COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Holdings Corporation.

3167

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Summary

Customer numbers are steadily expanding and operating profit of ¥14bn is in sight for FY3/19

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

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

1. Profits declined YoY in the FY3/18 3Q results, but still exceeded the forecast

In the FY3/18 3Q cumulative (April to December 2017) consolidated results, net sales increased 4.6% year-on-year (YoY) to ¥133,336mn and operating profit decreased 19.7% to ¥6,579mn. The reason for the decrease in operating profit was that the Company spent around ¥3bn on upfront-investment costs, including to acquire new customers, but this result was still approximately 5% above the Company forecast. This was mainly because within the CATV and the information and communications services businesses, corporate services continued to perform strongly. At the end of 3Q, the number of customers had increased by 275,000 from the end of the previous fiscal year to 2,839,000 customers. In 2Q, CATV company Tokyo Bay Network Co., Ltd., was made a subsidiary, which greatly increased customer numbers, by 250,000. But even when excluding this factor, the pace of the net increase in customers was 25,000, which is a pace more than 4 times the net increase in FY3/17, of 6,000 customers.

2. The FY3/18 results are expected to be in line with the initial Company forecasts

For the FY3/18 consolidated results, the Company has left unchanged its initial forecasts, of net sales to increase 6.0% YoY to ¥189,400mn and operating profit to decrease 10.5% to ¥11,410mn. Sales are expected to increase for the first time in 4 fiscal years, including due to the price revisions to be implemented in the LP gas business in 4Q, and the strong performance of the CATV business. For operating profit, upfront-investment costs, including to acquire new customers, are set to accumulate by several hundred million yen above the initial forecast of ¥2.5bn. But it seems possible that this increase will be absorbed by the amount that results exceeded the forecasts up to 3Q. By the end of the fiscal year, the number of customers is expected to increase by 316,000 from the end of the previous fiscal year to 2,880,000 customers. The outlook for FY3/19 is for operating profit to grow to ¥14bn from the effects of the higher sales following the expansion of the customer base, despite the fact that the Company will spend around the same amount on customer-acquisition costs.

3. In the new medium-term management plan (IP20), it will strategically invest ¥100bn over the four years

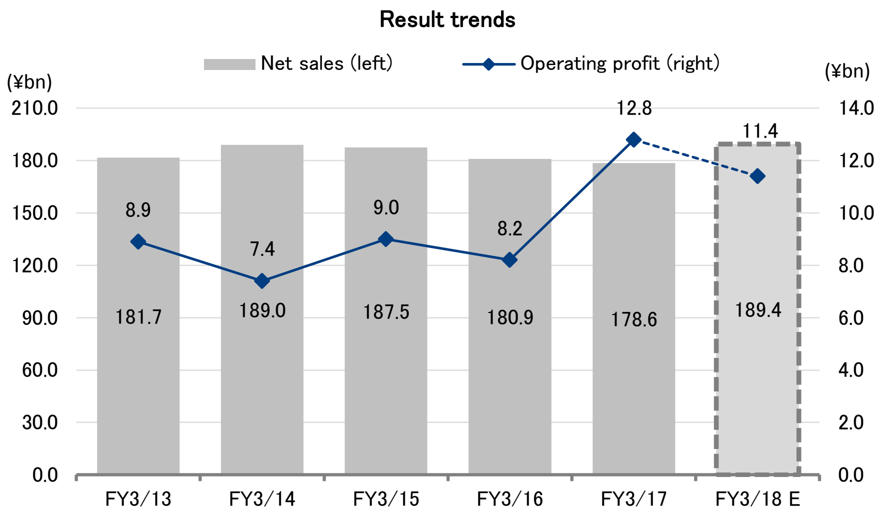
In the new medium-term management plan (IP20), the Company sets out its policy of conducting strategic investment of ¥100bn a year in the next four years and expanding the earnings base (the number of customers) for its mainstay businesses of gas, CATV, and information and communications services. Its aim is to increase customer numbers to more than 4,320,000 by the end of March 2021, while utilizing M&A. In addition, at the same time it is working on strengthening cross sales of services within the Group. Currently, only around 7% of the Company Group's customers have concluded contracts for more than one service, and its strategy is to raise this to 20% over the four years to increase earnings per customer. Moreover, over the coming four years it will be working on developing the new businesses that will become its next earning pillars. Within the Total Life Concierge concept, it is developing new services targeting fields like healthcare and mobility while utilizing advanced technologies such as AI and IoT, and it is also investigating M&A and related measures.

