17)

External growth	Expanding the customer base	○The period to reap the rewards of the prior investment <ul style="list-style-type: none"> • The number of aqua business customers to increase from 120,000 at the end of FY3/14→180,000 at the end of FY3/17 • The number of customers in the CATV business subscribing through fiber-optic lines to increase from 190,000 at the end of FY3/14→220,000 at the end of FY3/17 	+¥1.1bn
		○Expansion of the stock business in the information services business <ul style="list-style-type: none"> • Cloud service , data center business, etc 	+¥0.8bn
	Reduction in cost of acquiring customers		+¥0.8bn
		Sub-total	+¥2.7bn
Internal growth	Scale merits	○Improved productivity in the aqua business <ul style="list-style-type: none"> • FY3/14 , 1.28 million units→FY3/18, 3.66 million units (2.9 times) • A 35% reduction in the production cost unit price over three years 	+¥1.6bn
		○Improved delivery efficiency, etc., in the LP gas business. <ul style="list-style-type: none"> • A 15% reduction in the delivery cost unit price over three years from initiatives for joint delivery, etc. 	
	Reduction in amortization costs, etc.		+¥0.9bn
		Sub-total	+¥2.5bn
Total			+¥5.2bn

The Company’s basic policies in its new medium-term business plan are to “increase sales and improve profitability through accumulating customers,” “continue to improve the financial condition,” and “continuously and stably return profits to shareholders.” In this three year plan, it is particularly aiming to increase sales per customer and accumulate customers by introducing set menus.

Currently, out of the Company group’s 2.52 million customers, only 12% subscribe to multiple services. For a company that professes to be a total life infrastructure provider that offers services such as gas, broadcast, and communications, this cannot be described as a situation in which synergies between group companies are being fully leveraged, and as before this is a challenge for company management. For example, 790,000 of its approximately 870,000 broadband service customers only have a broadband contract, while 65,000 have one other contract and 13,000 have two other contracts.

The Company’s goal at the current time in introducing set menus for the group’s main services of LP gas and communication services is to use the discounted user fees and benefit programs, such as offering additional TLC points, to create a feeling among customers that its services are inexpensive. It intends this strategy to fortify its customer base. It began test marketing its set menus in Shizuoka and Greater Tokyo in August 2014 and plans to launch full-scale sales in November. Moreover, it is investigating sequentially adding set menus to its existing services that it offers in its other businesses, and is also considering offering an electricity service in conjunction with the complete liberalization of retail electricity from 2016.

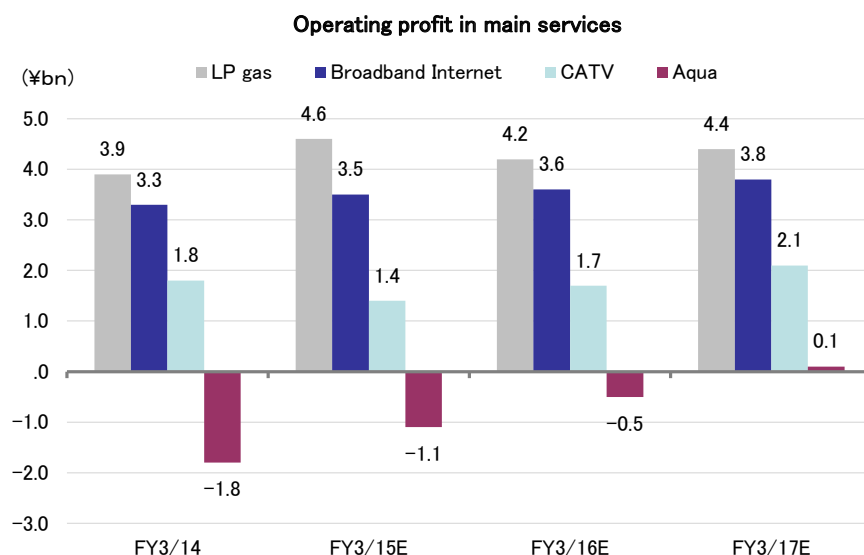
By introducing set menus, the Company anticipates that it will not only be able to increase customer numbers, but also to reduce the costs of acquiring new customers. If customers subscribe to a service from a set menu, the Company can reduce its costs by half. It also expects the cancellation rate to decline as this rate tends to be lower when a customer subscribes to multiple services compared to when they subscribe to only one. If the Company can use the reduction in costs from the set menus as a source of revenue to reduce prices, it should improve the profitability of the Company as a whole.

The targets in the three-year plan do not incorporate the effects of the set menus, and therefore if the introduction of the set menus results in an increase in the number of customers, it is entirely possible that the Company will surpass its targets.

The aqua business is expected to become profitable in FY3/17.

(2) Forecasts for the main services

The graph shows the operating profit targets for the main services in the three year plan.



