TOKAI Holdings
3167 Tokyo Stock Exchange First Section

17-Jan.-17

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Considering shifting the focus to implementing a growth strategy in the next medium-term management plan

Based in Shizuoka Prefecture, Japan, TOKAI Holdings Corporation <3167> (hereafter, also "the Company") is expanding its two main businesses, "energy and lifestyle-related services", primarily the provision of liquefied petroleum gas (LPG), and "information and communications services". Aiming to become a "Total Life Concierge" (TLC), a company offering a complete range of services for everyday life, the Company started the three-year medium-term management plan, called "Innovation Plan 2016 'Growing'", in FY3/15, and it is expected to largely achieve the plan's initial goals, including for strengthening its financial structure. In the next medium-term management plan (a four-year plan up to FY3/21), the Company intends to shift the focus to investment for growth and is aiming to grow earnings while actively utilizing M&A.

In the 1H FY3/17 (April to September 2016) consolidated results, net sales declined 3.0% year-on-year (YoY) to ¥82,201mn due to the impact of the reduction in the LP gas sales price, but operating profit increased 137.4% to ¥4,406mn following the higher profits in the information and communications services, CATV, and Aqua businesses. The number of Group customers at the end of September had fallen by 4,000 to 2,554,000 from the impact of the decline in the number of contracts for the previous ISP services from the transfer of these customers to Hikari Collaboration*.

* In March 2015, the Company began selling the @ T COM Hikari service and the TNC Hikari service, which bundle the Company's ISP service with NTT's fiber-optic cables for these services.

The outlook for the FY3/17 results is for net sales to decline 0.7% YoY to ¥179,700mn, but operating profit to increase 54.6% to ¥12,750mn and to achieve a record high for the first time in 5 fiscal years. In 2H, the results will be driven by three businesses; information and communications services, CATV, and Aqua. For the gas business and the CATV business, the Company is currently increasing spending on customer-acquisition costs toward increasing customer number of contracts and realizing growth from the next fiscal year onwards.

In addition to the complete liberalization of city gas retail sales from April 2017, investment is required for the CATV market in order to convert to fiber optics to realize ultra-high definition (UHD) broadcasting. Therefore going forward, it is forecast that industry restructuring will become more active in both industries, and it is considered that this will provide excellent opportunities for the Company to expand its customer base. In addition, the percentage of customers using multiple services among all its customers is currently only 7%, but from April 2017 onwards, it intends to focus on measures to raise this percentage and thereby increase earnings.

For shareholder returns, the Company aims for a dividend payout ratio of 40% to 50%, and in FY3/17, it plans to greatly increase the dividend per share by ¥14.0 YoY to ¥28.0 (dividend payout ratio, 48.9%). It also presents gifts to shareholders at the end of September and March, including Aqua products, QUO cards, and ¥1,000 worth of TLC Membership Service points. When including the gifts to shareholders in the estimate of the total investment yield per share unit from the current share price level (¥773 on December 13), it is in the range of 5% to 9% (depending on selection of either a QUO card or an Aqua product as the gift).

Check Point

- Outlook for the FY3/17 full year is for mostly unchanged sales YoY, but a major increase in profits
- Is currently formulating the next medium-term management plan toward implementing a growth strategy through active investment
- Plans to increase the dividend ¥6 to commemorate achieving the medium-term management plan's targets

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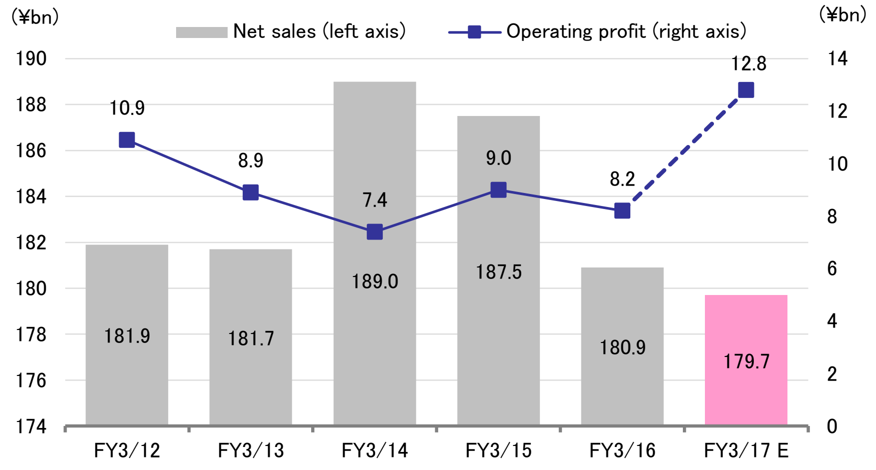
TOKAI Holdings
3167 Tokyo Stock Exchange First Section

17-Jan.-17

Business Performance Trends



Results Trends

Achieved record high profits in 1H FY3/17, exceeding the initial targets for the plan's interim period

(1) Review of 1H FY3/17 results

In the 1H FY3/17 consolidated results announced on October 31, net sales declined 3.0% YoY to ¥82,201mn, operating profit increased 137.4% to ¥4,406mn, recurring profit rose 148.9% to ¥4,428mn, and net profit attributable to owners of the parent climbed 760.2% to ¥2,384mn, and on profit basis, the Company achieved record highs exceeding the initial forecasts for the plan's interim period.

The decline in net sales was due to the approximately ¥4,800mn decline from the impact of the reduction in the sales price implemented in the previous fiscal period. Conversely, the major increase in operating profit was from the effects of keeping down customer-acquisition costs in the Hikari Collaboration and Aqua businesses, also from the higher profits from the CATV business following a rise in customer numbers. Operating profit exceeded the initial target by around ¥1,000mn, and on breaking this down, we see that it was from a decrease in customer-acquisition costs of ¥400mn because the net increase in the number of Hikari Collaboration customers was 53,000, which was about 30% below target; an increase of ¥300mn from CATV customer numbers growing more than anticipated; and an increase of ¥200mn from the reduction in the price of LP gas raw materials.