4. Continues to actively return profits to shareholders

There has been no change to the policy of continuously and stably returning profits to shareholders. The forecast dividend per share for FY3/18 is ¥28.0 (dividend payout ratio, 55.0%), which is unchanged from the previous fiscal year. Going forward, the Company intends to pay dividends while observing profit trends, with a benchmark dividend payout ratio of 40% to 50%. Also, at the end of March and the end of September, it presents one gift to shareholders from choices such as an Aqua product, a QUO card, points for a TLC member service worth ¥1,000, one-year free of charge course for inexpensive SIM service LIBMO. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (closing price of ¥1,094 on February 14, 2018), it is in the range of 4% to 6% (depending on the selection of either a QUO card or an Aqua product as the gift).

Key Points

- Sales increased but profits decreased due to the active spending on customer-acquisition costs, but the number of customers, which is its earnings base, is steadily increasing
- Results exceeded the Company forecasts in the strongly performing CATV and corporate information and communications services businesses
- Aiming for more than 4.32 million Group customers and consolidated operating profit of ¥22.5bn for FY3/21



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

Result trends

Sales increased but profits decreased due to active spending on customer-acquisition costs, but the number of customers, which is the Company's earnings base, is steadily increasing

1. Overview of the FY3/18 3Q results

In the FY3/18 3Q cumulative consolidated results, net sales increased 4.6% YoY to ¥133,336mn, operating profit decreased 19.7% to ¥6,579mn, recurring profit fell 19.2% to ¥6,662mn, and net income attributable to the owners of the parent declined 29.2% to ¥3,435mn. In order to achieve the targets in the medium-term management plan (IP20), the Company is investing in upfront costs to increase the number of customers, which is its earnings base, and it is actively working to acquire customers. As a result, at the end of 3Q the number of customers had increased by 275,000 YoY to 2,839,000 customers, which led to the higher sales. In the current 2Q, CATV company Tokyo Bay Network was made a subsidiary, and this added 250,000 to the customer numbers. But even on an existing-businesses basis, customer numbers increased by 25,000, which is a pace of increase around four times the net increase in FY3/17.

Conversely, the reasons for the decline in operating profit was spending of approximately ¥3bn on upfront-investment costs, including to acquire new customers, to prevent contract cancellations, and on sales promotion on the launch of LIBMO, which is a new service in the information and communications services business. However, operating profit was still around 5% above the Company forecast. This was mainly because although profits in the LP gas and LIBMO businesses were slightly below their respective forecasts, within the CATV and information and communications services businesses, corporate services (systems development and communication services) performed better than expected.

FY3/18 3Q consolidated results

(¥mn)

	FY3/17 3Q cumulative		FY3/18 3Q cumulative		
	Results	% of sales	Results	% of sales	YoY
Net sales	127,432	-	133,336	-	4.6%
Cost of sales	75,055	58.9%	79,175	59.4%	5.5%
SG&A expenses	44,183	34.7%	47,581	35.7%	7.7%
Operating profit	8,193	6.4%	6,579	4.9%	-19.7%
Recurring profit	8,246	6.5%	6,662	5.0%	-19.2%
Extraordinary income (loss)	-377	-	-689	-	-
Net income attributable to owners of the parent	4,850	3.8%	3,435	2.6%	-29.2%

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

Looking at the increases and decreases in customer numbers at the end of 3Q compared to the same period in the previous fiscal year, we see that they increased by 17,000 in the LP gas business, 274,000 in the CATV business, and 8,000 in the Aqua business, while the only decrease was in the information and communications services business, down 13,000 customers. Breaking down this decrease, although they increased 31,000 for the Hikari Collaboration (ISP optical communication line service), they decreased 39,000 for the former ISP service and 5,000 for mobile services. While the Company is making progress in transferring customers from the former ISP service to Hikari Collaboration, it seems that the main reason for the decrease was the outflow of some customers in the context of the continuing competition with the major mobile carriers to acquire customers. As a measure to prevent this outflow, in February 2017 the Company newly entered the MVNO* business. It is aiming to create a sense of low cost compared to the major mobile carriers by launching the LIBMO service and selling it as a set with Hikari Collaboration. This is preventing the outflow of some customers, but the situation is that it cannot be said to have as yet fully stopped this outflow. At the end of 3Q, the number of contracts for LIBMO was 21,000, which is basically in line with the forecast.

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

Customer numbers by key services

(thousand)

	FY3/15 3Q cumulative	FY3/16 3Q cumulative	FY3/17 3Q cumulative	FY3/18 3Q cumulative	YoY
Gas (LP gas, city gas)	624	629	635	653	+18
LP gas	571	575	582	599	+17
City gas	53	53	54	54	+0
Information and communications services	1,099	1,094	1,060	1,047	-13
Previous ISP, etc.	866	686	538	499	-39
Hikari Collaboration	0	173	288	319	+31
Mobile	234	235	234	229	-5
CATV	689	704	728	1,002	+274
CATV broadcasting	494	497	506	751	+245
CATV communications	195	207	222	251	+29
Aqua	133	134	135	143	+8
Security	18	18	17	17	+0
Total	2,540	2,553	2,551	2,839	+288
(Number of TLC members)	378	464	560	669	+109

