COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Holdings Corporation

3167

Tokyo Stock Exchange First Section

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FISCO Ltd. Analyst

Yuzuru Sato

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

The outlook for FY3/19 is for record high profits for the first time in two fiscal years from the effects of the active investment conducted in the previous fiscal year

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 communication 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, the Company intends to actively invest in M&A and alliances to realize high growth.

* 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. FY3/18 results

In the FY3/18 consolidated results, net sales increased 4.2% year-on-year (YoY) to ¥186,069mn and operating profit decreased 14.0% to ¥10,971mn, which were results basically in line with the Company forecasts. Operating profit declined in FY3/18, but this was because the Company actively conducted upfront investment, including for area expansion and the launch of new communication services, toward realizing high growth from FY3/19 onwards. Conversely, the number of customers, which serve as the Group’s earnings base, steadily increased by 312,000 on the end of the previous fiscal year to 2,876,000 customers. In the CATV business, the Company conducted two M&As, but even after excluding the M&A, the net increase in customers in the existing business was 39,000 customers, which is a rise of around 6 times YoY. By business, the number of customers for information and communication services continued to trend downward due to the intensification of competition, but in the LP gas and the CATV businesses, they steadily increased from the expansion of sales areas and the effects of the M&A. The customer cross-selling rate (the rate of multiple service contracts), which is an indicator that the Company prioritizes, is also steadily rising, from 6.9% at the end of the previous fiscal year to 7.6% at the end of the fiscal year under review.

2. FY3/19 earnings outlook

The outlook for the FY3/19 consolidated results is for net sales to increase 5.1% YoY to ¥195,600mn and operating profit to rise 27.2% to ¥13,960mn, for record high profits for the first time in 2 fiscal years. Profits will increase by approximately ¥3bn YoY, and breaking this down, the increase factors will be ¥2.1bn from the effects of higher sales from the rise in the number of customers and ¥800mn from the reduction in upfront costs that were spent in the previous fiscal year. So the effects of the investment conducted in the previous fiscal year will bear fruit. The outlook is that the number of customers, which serve as the earnings base, will continue to increase, mainly in the LP gas and CATV businesses, rising 65,000 on the end of the previous fiscal year to 2,941,000 customers. By business segment, sales will decrease slightly in consumer information and communication services, in which competition will continue to intensify. But the forecasts are for higher sales and profits in all of the other main businesses.

3. Medium-term management plan (IP20)

While actively utilizing M&A, the Company has set the targets in the medium-term management plan (IP20) for the Plan's final fiscal year of FY3/21 of net sales of ¥339.3bn and operating profit of ¥22.5bn. Its strategy is to increase the number of Group customers to more than 4,320,000 (up 1.7 times on the end of March 2017), to grow the customer cross-selling rate from the current rate of approximately 7% to 20%, and also to expand earnings per customer. In order to achieve its targets, currently the Company is investigating M&A candidates for each business, and it has 26 candidates with a deal amount on the scale of ¥190bn. The candidates include new businesses related to its Total Life Concierge concept, and we shall be paying attention to developments in the future.

4. Shareholder return policy

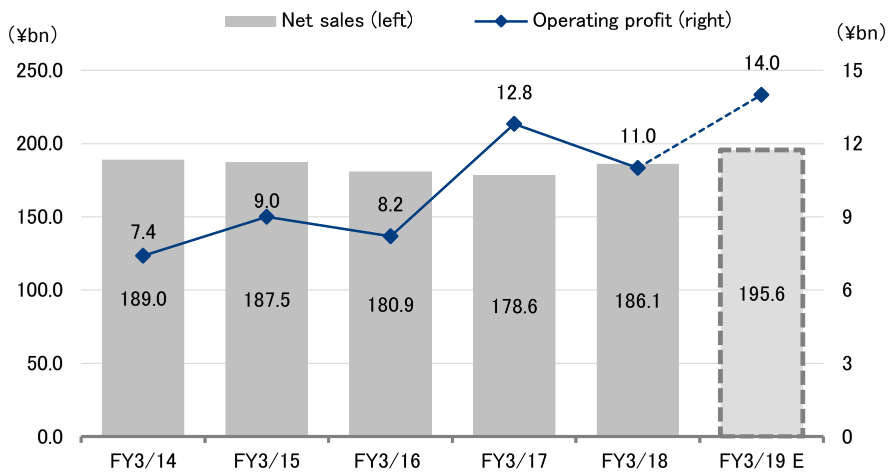
There has been no change to the policy of continuously and stably returning profits to shareholders. The forecast dividend per share for FY3/19 is ¥28.0 (dividend payout ratio, 46.3%), which is unchanged from the previous fiscal year. Going forward, the Company intends to pay dividends while observing profit trends and financing needs, 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 ¥1,190 on May 21, 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).