In addition, the number of customers in the entire Group at the end of September 2016 had decreased 4,000 YoY to 2,554,000. Looking at the numbers of contracts by main services, we see that they were basically unchanged in the gas business and increased in the CATV and Aqua businesses, but fell by 17,000 in the information and communications services business. This was because although transfers of existing customers and acquisitions of new customers for Hikari Collaboration proceeded smoothly, this increase was exceeded by the number of cancelled contracts, including for the previous ISP services. Also, member numbers for the TLC Membership Service, which was introduced in December 2012 with the aim of capturing customers and improving the percentage of customers who use more than one of the services provided by the Group, had increased 44,000 YoY to 535,000 members by the end of September.

1H FY3/17 results (consolidated)

(Unit: ¥mn)

	1H FY3/16		1H FY3/17				
	Results	Ratio to sales	Company target	Results	Ratio to sales	YoY change	vs. target
Net sales	84,773	-	85,300	82,201	-	-3.0%	-3.6%
Cost of sales	52,565	62.0%	-	48,577	59.1%	-7.6%	-
SG&A expenses	30,351	35.8%	-	29,218	35.5%	-3.7%	-
Operating profit	1,856	2.2%	3,380	4,406	5.4%	137.4%	30.4%
Recurring profit	1,779	2.1%	3,270	4,428	5.4%	148.9%	35.4%
Extraordinary profit and loss	-692	-	-	-208	-	-69.9%	-
Net profit attributable to owners of the parent	277	0.3%	1,120	2,384	2.9%	760.2%	112.9%

Number of customers for the main services

(Unit: 1,000)

	End of 1H FY3/15	End of FY3/15	End of 1H FY3/16	End of FY3/16	End of 1H FY3/17	vs. end of FY3/16
Gas (LP gas, city gas)	626	626	627	634	634	-0
LP gas	573	572	573	580	580	-0
City gas	53	53	53	54	54	+0
Information and communications services	1,093	1,097	1,093	1,088	1,071	-17
Previous ISP, etc.	861	858	742	633	565	-68
Hikari Collaboration	-	4	117	219	272	+53
Mobile	231	235	234	236	234	-2
CATV	690	690	698	710	722	+12
Aqua	132	130	132	133	135	+2
Security	18	18	18	18	17	-0
Total Group customer numbers	2,535	2,537	2,543	2,558	2,554	-4
(Number of TLC members)	356	396	439	491	535	+44

Note: Total customer numbers excludes the overlap in ISP and CATV communication customers

Sales are being driven by the information and communications services business, while the gas and petroleum business is contributing to profits

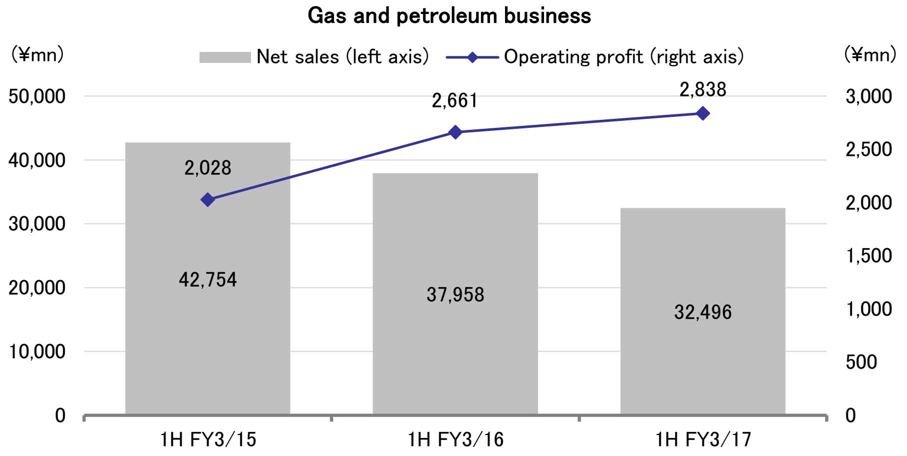
(2) Results by business segment

a) Gas and petroleum business

In this business, net sales decreased 14.4% YoY to ¥32,496mn, but operating profit increased 6.7% to ¥2,838mn, for lower sales but higher profits. Sales declined due to the effects of the reduction in the sales price following the lowering of purchase prices in the previous fiscal year (down ¥2,300mn in LP gas and ¥2,500mn in city gas), but profits rose from the reduction in purchase prices.

In the mainstay LP gas business, customer numbers at the end of September had risen by 7,000 YoY to 580,000. This was from the steady acquisition of 5,000 customers in the South Tohoku area and one part of Aichi Prefecture (Toyokawa City) that the Company newly entered in the previous fiscal year, and also from customer acquisition in existing areas. The level was basically the same as at the end of the previous fiscal year, but this was due to the impact of the temporary increase in cancelled contracts resulting from the intensification of competition with an industry peer in Shizuoka Prefecture in the June to August period. However, the Company implemented countermeasures and the cancellation trend has subsided and is expected to return to an increasing trend in the future. Also, in terms of sales volume, consumption volume per customer declined as temperatures trended higher than in a typical year, including a hot summer, and as a whole it was about level YoY, but net sales declined due to the effects of the sales price reduction.

On the other hand, in the city gas business, customer numbers increased 1,000 YoY to 54,000 (basically unchanged from the end of previous fiscal year), but net sales decreased due to the impact of the reductions in sales prices.



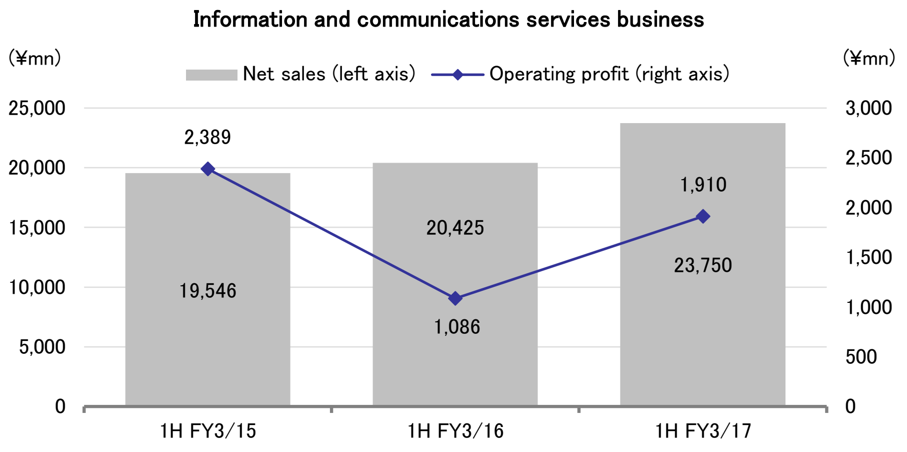
Note: Operating profit is prior to allocating indirect costs and other expenses
Source: Prepared by FISCO based on the Company's financial results briefing materials