* ISP and CATV both offer communications services, so total figures avoid duplication. Figures of less than 1,000 are rounded-off.
Source: Prepared by FISCO from the Company's financial results

Results exceeded the Company forecasts in the strongly performing CATV and corporate information and communications services businesses

2. Trends by business segment

Net sales by segment

(¥mn)

	FY3/15 3Q cumulative	FY3/16 3Q cumulative	FY3/17 3Q cumulative	FY3/18 3Q cumulative	YoY
Gas and petroleum	67,106	58,348	51,291	53,145	+3.6%
Information and communications services	30,020	31,988	36,212	37,760	+4.3%
CATV	18,207	18,345	18,901	20,871	+10.4%
Building and real estate	13,311	13,783	12,926	13,491	+4.4%
Aqua	3,707	4,130	4,391	4,652	+5.9%
Other businesses	3,626	3,507	3,708	3,415	-7.9%
Total	135,981	130,103	127,432	133,336	+4.6%

Operating profit by segment

(¥mn)

	FY3/15 3Q cumulative	FY3/16 3Q cumulative	FY3/17 3Q cumulative	FY3/18 3Q cumulative	YoY
Gas and petroleum	4,376	5,232	5,550	3,857	-30.5%
Information and communications services	3,716	1,472	2,993	2,410	-19.5%
CATV	1,309	1,453	2,125	2,758	+29.8%
Building and real estate	349	523	619	681	+10.0%
Aqua	-1,166	-933	299	221	-26.1%
Other businesses	-3,718	-3,741	-3,396	-3,350	-
Total	4,866	4,006	8,193	6,579	-19.7%

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

(1) Gas and petroleum business

In the gas and petroleum business, net sales increased 3.6% YoY to ¥53,145mn and operating profit* decreased 30.5% to ¥3,857mn. Within these amounts, in the mainstay LP gas business, customer numbers increased 17,000 YoY to 599,000 as the Company worked to acquire customers and to prevent contract cancellations in the existing areas (Shizuoka, metropolitan area, and south Tohoku), and it also steadily acquired customers in the areas it has newly entered-into, of the Sendai, Aichi, and Gifu areas that it entered-into up to FY3/17, and the Okayama area that it entered-into in September 2017. Around half of the increase in customer numbers was from these new areas. Net sales rose 3.5% YoY to ¥44,888mn, due to a rise in sales unit prices following the hike in purchasing prices in addition to the increase in customer numbers. On the other hand, in the city gas business, the number of customers remained basically unchanged YoY at 54,000, but net sales still increased 4.4% to ¥8,257mn because of the rise in sales unit prices.

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

Looking at the factors that caused profits to change, the majority of the decrease was due to the YoY increase in customer-acquisition costs of ¥700mn, for fee-related measures to acquire new customers of ¥600mn, and to prevent contract cancellations of ¥500mn. The rise in purchasing prices following the hike in the price of crude oil was a factor causing costs to increase ¥2.6bn. But the Company absorbed the majority of this by raising the sales unit prices, and on an actual basis, it kept the decline in profits down to slightly greater than ¥300mn. It revised the sales prices in January 2018 and this would offset the increase in purchasing costs for 4Q.

(2) Information and communications services business

In this business, net sales increased 4.3% YoY to ¥37,760mn and operating profit fell 19.5% to ¥2,410mn. Within it, in the consumer business, net sales decreased 0.2% to ¥23,732mn, roughly unchanged from the previous fiscal year. This was due to a decline in the number of customers for the previous ISP service and other services, despite an increase in the number of customers for the Hikari Collaboration service that has high monthly revenue. Operating profit declined, as although Hikari Collaboration became profitable, the Company invested ¥700mn including on sales promotion costs for LIBMO and on measures to prevent the cancellation of contracts for broadband services.

In corporate services, the stock-type business, which includes cloud services, is steadily growing, and in addition, orders for systems development projects are trending stably. As a result, net sales increased 12.9% YoY to ¥14,028mn, while profits also rose double-digit due to the effects of the higher sales.