* Limited to gifts to shareholders at the end of September 2017 and at the end of March 2018

Key Points

- Although profits declined in FY3/18 due to the active investment to expand the customer base, the results were basically in line with the Company forecasts
- The outlook for FY3/19 is for record high profits for the first time in 2 fiscal years from the effects of the higher sales due to the expansion of the customer base and the cost reductions
- Considering 26 M&As to aim for more than 4,320,000 Group customers and consolidated operating profit of ¥22.5bn for FY3/21

Results trends



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

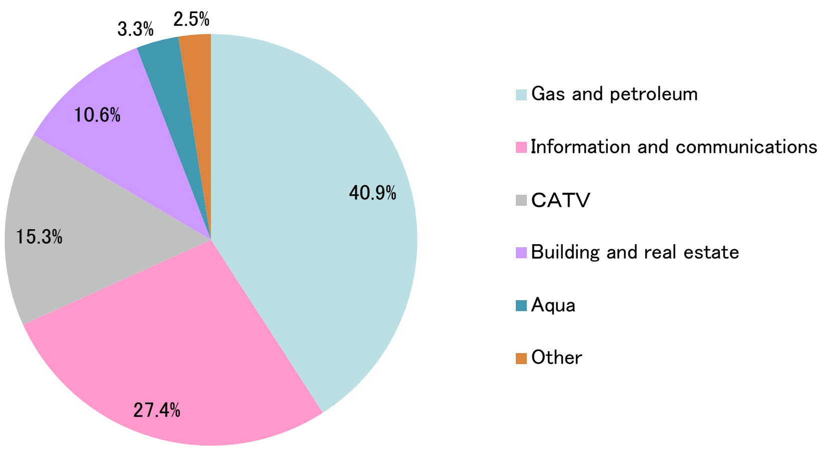
Business overview

Focuses on energy and lifestyle-related services, primarily the provision of LP gas, and information and communication services

Based in Shizuoka Prefecture, Japan, the Company is expanding its two main businesses, "energy and lifestyle-related services," primarily the provision of liquefied petroleum (LP), and "information and communication services," and it is aiming to achieve its management vision of being a "Total Life Concierge" (TLC). It provides a complete range of one-stop services for everyday life and while deepening its connections with its customers, their local communities, society, and the global environment, and it is striving to enrich people's lives and to contribute to the development of local communities and to the conservation of the global environment, and also to a grow as a comprehensive provider of life services that represents Japan.

The Company currently discloses information on six business segments; the gas and petroleum business, the information and communication services business, the CATV business, the building and real estate business, the Aqua business, and other businesses. Looking at the sales structure by segment in FY3/18, the Company's original business, the Gas and Petroleum segment accounted for 40.9% of sales, the Information and Communications for 27.4%, and CATV for 15.3%. These three mainstay businesses accounted for over 80% of sales. The details by business segment are as follows.

Sales structure by segment (FY3/18)