b) Information and communications services business

In this business, net sales increased 16.3% YoY to ¥23,750mn and operating profit rose 75.9% to ¥1,910mn. In the broadband business, the Company focused on actively transferring existing ISP customers to Hikari Collaboration and also acquiring new customers, and as a result, the number of Hikari Collaboration customer increased 155,000 YoY to 272,000 (up 53,000 from the end of previous fiscal year). Conversely, the number of customers for the previous ISP services declined 177,000 to 565,000 (down 68,000 from the end of previous fiscal year), meaning the decrease in customers exceeded the increase for Hikari Collaboration, and consequently total customer numbers in the broadband business were down 21,000 YoY and down 15,000 from the end of previous fiscal year. It seems that the majority of the customers in this decrease transferred to other major mobile carriers.

However, alongside the increase in the number of Hikari Collaboration customers, monthly income per contract in the broadband business rose 32% YoY to ¥3,000, with the majority of this being accounted for by the increase in the information and communications services business. For operating profit also, Hikari Collaboration customer-acquisition costs fell from ¥1,700mn in the same period in the previous fiscal year to ¥1,200mn, and in addition, the gross profit per contract rose due to the increase in monthly income. In these ways, Hikari Collaboration-related operations accounted for most of the increase in operating profit in this business.

Conversely, in corporate data communication services and system development, both net sales and operating profit increased slightly YoY.



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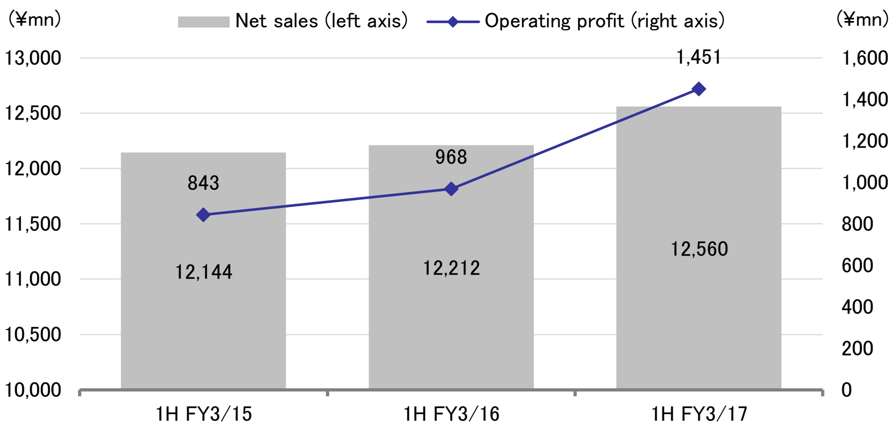
TOKAI Holdings
3167 Tokyo Stock Exchange
First Section

17-Jan.-17

c) CATV business

In this business, net sales increased 2.9% YoY to ¥12,560mn, and operating profit rose 49.8% to ¥1,451mn. The number of contracts rose steadily in both broadcasting service and telecommunication service, up 9,000 to 503,000 YoY (up 4,000 from the end of previous fiscal year) and up 15,000 to 218,000 (up 7,000), respectively. Continuing on from the previous fiscal year, the Company increased new customers by focusing on bulk sales to multiple-household dwellings, and also by continuing bundling discount measures for broadcasting and telecommunication services, and bundling discount with smartphones through collaborations with major mobile phone carriers. It also worked to prevent contract cancellations through strengthening customer support, which contributed to the increase in the number of contracts.

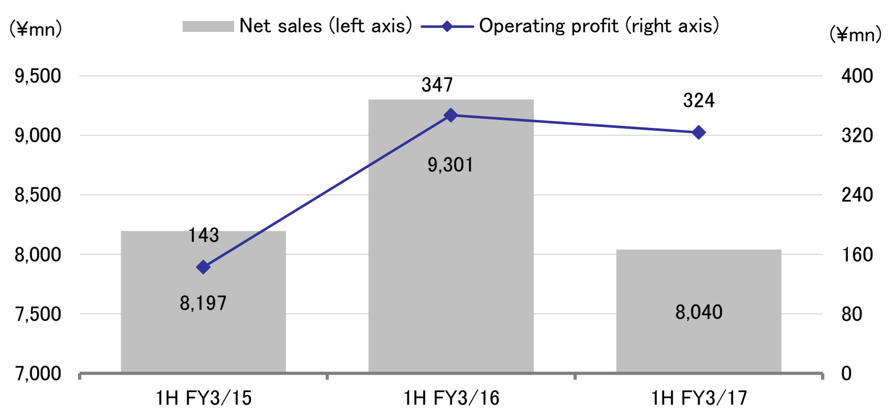
In addition to the growth in the number of contracts, operating profit rose due to factors including increases in contracts for telecommunications, telephones, and other value-added services, and reductions in costs and the amortization of goodwill.



Note: Operating profit is prior to allocating indirect costs and other expenses
Source: Prepared by FISCO based on the Company's financial results briefing materials

d) Building and real estate business

In this business, net sales decreased 13.6% YoY to ¥8,040mn, while operating profit fell 6.8% ¥324mn. Although orders trended favorably, sales were down because there were no condominium sales or new construction projects, such as stores. Furthermore, sales of photovoltaic power generation equipment in the renovation business declined. In the reception desk business (building management support), the number of buildings managed increased steadily, up 7% to 650,000. Alongside the fall in net sales, operating profit also declined.