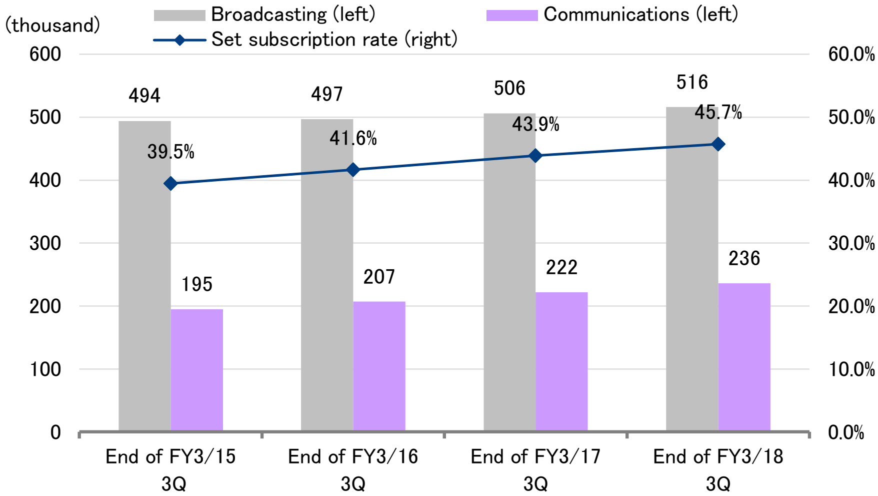
(3) CATV business

In the CATV business, net sales increased 10.4% YoY to ¥20,871mn and operating profit rose 29.8% to ¥2,758mn. It was the only one of the three main businesses in which both sales and profits increased, and moreover, both net sales and operating profit exceeded their Company forecasts. At the end of 3Q, the number of customers had risen greatly, by 274,000 YoY to 1,002,000 (751,000 broadcasting services and 251,000 communications services) on the addition of 250,000 customers (235,000 broadcasting services and 15,000 communication services) from Tokyo Bay Network, which was made a subsidiary in 2Q. Tokyo Bay Network's contribution to net sales was around ¥1.4bn, although it seems its effect on operating profit was negligible.

The actual sales increase rate excluding Tokyo Bay Network, was approximately 3%, and taken as a whole, customer numbers in the seven CATV subsidiaries increased and their results trended steadily. In the CATV business, the Company is collaborating with major mobile carriers to provide set discounts with smartphones to improve its price appeal, which is leading to an increase in the number of subscribers. In particular, the set contract rate for broadcasting and communication services is rising year by year, and at the end of FY3/18 3Q, it was 45.7%, up 1.8 percentage points YoY (excluding Tokyo Bay Network). It is considered that the increase in monthly earnings per customer from the rise in the set subscription rate will lead to improved profitability.

Looking at the number of contracts for Tokyo Bay Network according to service, at the end of FY3/18 3Q, it had 235,000 for broadcasting services and 15,000 for communications services, and the set contract rate was at a level of below 10%. This is considered to be due to the fact that Tokyo Bay Network's infrastructure has not yet been converted to fiber optics. Therefore, currently, the company is investing in converting it to fiber optics, and its strategy is to rapidly launch high-speed Internet services over fiber optic communication lines, thereby raising the communications services contract rate and improving profitability. Tokai Holding's CATV operating company plans to achieve practically 100% fiber optic coverage within its service areas by FY2020 and respond to the future launch of 4K/8K broadcasting.

The number of contracts for broadcasting and communications services and the set subscription rate



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

(4) Building and real estate business

In this business, net sales increased 4.4% YoY to ¥13,491mn, and operating profit rose 10.0% to ¥681mn. Sales from renovation business and home sales declined, but this was covered by higher sales of equipment work and in the building management support business.

(5) Aqua business

In the Aqua business, net sales increased 5.9% YoY to ¥4,652mn and operating profit decreased 26.2% to ¥221mn. Sales increased because at the end of 3Q, the number of customers had risen 8,000 YoY to 143,000. But the reason for the decline in profits was that the Company spent on strengthening sales, including to commercial facilities in urban areas. In the water home delivery industry, the majority of businesses raised their prices for delivery volumes in the fall of 2017, and the Company also increased the price of its "Fuji-no-Tennensui Sarari" (Mt. Fuji Natural Water) by ¥150, from ¥1,900 (including tax) to ¥2,050, although no particular negative effects were seen from this price increase.

(6) Other businesses and adjustments

In the other businesses, net sales decreased 7.9% YoY to ¥3,415mn. Breaking this down, the nursing care business performed strongly, with net sales rising 19.4% to ¥778mn following an increase in the number of facility users, and it has in sight achieving profitability in FY3/18. As the occupancy rate in its nursing homes is close to 100%, the Company has started looking into building a new facility within Shizuoka Prefecture.

In the wedding ceremony business, net sales fell 22.6% to ¥1,131mn following the closure of one of the two facilities at the end of March 2017, but its profits are improving. In the shipbuilding business, net sales decreased 8.2% to ¥972mn due to the decline in the volume of ship repair work. This segment's operating loss, including internal adjustments, was ¥3,350mn (a loss of ¥3,396mn in the previous fiscal year).