○LP gas business

In the LP gas business it is anticipated that consumption on the unit of households will decline by an annual rate of 1.8% to 2.0% against the backdrop of the declining population and people's greater orientation to save energy. Also, the market environment is expected to continue to be characterized by fierce competition between peer companies.

The Company is targeting an increase of ¥500mn y-o-y, to ¥4.4 billion, for its operating profit in FY3/17. Breaking this increase down, while the fall in household consumption will reduce profits by ¥800mn, the Company expects the increase in customer numbers (+30,000) to contribute ¥900mn, and the effects of initiatives for joint supply and of rationalization, including integrating the indirect sectors in Greater Tokyo and Shizuoka, to contribute ¥800 million.

○Broadband Internet services

The cable broadband market is expected to peak and become a mature market in FY3/16. The Company is targeting operating profit in FY3/17 of ¥3.8 billion, an increase of ¥500mn y-o-y. By utilizing its acquiring of customers in the three major mass retailers of electronic goods, the Company expects to increase the number of customer by 80,000 over the plan's three years. In addition, it intends to achieve this target by upgrading its ISP system and increasing the efficiency of the backyard operations of the two brands it currently manages, @T COM (an ISP offered nationwide) and TNC (an ISP offered only in Shizuoka Prefecture)

○CATV

The market environment is expected to be continued to be characterized by price competition between the broadcast services provided by large communications companies. Within this environment, the Company forecasts operating profit in FY3/17 of ¥2.1bn, an increase of ¥300mn y-o-y. Leveraging its alliance with a mobile phone company (smartphone discount), the Company expects a net increase of 30,000 customers for its CATV communication services. In addition, in broadcast services, its strategy is to acquire new customers by rolling out a plan for free broadcast basic fees using an aggregated bulk method+additional services for housing complexes such as condominiums.

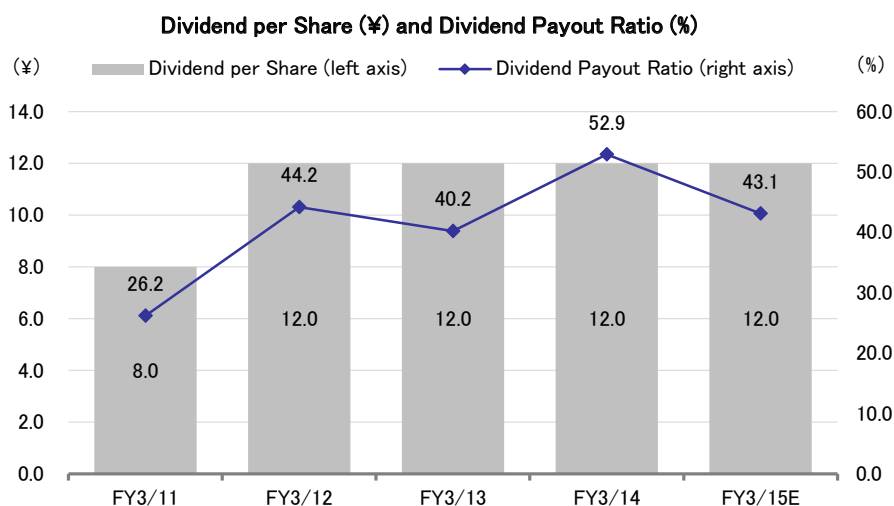
○Aqua business

Customers' demand for "safe" drinking water continues to be high and growth is expected to continue in the water home delivery market. The Company expects the aqua business to become profitable in FY3/17 and in that year it is targeting its first operating profit of ¥100mn, an increase of ¥1.9bn y-o-y. It plans to achieve this by increasing customer numbers by 60,000 over the three years and by advancing its highly profitably regular delivery service. It also expects productivity at its factories to improve in conjunction with the increase in the number of customers (with the number of units produced to increase by 2.9 times, to 3.66 million units, over the three years, reducing the production unit cost by 35% over the same time period).

■ Shareholder Return Policy

Maintaining a dividend payout ratio in excess of 40% in the three years since changing to a holding company system

The Company's basic policy toward shareholder returns is to pay a steady dividend. Over the past three fiscal years since changing to a holding company system, it has maintained a dividend payout ratio of more than 40%, so it is likely to keep a ratio of at least 40% for FY3/15. As awards to holders of 100 – 999 of its shares, the Company offers 12 bottles of Fuji Natural Water with a retail value of ¥1,800 each, Quo cards worth ¥500 each, food coupons worth ¥1,000 each, or ¥1,000 worth of points to members of the TLC Membership Service at the interim and end of a fiscal year. An investor holding the minimum lot of the Company's shares therefore receives a total yield on investment, including dividend yield and the value of 12 bottles of Fuji Natural Water, of about 13%, relative to the Company's current share price.



Note: Figures through FY3/11 are for Tokai Corp.

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