Note: Operating profit is prior to allocating indirect costs and other expenses
Source: Prepared by FISCO based on the Company's financial

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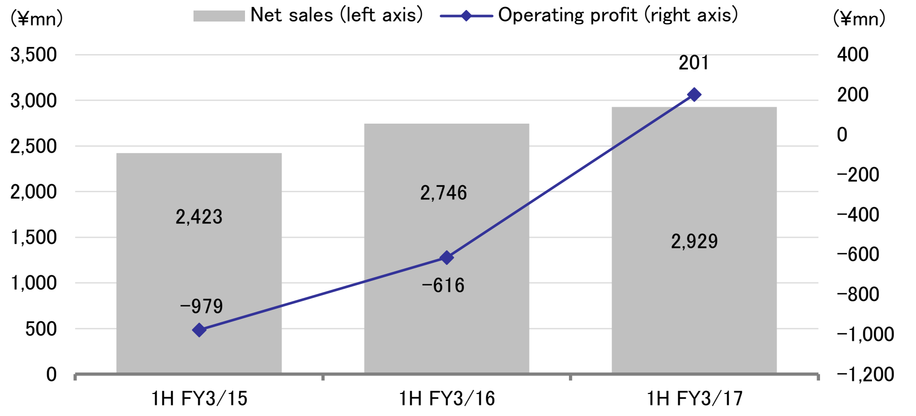
TOKAI Holdings
3167 Tokyo Stock Exchange
First Section

17-Jan.-17

e) Aqua business
In this business, net sales increased 6.7% YoY to ¥2,929mn and the operating profit was ¥201mn (compared to a loss of ¥616mn in the same period in the previous fiscal year) and for the first time it was profitable on a fiscal half-year basis. At the end of September, customer numbers had risen steadily, by 3,000 YoY, to 135,000 (up 2,000 from the end of previous fiscal year), resulting in the higher sales and profits. As the Company recognizes that the bottled water delivery market has entered its mature period, from this period onward it has switched to a more efficient marketing strategy (prioritizing cost efficiency), and it reduced customer acquisition costs from ¥660mn in the same period in the previous fiscal year to ¥480mn, and additionally reduced advertising costs, including for TV commercials, from ¥200mn to ¥40mn. As a result, profits also increased.

Aqua business

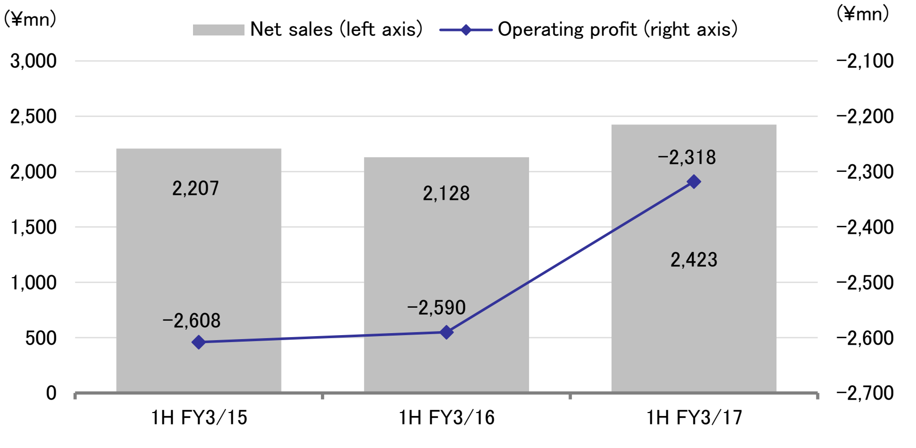


Note: Operating profit is prior to allocating indirect costs and other expenses
Source: Prepared by FISCO based on the Company's financial results briefing materials

f) Other businesses and adjustments
In other businesses and adjustments, net sales increased 13.8% YoY to ¥2,423mn and the operating loss was ¥2,318mn (compared to a loss of ¥2,590mn in the same period in the previous fiscal year).

The nursing care business posted higher sales and a smaller operating loss owing to increases in usage numbers for day care facilities and paid-for nursing homes with care services (TOKAI operates seven sites in Shizuoka Prefecture). Sales improved in both wedding ceremony services, because of the increase in the number of weddings, and in the shipbuilding business, from the rise in the ship-repair project volume.

Other businesses and adjustments



Note: Operating profit is prior to allocating indirect costs and other expenses
Source: Prepared by FISCO based on the Company's financial results briefing materials

Significant decrease in interest-bearing debt and further improvement to financial soundness

(3) Financial position

At the end of September 2016, total assets were down ¥6,853mn from the end of the previous fiscal year to ¥153,384mn. Looking at the main change factors, in current assets, cash and deposits increased ¥499mn, but inventory and other current assets decreased ¥723mn and ¥1,244mn, respectively. In non-current assets, tangible non-current assets fell ¥3,585mn due to the progress of depreciation, while goodwill and investments and other assets were down ¥1,041mn and ¥1,967mn, respectively.

Total liabilities were down ¥8,342mn from the end of the previous fiscal year to ¥109,380mn, mainly because interest-bearing debt was reduced ¥10,492mn. Net assets were up ¥1,490mn to ¥44,004mn, with the main factors being an increase in shareholders' equity of ¥2,606mn due to the rise in retained earnings, and a decrease of ¥928mn in other cumulative comprehensive income (securities valuation difference, remeasurement of defined retirement benefit plans, and other items).

In our review of TOKAI's business indicators, we think its financial structure is steadily improving due to measures implemented in the past few years with the 2.3 ppt YoY rise in the equity ratio to 28.2% and a 4.7 ppt decline in reliance on interest-bearing debt to 42.9%. Furthermore, ¥10,00mn of the interest-bearing debt comes from a zero-coupon convertible bond issued in June 2015, and the Company has lowered its interest-bearing debt on a real basis to just over ¥34,000mn. The conversion price to equity is ¥585, and the bond has a dilutive share volume that equates to about 11% of outstanding shares. We expect a further increase in the equity ratio if the share price rises and convertible bondholders convert their bonds to shares.

Consolidated Balance Sheet

(Unit: ¥mn)

	1H FY3/14	1H FY3/15	1H FY3/16	1H FY3/17	Change
Assets total	168,296	164,477	160,237	153,384	-6,853
Liabilities total	134,983	125,521	117,722	109,380	-8,342
Net assets total	33,313	38,956	42,514	44,004	1,490
Balance of interest-bearing debt	90,487	80,930	76,253	65,761	-10,492
Equity ratio	19.3%	23.1%	25.9%	28.2%	+2.3pt
Reliance on interest-bearing debt	53.8%	49.2%	47.6%	42.9%	-4.7pt

Source: From the Company's financial results briefing materials

Results Outlook

Outlook for the FY3/17 full year is sales basically unchanged YoY, but a major increase in profits

(1) Results Outlook for FY3/17

The outlook for the FY3/17 consolidated results are for net sales to decrease 0.7% YoY to ¥179,700mn, operating profit to increase 54.6% to ¥12,750mn, recurring profit to rise 51.7% to ¥12,360mn, and net profit attributable to owners of the parent to climb 88.0% to ¥6,500mn. Based on the rate of progress up to 1H, the Company downwardly revised the net sales forecast by ¥7,400mn, but upwardly revised each of its profit forecasts and expects to achieve record profits.