Business outlook

Making steady progress in building the customer base toward achieving operating profit of ¥14bn in FY3/19

1. FY3/18 earnings outlook

For the FY3/18 consolidated results, the initial forecasts have been left unchanged, of net sales to increase 6.0% YoY to ¥189,400mn, operating profit to decline 10.5% to ¥11,410mn, recurring profit to decrease 11.1% to ¥11,360mn, and net income attributable to owners of the parent to fall 12.1% to ¥6,450mn. The outlook is for net sales to increase for the first time in four fiscal years and for operating profit to decrease for the first time in two fiscal years. Up to 3Q, the progress rates for the full fiscal year forecasts were 70.4% for net sales and 57.7% for operating profit, which is progress about the same as the averages for the last three fiscal years (71.9% for net sales and 56.9% for operating profit.) As no major changes to the market environment can be seen in 4Q, at FISCO we think that the Company will basically achieve its full fiscal year forecasts.

Looking at the factors in FY3/18 causing operating profit to increase and decrease, the increase factor is that fee revenue is expected to rise ¥1.1bn from the growth in the number of customers, while the decrease factors are expected to increase ¥2.5bn in total for upfront investment. Specifically, ¥1.1bn in the LP gas business, including for base costs following the area expansion, customer-acquisition costs, and the reduction in fees; ¥500mn for sales promotions costs for LIBMO; and ¥900mn for costs to prevent customers cancelling their contracts, mainly in the gas business and communications services business. However, as previously mentioned, the pace of increase in upfront investment costs is slightly above forecast in the LP gas business and the LIBMO business, and they are expected to rise in the range of ¥3.3bn to ¥3.4bn for the full fiscal year. This increase in costs will be covered by the higher earnings in the CATV business and the corporate information and communications services business.

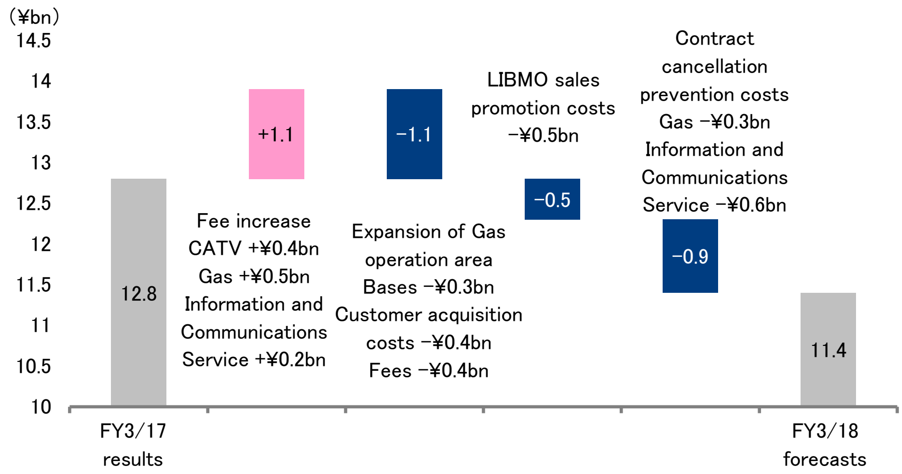
Outlook for the FY3/18 consolidated results

(¥mn)

	FY3/17		FY3/18		
	Results	% of sales	Full-year forecast	% of sales	YoY
Net sales	178,631	-	189,400	-	6.0%
Operating profit	12,750	7.1%	11,410	6.0%	-10.5%
Recurring profit	12,775	7.2%	11,360	6.0%	-11.1%
Net income attributable to owners of the parent	7,337	4.1%	6,450	3.4%	-12.1%
Net income per share (yen)	64.46		50.88		

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

Factors expected to impact operating profit in FY3/18 (initial Company forecasts)



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

The Company is forecasting that at the end of FY3/18, the number of customers will have increased by 316,000 from the end of the previous fiscal year to 2,880,000. Therefore, it will need to acquire the remaining 41,000 in 4Q, but it has already acquired 14,000 customers (10,000 broadcasting services around 4,000 communication services) when it made TV Tsuyama Inc. (Okayama Prefecture) a subsidiary in February 2018. It will acquire the remaining 27,000 from the continuing growth in customer numbers in the other businesses, including the LP gas, CATV, Hikari Collaboration, LIBMO, and Aqua businesses. In particular, within the upward trend in the sales prices, the Company can be said to be utilizing its advantage in price competitiveness to create opportunities to acquire customers in its new areas, and this is expected to lead to an increase in the customer numbers.

2. FY3/19 earnings outlook

In FY3/18, operating profit will fall temporarily because the Company is prioritizing actively spending on upfront investment costs to increase the customer numbers, which is its earnings base. But it seems likely to achieve the targets in the medium-term management plan for FY3/19, of net sales of ¥202bn and operating profit of ¥14bn, through steadily increasing the number of customers. The plan is to spend around the same on customer-acquisition and other costs as in FY3/18, and for the number of customers to have increased by around 4% compared to the forecast for the current fiscal year, to 2,990,000 customers, by the end of March 2019. It is also concurrently investigating M&A for the CATV, gas, and other businesses. With regards to operating profit, as the upfront investment costs will be around the same as the amount expected in the current fiscal year, it is forecast that the amount of the increase in sales will directly contribute to the increase in profits.