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

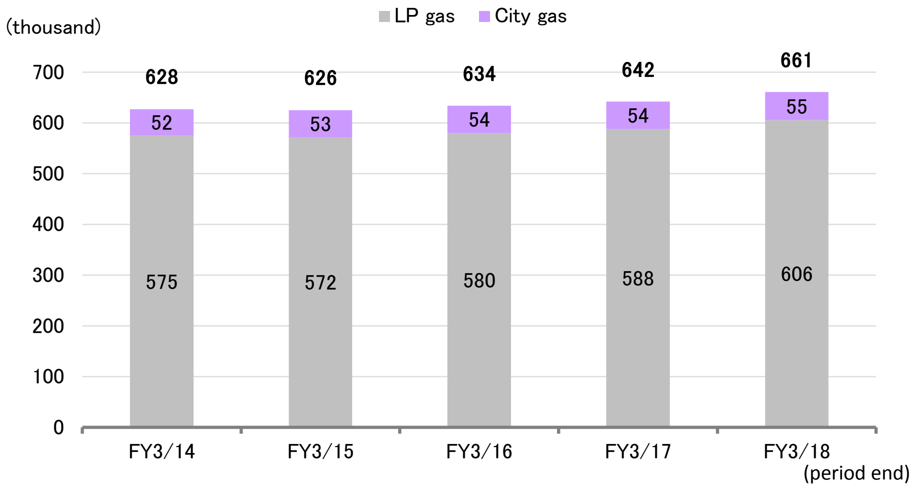
1. Gas and petroleum business

In this business, approximately 85% of net sales are provided by the LP gas business and around 15% by the city gas business. The mainstay LP gas business is developed by TOKAI Corporation, primarily for homes and businesses. The service areas are mainly in the Shizuoka and Kanto regions, but since 2015 it has also sequentially expanded into the south Tohoku, Chubu/Tokai, Chugoku, and Kyushu areas and has been focusing on increasing customer numbers. As of the end of March 2018, it had 606,000 contracts, and in direct sales, it ranked third after Iwatani Corporation <8088> and Nippon Gas <8174>. In terms of market share, it is the leader in Shizuoka, its home territory, with around 20%, while it has a share of just under 10% in the highly competitive Kanto region, putting it in second place. As there are approximately 20 million households nationwide that use LP gas, its nationwide market share is at the level of 3%, and going forward there remains room for it to grow its share, including by expanding sales areas and conducting M&A.

In the city gas business, TOKAI GAS CORPORATION supplies city gas in Yaizu City, Fujieda City, and Shimada City in Shizuoka Prefecture. As the service area is limited, the number of contracts, which was 55,000 at the end of March 2018, remains basically constant. Currently, there are 202 city gas business operators nationwide, but with the exception of the four largest companies, most are small- to medium-sized operators with limited service areas. Following the liberalization of the retail city gas market in April 2017, the Company plans to expand its customer base by aggressively pursuing M&A deals. As the first stage of this, it announced that it will acquire the gas business of Shimonita Town in Gunma Prefecture* in April 2019.

* 1,336 customers and annual net sales of ¥143mn in FY16

Trends in customer numbers in the gas business



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

2. Information and communication services business

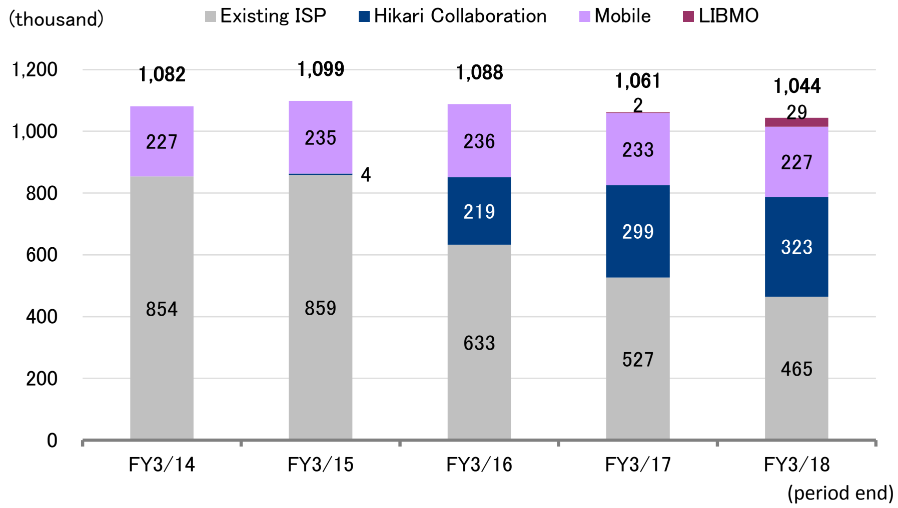
The information and communication services business, which is conducted by TOKAI Communications Corporation, is comprised of the consumer ISP (Internet service provider) business and mobile business (sales of mobile phones), and a business to provide communication lines and systems development for corporations. Looking at the percentages of total net sales in FY3/18, the consumer business contributed 62% and the corporate business 38%.