Operating profit in 1H was ¥1,026mn above the initial forecast, although the full fiscal year forecast has only been upwardly revised ¥190mn because profits are expected to decline by ¥800mn in 1H, including due to additional costs. Specifically, in the LP gas business, it plans to spend ¥200mn on customer acquisition costs in order to recover the number of customers it lost in 1H due to competition with some industry peers; in the CATV business, it will spend ¥200mn on upfront costs to expand the customer base toward growth from the next fiscal year onwards; and in Hikari Collaboration, profits are expected to decrease ¥400mn from a fall in sales following a review of customer numbers.

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TOKAI Holdings
3167 Tokyo Stock Exchange First Section

17-Jan.-17

FY3/17 Consolidated Results Outlook

(Unit: ¥mn)

	FY3/16		FY3/17				
	Results	Ratio to sales	Initial forecast	Revised forecast	Ratio to sales	YoY change	Adjusted amount
Net sales	180,940	-	187,100	179,700	-	-0.7%	-7,400
Operating profit	8,245	4.6%	12,560	12,750	7.1%	54.6%	+190
Recurring profit	8,150	4.5%	11,830	12,360	6.9%	51.7%	+530
Net profit attributable to owners of the parent	3,458	1.9%	6,240	6,500	3.6%	88.0%	+260

The number of customers in the Group as a whole is expected to rise by 17,000 from the end of previous fiscal year to 2,575,000. In the gas business, they are forecast to increase by 13,000 to 646,000 due to the expansion of the LP gas sales area and higher shares within existing areas. The Company launched sales activities in Gifu Prefecture in October 2016 and will launch in Aichi Prefecture in January 2017, and in such ways it is working to acquire new customers. In the areas the Company newly entered in the previous fiscal year, there are many medium- and small-scale operators and the LP gas price is also higher than the national average, so there can be said to be plenty of room in these areas for the Company, as it possesses price competitiveness.

In the Hikari Collaboration business, progress is being made in transferring customers from the previous ISP services and acquiring new customers, and customer numbers are forecast to increase 100,000 from the end of previous fiscal year to 319,000, although this will be below the initial target (of 357,000) due to the intensification of competition and other factors. Customer numbers are also expected to rise steadily in the CATV business, up 24,000 from the end of previous fiscal year to 734,000, and in the Aqua business, up 4,000 to 137,000.

Customer numbers by service

(Unit: 1,000)

	FY3/14	FY3/15	FY3/16	FY3/17	
	Results	Results	Results	Forecast	vs. end of FY3/17
Gas (LP gas, city gas)	628	626	634	646	+12
Information and communications (fixed and wireless)	854	864	852	826	-26
(of which, Hikari Collaboration)	-	4	219	319	+100
Information and communications (mobile)	227	235	236	237	+1
CATV	693	690	710	734	+24
Aqua	122	130	133	137	+4
Security	19	18	18	17	-0
Total	2,519	2,537	2,558	2,575	+17

Note: The forecasts are FISCO's forecasts
Source: From the Company's financial results briefing materials

Net sales by segment

(Unit: ¥bn)

	FY3/14	FY3/15	FY3/16	FY3/17	
	Results	Results	Results	Forecast	YoY change
Gas and petroleum	97.2	93.1	80.7	72.1	-10.7%
Information and communication services	38.8	40.1	44.2	49.9	12.9%
CATV	24.2	24.4	24.6	25.3	2.9%
Building and real estate	19.2	20.0	21.0	21.1	0.7%
Aqua	4.4	5.0	5.5	5.8	7.2%
Other businesses and adjustments	5.1	5.0	4.9	5.3	9.1%
Total	189.0	187.5	180.9	179.7	-0.7%

Note: The forecasts are FISCO's forecasts
Source: From the Company's financial results briefing materials

Operating profit by segment

(Unit: ¥bn)

	FY3/14	FY3/15	FY3/16	FY3/17	
	Results	Results	Results	Forecast	YoY change
Gas and petroleum	6.5	7.7	9.0	8.9	-0
Information and communication services	4.4	5.0	2.3	4.2	+1.9
CATV	1.8	1.7	2.0	2.7	+0.7
Building and real estate	1.4	1.0	1.3	1.3	+0
Aqua	-2.0	-1.3	-1.1	0.3	+1.4
Other businesses and adjustments	-4.7	-5.0	-5.2	-4.8	+0.4
Total	7.4	9.0	8.2	12.7	+4.5

Notes: Values are prior to allocating indirect costs and other expenses
Forecasts are FISCO's forecasts
Source: From the Company's financial results briefing materials

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TOKAI Holdings
3167 Tokyo Stock Exchange First Section

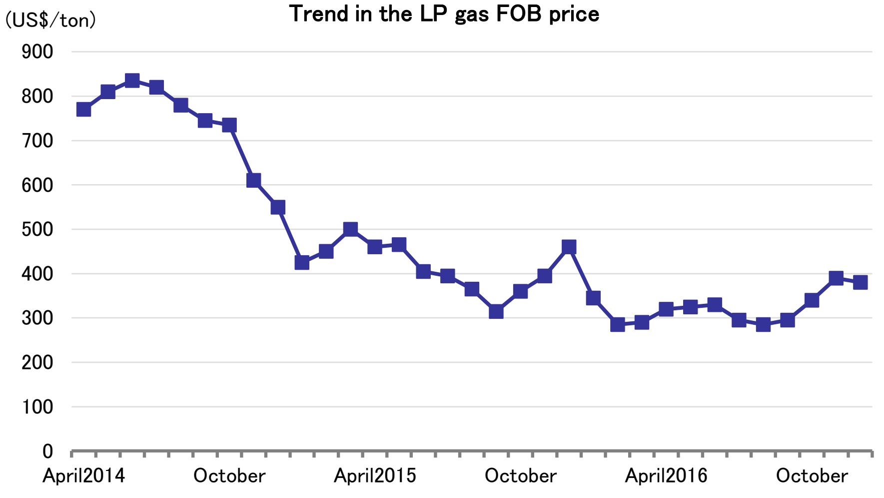
17-Jan.-17

Aiming for higher profits in all businesses for the full fiscal year

(2) Outlook by business segment

a) Gas and petroleum business
In this business, net sales are forecast to decrease 10.7% YoY to ¥72,100mn, while operating profit is expected to remain at basically the same level. Despite the fact that LP gas customer numbers will increase, net sales are set to decline due to the impact of the price reduction. On the other hand, operating profit is expected to remain basically unchanged YoY from the effects of the reduction in purchasing costs. Recently, the CP price has risen to nearly US$400 / ton due to the higher price of crude oil, but the Company already has in place the contract reservations for the required amount, so this will have no effects on FY3/17 results.