Aiming for more than 4.32 million Group customers and consolidated operating profit of ¥22.5bn for FY3/21

3. Medium-term management plan

(1) Basic policy

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

(2) Targets for management indicators

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

The Company considers candidate proposals with a ROI (operating profit before amortization of goodwill ÷ investment amount) on a level of around 8% as the investment standard for this investment totaling ¥100bn. In FY3/18, it has already made subsidiaries of two companies in the CATV business (Tokyo Bay Network and TV Tsuyama). Moreover, it is currently concurrently examining multiple M&A candidates, including in the gas business, so it is possible that it will become involved in various proposals in the future.

Financial targets in Innovation Plan 2020

(¥bn)

	FY3/17 Results	FY3/18 Targets	FY3/19 Targets	FY3/20 Targets	FY3/21	
					Targets	Vs. FY3/17
Net sales	178.6	189.4	202.0	224.4	339.3	1.9x
Operating profit	12.8	11.4	14.0	16.2	22.5	1.8x
Net income attributable to owners of the parent	7.3	6.4	7.9	8.7	11.5	1.6x
Total assets	161.1	169.8	173.8	191.2	283.4	1.8x
Interest-bearing debt/EBITDA ratio (x)	2.0	2.4	2.2	2.0	2.8	
Equity ratio (%)	34.5	33.9	35.6	34.9	31.6	
ROE (%)	15.2	11.1	12.8	13.0	13.0	
Number of customers (million contracts)	256	288	299	372	Over 4.32	Over 1.7x

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

4. Major business initiatives

(1) LP gas business

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

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

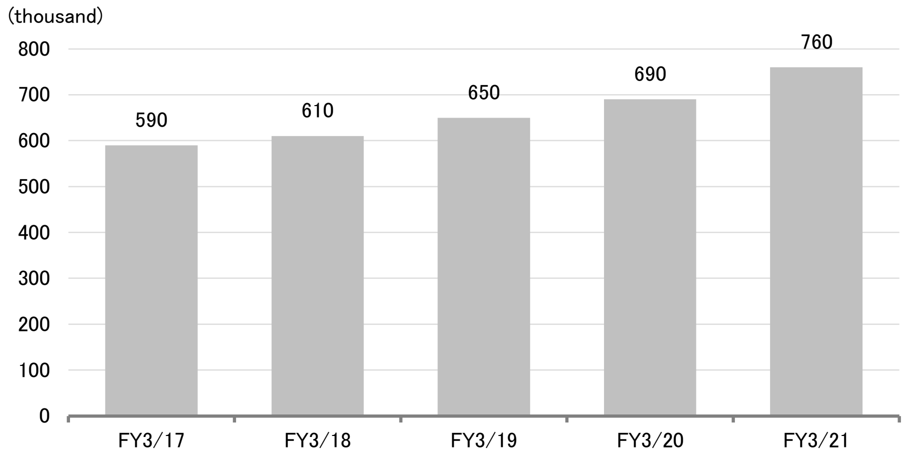
The Company plans to increase the number of customers in these new areas by 9 times, from 8,000 at the end of FY3/17 to 70,000 in four years' time, which will give it a share of approximately 2% in these areas and this certainly seems possible considering the Company's advantage in price competitiveness.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

Number of LP gas direct sales customers

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

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

Trends in LP Gas Customer Numbers



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

(2) City gas business

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

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

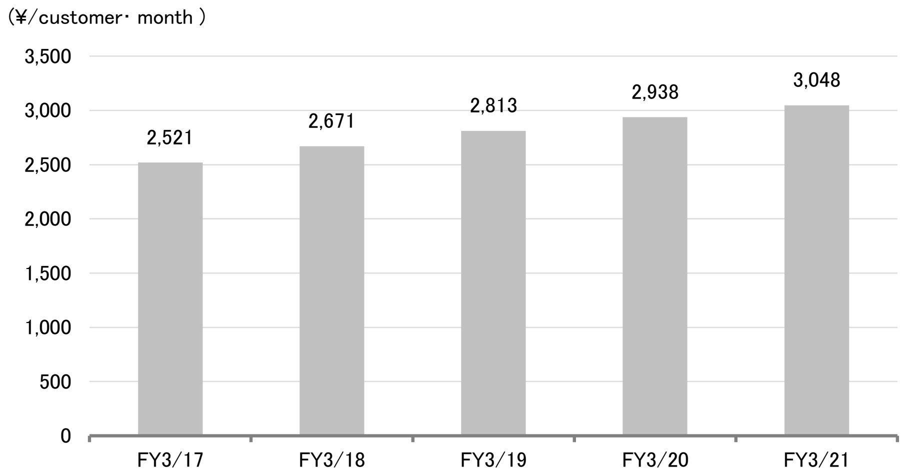
(3) Information and Communications business

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

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

The number of customers for broadband services is expected to increase by 1.7 times in the next four years, to 1,340,000. But as previously mentioned, the competition with the major mobile carriers to acquire customers continues to be severe, and the situation at the current point in time is that the Company has not yet halted the downward trend in customer numbers. The effects of the set sales with LIBMO have also been limited, so this is a management issue to be addressed in the future.