The ISP business provides the “@ T COM” service for the nationwide area and the TOKAI Network Club (TNC) service for the Shizuoka Prefecture area, and it has the leading share within Shizuoka Prefecture of approximately 23%. In addition, from February 2015 it launched the @TCOM Hikari and TNC Hikari services, in which it is receive wholesale provision of optical lines from NTT <9432> and provides its own optical (hikari) Internet connection service. As of the end of FY3/18, the Company had 465,000 customers using its existing ISP service and 323,000 customers using its Hikari Collaboration service and customers are shifting toward Hikari Collaboration. The two services have a total of 788,000 customers. This number has declined for three consecutive fiscal years because the Hikari Collaboration service is facing more competition as mobile phone carriers have entered the market, making use of NTT’s wholesale optical line business.

The mobile business operates mobile phone stores, mainly within Shizuoka Prefecture, as a sales agency of SoftBank Mobile, and as of the end of March 2018, it had 227,000 customers. Also, in February 2017 the Company began sales of LIBMO, which is an inexpensive smartphone service, as an MVNO business*. At the end of March 2018, it had 29,000 customers.

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

Information and communication services business customer numbers

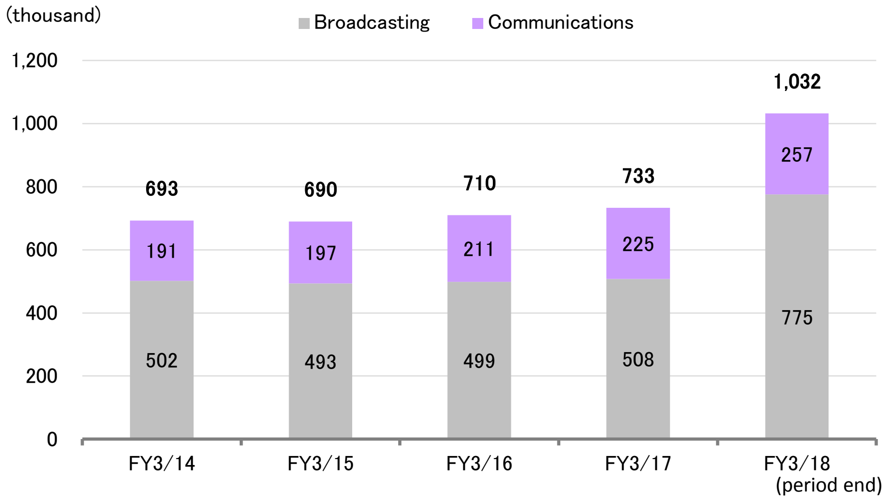


Source: Prepared by FISCO from the Company’s press releases

3. CATV business

In addition to the five prefectures of Shizuoka Prefecture, Kanagawa Prefecture, Chiba Prefecture, Nagano Prefecture, and Okayama Prefecture, in FY3/18 the Company newly expanded its CATV business into Tokyo by M&A, and nine Group companies provide broadcasting and communication services (Internet connection services). At the end of March 2018, the number of customers was increased by 273,000 on Tokyo Bay Network Co., Ltd., and TV Tsuyama Inc., being made subsidiaries, with broadcasting services having 775,000 customers and communication services 257,000 customers, for a total of 1,032,000 customers. This business ranks third in its industry for net sales.