Trend in the LP gas FOB price



Source: Japan LP Gas Association's FOB Price (contract price from Saudi Arabia to importers)

b) Information and communication services business
In this business, net sales are forecast to increase 12.9% YoY to ¥50,000mn and operating profit to rise ¥1,900mn to ¥4,200mn. The majority of the higher sales will be from increases in contract numbers for Hikari Collaboration, while for operating profit also, Hikari Collaboration will contribute ¥2,900mn of the increase. Breaking down the increase in profits from Hikari Collaboration, ¥1,300mn will be from the reduction in customer-acquisition costs, and the remainder will be from the effects of higher sales from the increase in the number of contracts. Hikari Collaboration is expected to become profitable from FY3/18. Conversely, the operating profit from previous ISP services will decline due to the fall in the number of customers. Corporate information and communications services are also expected to achieve single-digit increases in sales and profits for the full-fiscal year.

The Company is aiming to raise the Hikari Collaboration rate*, which was 49% at the end of September 2016, to 90% by the end of FY3/21. Hikari Collaboration's gross profit is 1.5 times that of the previous services, so going forward, if steady progress is made in transferring customers to Hikari Collaboration, it will result in higher sales and profits. However, as competition to acquire customers is also intensifying, the key will be the extent to which the Company can transfer existing customers and acquire new customers without incurring costs.

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

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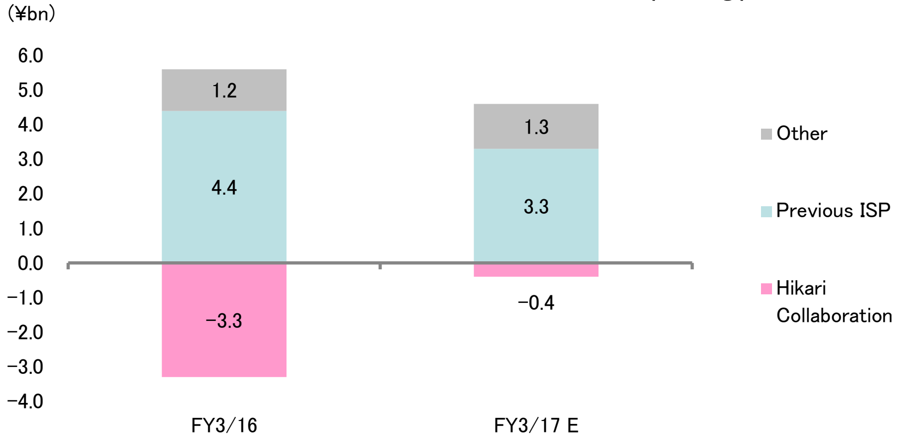
TOKAI Holdings
3167 Tokyo Stock Exchange First Section

17-Jan.-17

Information and communications services business operating profit



Note: Others are information and communications (mobile) and corporate information and communication services

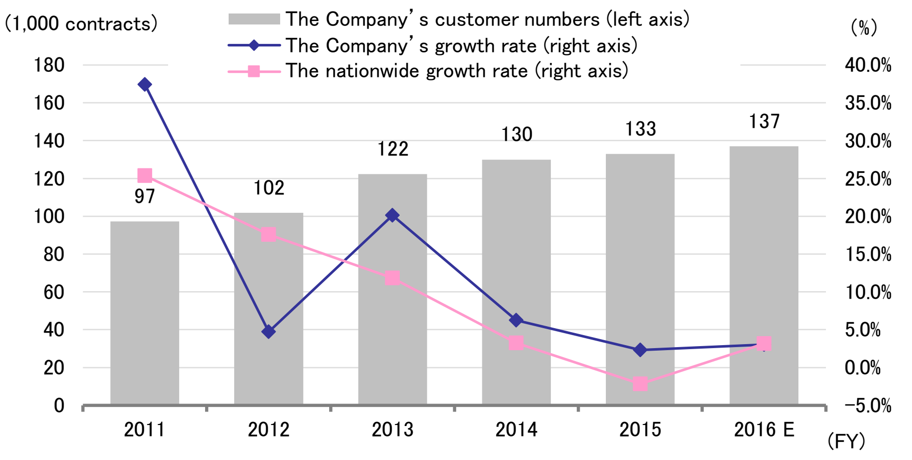
c) CATV business

In this business, the increases in both sales and profits are expected to continue, with net sales set to rise 2.9% YoY to ¥25,300mn and operating profit to climb ¥800mn to ¥2,700mn. Customer numbers are forecast to increase by 24,000 from the end of previous fiscal year (broadcasting + 8,000, telecommunications, + 16,000) to 734,000. The Company has been implementing its customer acquisition measures, including for sale promotions like bundling discount and bulk sales to multi-housing dwellings, and the effects of these measures are appearing. However, in the current 1H it is aiming to further increase customer numbers by developing new acquisition channels for recently built detached housing (developing home-builder and construction-company routes), and also launching the new "Hikari TV Plus" service for existing antenna-viewer householders. On a fiscal half-year basis, operating profit is forecast to decrease from ¥1,450mn in the current 1H to ¥1,250mn in the current 1H, but of this decrease, ¥200mn will be for upfront costs for these customer-acquisition measures.

d) Aqua business

In this business, net sales are expected to increase 7.2% YoY to ¥5,900mn and operating profit to be ¥300mn (compared to a loss of ¥1,100mn in the previous fiscal year), meaning it will achieve profitability for the first time for a full fiscal year. Customer numbers are forecast to increase by 4,000 from the end of previous fiscal year to 137,000. As the growth in the bottled water home delivery market is slowing, from the current fiscal year the Company has switched to a strategy of acquiring customers by focusing on areas with high sales efficiency and going forward, profits are expected to continue to increase, although growth will be moderate. Customer-acquisition costs in the next fiscal year are forecast to be around the same as in the current fiscal year.