Monthly revenue per customer for FTTH



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

Conversely, for corporate information and communications services, the Company is forecasting annual growth of 9%, with net sales to increase from ¥20.6bn in FY3/17 to ¥29.5bn in FY3/21. Within this business, it will strengthen cloud-related services for which the market is rapidly expanding. The Company owns three data centers in Shizuoka, Okayama, and Nagano, in addition to constructing its own optical fiber network of about 6,000km, so it already has in place the infrastructure to support growth. The market for corporate cloud connection services is forecast to grow greatly by 3.7 times, from ¥5.3bn in FY2016 to ¥19.5bn over the four years. The Company is aiming to increase sales by utilizing its strengths having full coverage for the largest AWS and other major public Clouds in its connection solutions.

In October 2017, the Company announced a strategic business collaboration with Cloud Ace, Inc., which has the leading track record domestically for the introduction and technical support for the Google Cloud Platform (GCP), and that they will work together to promote the sales of GCP. For TOKAI Communications Corporation, this collaboration is expected to contribute to an increase in sales of its GCP connection line services. Also, in November the Company announced that it had concluded a business outsourcing agreement with Educational Foundation Shingakukai (Nagano Prefecture) and that it has started providing optical Internet services under Shingakukai's own brand to the Foundation's members and to teachers. For its services to businesses wanting to develop an optical Internet service, which is a lifestyle infrastructure service, under their own brands, it has already received inquiries from energy businesses (city gas and LP gas), and it intends to actively expand sales of these services in the future.

Furthermore, in December, in the cloud services provided by TOKAI Communications, it began providing a “Data Linkage Option” that is installed as standard in ASTERIA WARP Core*, which is the data linkage middleware of Infoteria Corporation <3853> that has the leading domestic share. In such ways, the Company is working to strengthen its own services at the same time as actively progressing collaborations with IT companies, which is expected to lead to high growth in the future.

* The ASTERIA series are middleware products that use ASTERIA WARP as the main product and which can link the data on different computer systems with non-programming. They make it possible to carry out the logic for converting the connections between various systems and the data, from servers on mainframes and on the Cloud through to spreadsheet software, without the need for complicated programming. Infoteria has held the top share domestically for corporate data linkage products for eleven consecutive years.

As a new measure, the Company Group has launched a new development support service that utilizes AI. Specifically, in November 2017, TOKAI Communications launched a service to support the development and construction of a voice service that is compliant with Amazon Alexa*, which is a cloud-based voice service provided by Amazon. As the first stage, it began the development and management of an ordering system for the home delivery of water in the Company’s Aqua business. Users of the water delivery service will be able to order additional bottles of water for home delivery by speaking into the Amazon Echo device installed in a room in their home.

* It corresponds to the ‘brain’ that supports Amazon’s smart speaker, Amazon Echo.

(4) CATV business

As of February 2018, the CATV business is managed by nine Group companies in one metropolis and five prefectures (Shizuoka Prefecture, Tokyo metropolis, Kanagawa Prefecture, Chiba Prefecture, Nagano Prefecture, and Okayama Prefecture). Due mainly to the effects of the M&A, customer numbers are increasingly greatly, rising from 730,000 at the end of FY3/17 to 1,000,000 at the end of December 2017 (750,000 broadcasting service and 250,000 communication services). In February 2018, the Company made a subsidiary of TV Tsuyama (Okayama Prefecture), which added 14,000 customers (around 10,000 broadcasting service and 4,000 communication services), and the plan for the future is to increase customers numbers by around 20,000 a year in its existing areas. It seems that it will be able to achieve this, as the net increase in the past has been on a pace of 20,000 a year. But it is also possible that it will conduct M&A if this number is not achieved, and in fact, the Company is currently investigating several M&A candidates.

In this business, the Company plans to grow operating profit from ¥2.8bn in FY3/17 to ¥4.9bn in FY3/21 by increasing the number of customers and by raising the communication-services contract rate and improving the customer unit price. Its strengths include that it is constructing its own optical fiber network. In advance of the Tokyo Olympic and Paralympic Games in 2020, it will start testing and commercialization for high definition 4K/8K broadcasting, but it is necessary to invest in optical fiber and related equipment to provide this high definition broadcasting. Therefore, the Company plans to invest ¥6.5bn up to FY2020 and achieve practically 100% fiber optic coverage within its service areas

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

Financial position

Will keep the equity ratio in a range of 30% to 39% even while actively conducting investment

Looking at the financial condition at the end of FY3/18 3Q, total assets were up ¥4,785mn on the end of the previous fiscal year to ¥165,897mn. The main increases were ¥2,014mn in property, plant and equipment following Tokyo Bay Network being made a consolidated subsidiary, ¥1,083mn in investment securities due to the rise in share prices and other reasons, and ¥755mn in work in process due to a rise in the number of construction projects.