Trends in customer numbers for CATV services



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

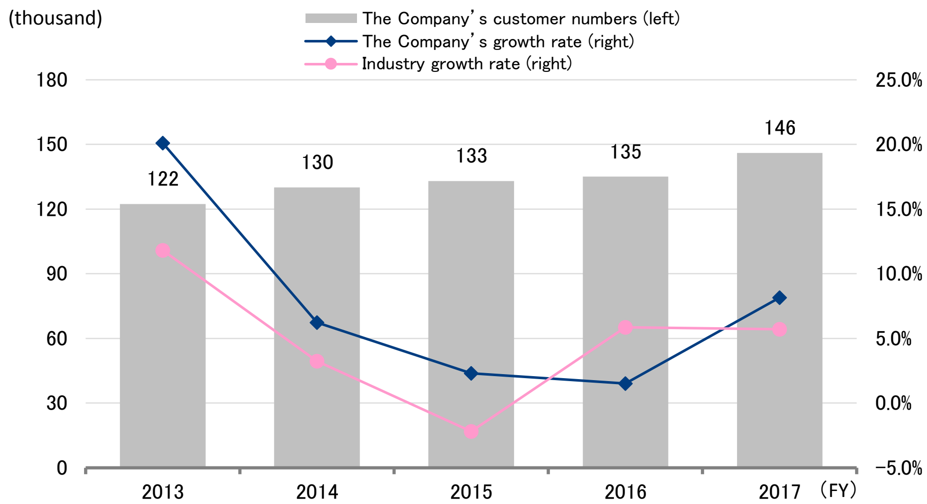
4. Building and real estate business

In this business, TOKAI Corporation engages in the construction and design of detached housing, multi-dwelling housing, stores, and office buildings. It also provides a building management service, sells home facilities and equipment, provides a security service (classified in the gas and petroleum business), operates insurance agencies (classified in other businesses), and develops and trades real estate. In addition, TOKAI Corporation and Tokai Gas Corporation are developing a renovation business.

5. Aqua

This business began in 2007 when the Company launched a bottled water home delivery service in Shizuoka Prefecture. It provides a returnable bottle service in Shizuoka Prefecture, while in 2011 it also launched a one-way (non-returnable, disposable) bottle service in areas other than Shizuoka Prefecture, and customer numbers have increased. It bottles Mt. Fuji natural spring water at two factories in Shizuoka Prefecture that have a total production capacity of approximately 180,000 customers. The Company had 146,000 customers at the end of March 2018. The overall industry had 3,500,000 customers in 2016, giving the Company a share at around 4%.

Trends in customer numbers in the Aqua business and the industry growth rate



Note: The industry growth rate is from a survey by the Japan Delivery Water & Server Association
Source: Prepared by FISCO from the Company's financial results

6. Others

Other businesses include a nursing care business operated by TOKAI LIFE PLUS CORPORATION, a wedding ceremony business by TOKAI City Service Corporation, and a shipbuilding and repairs business by Tokaizosen-unyu Corporation.

The Company launched the nursing care business in 2011, and as of March 2018, it operated five day service facilities, a short stay facility, and a paid-for nursing home in Shizuoka Prefecture. In addition, it has opened one care plan center. For its wedding ceremony business, it operates one facility in Shizuoka Prefecture.

Results trends

Although profits declined in FY3/18 due to the active investment to expand the customer base, the results were basically in line with the Company forecasts

1. Overview of the FY3/18 results

In the FY3/18 consolidated results, net sales increased 4.2% YoY to ¥186,069mn, operating profit decreased 14.0% to ¥10,971mn, recurring profit fell 12.4% to ¥11,191mn, and net income attributable to the owners of the parent declined 9.8% to ¥6,620mn. Toward achieving the targets in the medium-term management plan (IP20), the Company is aiming to increase the number of customers, which serve as the earnings base. Therefore for this fiscal period, which it positioned as a period for upfront investment, it forecast an increase in sales and a decline in profits, so the results were basically in line with these forecasts.

At the end of FY3/18, the number of Group customers had increased by 312,000 on the end of the previous fiscal year to 2,876,000 customers, which was basically as the Company forecast. The result was less than forecast for consumer communication services, which includes Hikari Collaboration, due to the intensification of competition, but this was covered by the increase in the CATV business. In the CATV business, even after excluding the effects of M&A (273,000 customers), the net increase was 39,000 customers. As the net increase in FY3/17 was 6,000 customers, it can be said that the Company is making steady progress in increasing customer numbers in its existing business. The cross-selling rate also rose steadily, from 6.9% to 7.6%. As a rise in the cross-selling rate has the effect of preventing contract cancellations, the Company is working on this is an important measure.