Number of customers in the Aqua business and the industry growth rate



Note: The nationwide growth rate is from a survey by the Japan Delivery Water & Server Association

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e) Building and real estate business

In this business, net sales are forecast to rise 0.7% YoY to ¥21,100mn and operating profit to be basically unchanged at ¥1,300mn. Sales are expected to trend strongly in each of home sales, equipment installation sales, and the renovation business.

f) Other businesses and adjustments

In other businesses and adjustments, net sales are forecast to rise 9.1% YoY to ¥5,300mn and the operating loss to be ¥4,800mn (compared to a loss of ¥5,200mn in the previous fiscal year). Sales are also expected to continue to increase in the current 1H in the nursing care business and the wedding ceremony business.

Is set to achieve practically all of its current medium-term management plan targets

(3) Reflecting on "Innovation Plan 2016 'Growing'"

The current medium-term management plan (three-year plan) "Innovation Plan 2016 'Growing'", which ends in FY3/17, describes the Company's three basic policies–continue to increase sales and improve profitability by acquiring new customers, continue to improve the financial structure and management stability, and provide continuous and stable returns to shareholders–and it has steadily expanded earnings and improved its financial structure under this plan.

The plan's FY3/17 (final-year) targets are to achieve Group customer numbers of 2.73 million, consolidated net sales of ¥209,500mn, operating profit of ¥12,600mn, interest-bearing debt of ¥64,700mn, and an equity ratio of 28.6%. Based on the most recent Company targets, it is slightly below its initial targets for customer numbers and net sales, but this is due to the fact that the market environment has changed significantly compared to when it formulated the medium-term management plan, including a significant reduction in the price of gas raw materials, intensification of competition from the launch of Hikari Collaboration services, and the maturation of the bottled water home delivery market. However, in addition to achieving the profits targets, the improvement to the financial structure has progressed further than anticipated, and the Company can be highly evaluated on the fact that it has basically achieved all its targets in the medium-term management plan.

Medium-Term Management Plan's Targets and Prospects for Attaining Them

	FY3/14 Results	FY3/17 initial target	FY3/17 current target
Number of customers (10,000 contracts)	252	273	257
Net sales (¥bn)	1890	2,095	1,797
Operating profit (¥bn)	74	126	128
Interest-bearing debt (¥bn)	858	647	622
Equity ratio	21.6	28.6%	30.8%

Is currently formulating the next medium-term management plan toward implementing a growth strategy through active investment

(4) Key points for the next medium-term management plan

The next medium-term management plan is expected to be a four-year plan up to FY3/21 and the Company plans to announce the details in May 2017. The key point for the next plan is that, based on the steady progress made in improving the financial structure in the medium-term management plan up to FY3/17, the Company plans to expand earnings by shifting the focus to investment for growth. Previously, it allocated approximately 40% of cash flow from operating activities to capital investment, about 20% was returned to shareholders, and the remaining approximately 40% was used to reduce interest-bearing debt. However, as it has already reduced its interest-bearing debt to an appropriate level, from FY3/18 onwards it plans to allocate this approximately 40% that it previously used for debt repayments to capital investment and other investment, such as for M&A. In the past, its annual investment costs have been on a scale of ¥10,000mn, but it plans to double this to ¥20,000mn and to accelerate earnings growth through actively investing. It has also set “Expanding the core businesses’ customer base and promoting M&A” and “Promoting TLC as our comprehensive strength” as points to focus on in the next medium-term management plan.

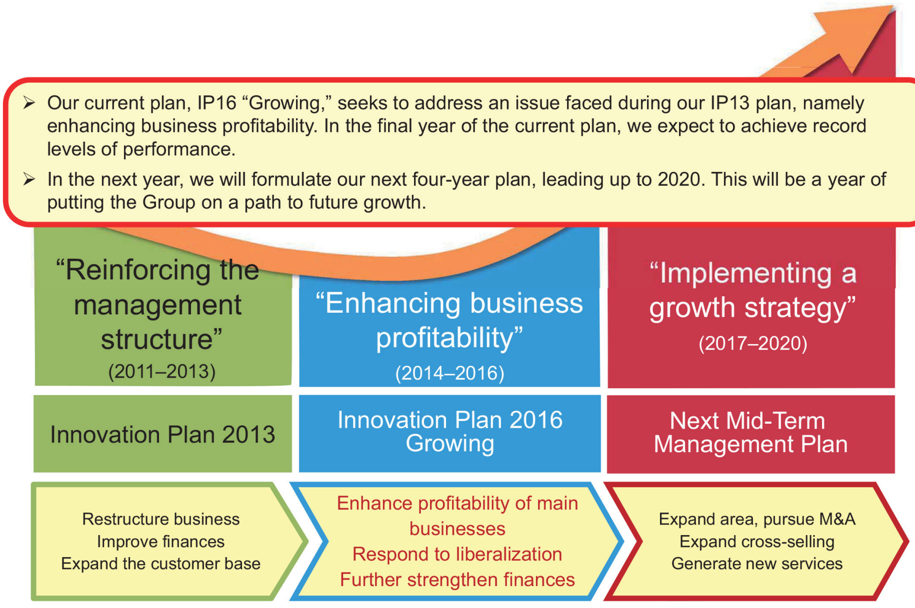
a) Expanding the core businesses’ customer base and promoting M&A
The Company plans to expand its sales areas by utilizing M&A in order to expand the customer bases of its core businesses, which include the gas and petroleum business and the CATV business.

The LP gas industry has many small- and medium-scale operators, but going forward an oligopoly of the major operators is expected to form. This is because it is considered that, in the context of the liberalization of sales of life infrastructure services, such as communications and electric power, and the intensification of competition to acquire customers including from the sales of bundling discount, medium- and small-scale operators that are not price competitive will be weeded-out. Therefore going forward, the Company’s strategy is to expand its sales areas and increase its customer numbers. In addition to newly entering into Mie Prefecture from FY3/18, it is looking to enter Nagano Prefecture and Okayama Prefecture, which are CATV business sales areas. Furthermore, it is expected to select M&A and other such measures to smoothly enter and develop areas.