Conversely, total liabilities increased ¥2,006mn from the end of the previous fiscal year to ¥106,672mn. This was because although income taxes payable deceased ¥2,638mn, interest-bearing debt increased ¥3,374mn and other current liabilities, which includes advances received and accounts payable-other, rose ¥1,092mn. Net assets increased ¥2,778mn from the end of the previous fiscal year to ¥59,224mn. While the Company paid ¥4,001mn in dividends from surplus, it recorded ¥3,435mn of net income attributable to the owners of the parent and a ¥2,400mn increase in asset following the conversion of convertible bonds with stock acquisition rights.

Looking at the management indicators, the equity ratio, which indicates financial soundness, is steadily rising and it increased 0.5 of a percentage point from the end of the previous fiscal year to 35.0%. As interest-bearing debt grew, reliance on interest-bearing debt rose by 1.1 percentage points. But on looking at the trend over the last few years, we see it has continued to improve and can be judged to be at a level that is not a problem. In the medium-term management plan, the Company sets out its policy of conducting strategic investment of ¥100bn, so it is possible that interest-bearing debt will increase in the future also, but it intends to keep the equity ratio in range of 30% to 39%.

Consolidated balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18 3Q	Change
Total assets	173,620	165,702	160,303	161,112	165,897	+4,785
Total liabilities	135,291	122,234	118,332	104,665	106,672	+2,006
Total net assets	38,329	43,467	41,970	56,446	59,224	+2,778
Balance of interest-bearing debt	85,843	73,114	71,410	54,137	57,511	+3,374
Equity ratio	21.6%	25.7%	25.6%	34.5%	35.0%	+0.5pt
Reliance on interest-bearing debt	49.4%	44.1%	44.5%	33.6%	34.7%	+1.1pt

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

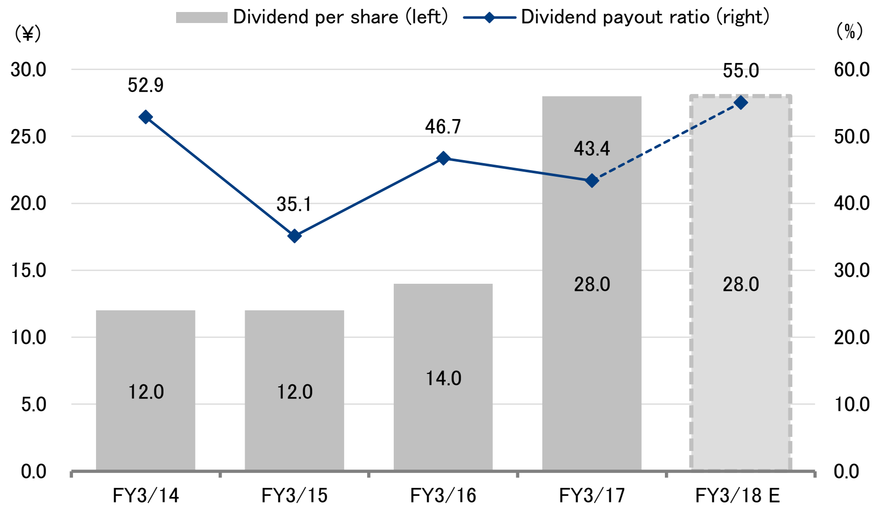
Shareholder return policy

Intends to continue to actively return profits to shareholders in the future

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

The Company presents gifts to shareholders at the end of March and September depending on the number of shares held. For each unit of shares (100 shares) held, shareholders can receive one of the following gifts: an Aqua product worth ¥2,000 (such as the Ulunom) "Fuji-no-Tennensui Sarari" (Mt. Fuji natural water), a QUO card worth ¥500, food coupons worth ¥1,000, or ¥1,000 worth of TLC Membership Service points. Further, shareholders registered at the end of September or March in FY3/17 can also select a special course for LIBMO, the inexpensive SIM service, in which the monthly fee of ¥1,880 becomes free of charge for the maximum of one year. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (¥1,094 on February 14, 2018), it is in the range of 4% to 6% (depending on the selection of either a QUO card or an Aqua product as the gift).

Dividend per share and dividend payout ratio



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

Information security measures

As its information security measures, previously each Group company had separately managed the personal information held and conducted measures against system failures and cyber-attacks. Since FY3/18, it has established a Group-wide expert committee in order share information between all the Group companies and at the same time, to heighten awareness of its security measures.

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