Overall, net sales increased for the main businesses except for consumer communication services. On the other hand, operating profit declined, as although profits increased alongside the growth in sales (+¥1.8bn), upfront costs toward growth in the future, mainly for the LP gas and communication service businesses, increased by approximately ¥3.7bn YoY, which was the main reason for the decline. However, the effects of the growth in profits during the period from the rise in the customer numbers caused profits to increase ¥1.8bn compared to the original assumption of ¥1.1bn. So it can be said that the Company has established an earnings base that will lead to higher profits from FY3/19 onwards.

FY3/18 consolidated results

(¥mn)

	FY3/17		FY3/18				
	Results	% of sales	Forecast	Results	% of sales	YoY change	vs. forecast
Net sales	178,631	-	189,400	186,069	-	4.2%	-1.8%
Cost of sales	105,590	59.1%	-	110,733	59.5%	4.9%	-
SG&A expenses	60,290	33.8%	-	64,365	34.6%	6.8%	-
Operating profit	12,750	7.1%	11,410	10,971	5.9%	-14.0%	-3.8%
Recurring profit	12,775	7.2%	11,360	11,191	6.0%	-12.4%	-1.5%
Net income attributable to owners of the parent	7,337	4.1%	6,450	6,620	3.6%	-9.8%	2.6%

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

Sales and profits increasing greatly in the CATV business, including from the contributions of the M&A

2. Trends by business segment

Net sales and operating profit by segment

Net sales (¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	YoY
Gas and petroleum	93,067	80,745	73,344	76,073	3.7%
Information and communication services	40,118	44,246	49,508	50,894	2.8%
CATV	24,359	24,608	25,396	28,386	11.8%
Building and real estate	20,019	20,975	19,511	19,807	1.5%
Aqua	4,959	5,487	5,762	6,200	7.6%
Other businesses	4,987	4,875	5,108	4,706	-7.9%
Total	187,511	180,940	178,631	186,069	4.2%

Operating profit (¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	YoY
Gas and petroleum	7,679	8,991	9,161	7,364	-19.6%
Information and communication services	4,956	2,308	4,213	3,174	-24.7%
CATV	1,669	1,975	2,752	3,554	29.1%
Building and real estate	1,029	1,266	1,098	1,330	21.1%
Aqua	-1,313	-1,119	298	246	-17.4%
Other businesses	-5,016	-5,175	-4,775	-4,699	-
Total	9,003	8,245	12,750	10,971	-14.0%

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

(1) Gas and petroleum business

In this business, net sales increased 3.7% YoY to ¥76,073mn and operating profit* decreased 19.6% to ¥7,364mn. Within these results, in the mainstay LP gas business, net sales increased 3.3% to ¥64,512mn, and in the city gas business, they rose 6.1% to ¥11,561mn.

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

In the LP gas business, the Company has worked to acquire customers and to prevent contract cancellations in its existing areas (Shizuoka, metropolitan area, and South Tohoku), and it is steadily acquiring customers in the areas it newly entered-into up to FY3/17 (Sendai, Aichi, and Gifu), and in the Okayama and other areas that it entered-into in September 2017. As a result, the number of customers increased by 19,000 on the end of the previous fiscal year to 606,000 customers. The number of newly acquired customers also rose by 6,000 to 47,000 customers, and within this number, they increased by 3,000 in the new areas to 7,000 customers. In the city gas business, the number of customers was basically unchanged YoY, at 55,000 customers.

Looking at the factors causing operating profit to increase and decrease, the decrease factors were costs of ¥200mn on the establishment of new bases in the LP gas business (Okayama Prefecture and Gifu Prefecture), customer acquisition costs (including fee-related measures to acquire new customers) of ¥1.5bn, and costs of ¥500mn to prevent contract suspensions and cancellations. The increase factor was ¥300mn on the rise in the LP gas unit consumption volume. It would seem that the increase in purchasing costs following the rise in the price of crude oil was absorbed by passing it on to sales prices.