In the city gas industry, completely liberalized retail sales will begin from April 2017. Currently, there are 203 city gas business operators nationwide (of which, 26 are publically managed operators), but apart from the major gas companies, there are many operators with only small capital strength, and it is possible that an industry restructuring will take place in the future. The Company’s strategy is to expand its customer base by utilizing its strength of being not just a gas operator, but also a provider of many life infrastructure services, such as its information and communications services and CATV services, and bringing in companies with potential of generating synergies into the Group through M&A.

Through this strategy of expanding its sales areas, the Company is aiming to increase customer numbers in its gas business by approximately 1.26 times, from 634 thousand in FY3/16 to 800 thousand in FY3/21.

Moving to the Next Growth Phase



Source: Company briefing materials

In the CATV business also, operators will need to make investment to convert to fiber optics alongside the expected spread of 4K and 8K UHD broadcasting, so medium- and small-scale operators without the financial resources for this investment are expected to be absorbed into the larger operators. In the CATV industry, Jupiter Telecommunications Co, Ltd, (brand name, J:COM) possesses an overwhelmingly strong position, having a 47% share of households able to watch pay-per-view broadcasting (as of December 2015), 5.24 million subscribers to its services, and 28 CATV companies and 75 stations within its group. The Company's Group ranked sixth in the industry for customer numbers, and it is operating six stations in five sales areas, of Shizuoka Prefecture, Kanagawa Prefecture, Chiba Prefecture, Nagano Prefecture, and Okayama Prefecture. Group Company LCV Corporation's station in Nagano is currently the only one that has not started the conversion to fiber optics, while the other stations have completed 50% to 100% of the conversion, and the Company plans to have 100% conversion at all stations in around the next 10 years. Going forward, in addition to investment to convert existing stations to fiber optics, it intends to expand its customer base by using M&A to newly bring in CATV operators in the group.

In addition to for its core businesses, the Company intends to proactively conduct M&A if there are candidates that can be expected to generate synergies in all directions within the Group. As a comprehensive provider of life services, the Company is looking into launching new businesses relating to life events and if necessary, it will consider conducting M&A and other such measures for this.

b) Further promoting TLC as a comprehensive strength

An issue that the Company intends to focus on in the next medium-term management plan is improving the rate of contracts for multiple services per customer. Currently, only around 7% of its customers are contracted to more than one of the various services provided by the Company's Group (the cross-selling rate), so for the Company that is advocating its Total Life Concierge concept*, the current situation is that it is not fully utilizing its strengths. However, the cross-selling rate in Shizuoka Prefecture, the location of its head office, is 15.9%, which is high compared to in the other areas. Looking at the breakdown by service, the cross-selling rate among city gas users is the highest at 36.7%, followed by CATV at 32.7% and then LP gas at 23.1%. Therefore, it is thought that developing the sales areas of these services outside of Shizuoka Prefecture will also be effective in improving the cross-selling rate.

In addition, up until now sales activities for cross selling have been carried out using a passive approach, limited to sharing customer information between Group companies. But the Company is now considering measures for a more active approach within the Group from April 2017. Through these measures, it intends to raise the cross-selling rate to as high as 30% to 40% in the future and is aiming to further grow earnings by promoting its TLC concept.

* The Total Life Concierge concept: it indicates the Company's aim to provide every type of lifestyle support service under a one contract, one stop, and one call center model, and while deepening its connection with customers, their local communities, society, and the global environment, to be a company that enriches people's lives, assists in the development of local communities, and contributes to protecting the global environment.

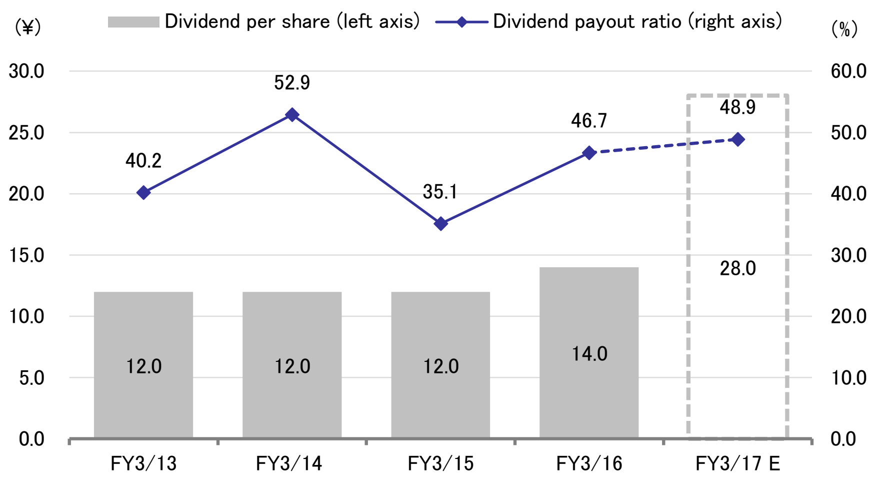
Shareholder Returns

Plans to increase the dividend by an additional ¥6 to commemorate achieving its medium-term management plan targets

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 FY3/17, it initially planned to increase the dividend by ¥8.0 YoY to ¥22.0, but as it gained clear idea in achieving the targets set in the medium-term management plan, it announced that it will add ¥6.0 to the dividend to commemorate this achievement, for a total dividend of ¥28.0 (dividend payout ratio, 48.9%). From FY3/18 onwards also, based on its policy of stably paying dividends, it can be expected to maintain dividends at least at this level of ¥28.0.

The Company presents gifts to shareholders at the end of September and March depending on the number of shares held. For each unit of shares (100 shares) held, shareholders can receive one of the following gifts: an Aqua product worth ¥1,900 (such as the Ulunom) “Fuji-no-Tennensui Sarari” (Mt. Fuji natural water), a QUO card worth ¥500, food coupons worth ¥1,000, or ¥1,000 worth of TLC Membership Service points. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (¥773 on December 13), it is in the range of 5% to 9% (depending on selection of a QUO card or an Aqua product is selected as the gift).

Dividend per share and dividend payout ratio



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