(2) Information and communication services business

In this business, net sales increased 2.8% YoY to ¥50,894mn, while operating profit decreased 24.7% to ¥3,174mn. Within these amounts, net sales in the consumer business decreased 0.7% to ¥31,703mn, as although the number of customers for Hikari Collaboration, which has high monthly revenue, increased by 24,000 on the end of the previous fiscal year, customer numbers for the existing ISP service and other services decreased by 62,000 due to the intensification of competition with major mobile carriers. The Company has been competing with the major mobile carriers by creating a sense of low cost through set sales with LIBMO, its inexpensive smartphone, but it has been unable to stop the downward trend. The number of LIBMO customers increased by 27,000 on the end of the previous fiscal year to 29,000.

Profits in the consumer business decreased ¥1.3bn YoY, as despite higher profits from the Hikari Collaboration, costs rose as the Company invested ¥700mn in LIBMO sales promotion costs and added ¥800mn to prevent contract suspensions and cancellations.

On the other hand, in the corporate business, net sales increased 9.2% YoY to ¥19,191mn, and operating profit rose ¥300mn due to the effects of the higher sales. Against the backdrop of the expansion of the Cloud services market, demand for data communication services trended strongly and sales also increased for system outsourcing development.

(3) CATV business

In this business, net sales increased 11.8% YoY to ¥28,386mn and operating profit grew 29.1% to ¥3,554mn, and it was the only one of the 3 main businesses to achieve higher sales and profits. The Company made subsidiaries of Tokyo Bay Network in Q2 and TV Tsuyama in Q4 and as a result, it acquired 273,000 customers (254,000 broadcasting customers and 18,000 communication customers). It also steadily acquired customers in its existing areas, where they increased by 26,000 customers. At the end of the fiscal year, the number of broadcasting service customers had increased by 267,000 on the end of the previous fiscal year to 775,000 customers, and the number of communication service customers had grown by 32,000 to 257,000 customers. Tokyo Bay Network's contribution to sales was around ¥2bn, while it seems its effect on operating profit was negligible.

The operating profit margin rose from 10.8% in the previous fiscal year to 12.5%. The main factors behind this were the rise in the broadcasting and communication set contracts rate in the existing areas*, the increase in earnings per customer, and the decrease in depreciation costs, of slightly less than ¥300mn.

* The set contracts rate (communication contracts ÷ broadcasting contracts) in existing areas increased from 44.3% in FY3/17 to 45.9% in FY3/18.

(4) Building and real estate business

In this business, net sales increased 1.5% YoY to ¥19,807mn and operating profit rose 21.1% to ¥1,330mn. Sales declined from the renovation business and home sales, but this was covered by higher sales of equipment and equipment work, and also in the building management support business.

(5) Aqua business

In this business, net sales increased 7.6% YoY to ¥6,200mn, while operating profit decreased 17.4% to ¥246mn. The Company worked actively to acquire customers, including large-scale commercial facilities, and at the end of the fiscal year customer numbers had increased 11,000 on the end of the previous fiscal year to 146,000 customers, which was the main reason for the higher sales. Conversely, operating profit decreased due to the rise in customer acquisition costs.

(6) Other businesses and adjustments

In the other businesses, net sales decreased 7.9% YoY to ¥4,706mn. Breaking this down, the nursing care business performed strongly, with net sales rising 18.0% to ¥1,036mn following an increase in the number of facility users, and it achieving profitability. In the wedding ceremony business, net sales fell 23.2% to ¥1,534mn following the closure of one of the two facilities at the end of March 2017, but its profits improved to nearly the breakeven line. In the shipbuilding business, net sales decreased 5.9% to ¥1,437mn due to the decline in the volume of ship repair work. This segment's operating loss, including internal adjustments, was ¥4,699mn (a loss of ¥4,775mn in the previous fiscal year).

Outlook

The outlook for FY3/19 is for record high profits for the first time in 2 fiscal years from the effects of higher sales from the expansion of the customer base and the cost reductions

1. FY3/19 earnings outlook

For consolidated FY3/19, the Company forecasts net sales to increase 5.1% YoY to ¥195,600mn, operating profit to increase 27.2% to ¥13,960mn, recurring profit to increase 24.0% to ¥13,880mn, and net income attributable to owners of the parent to increase 19.6% to ¥7,920mn. Net sales are forecast to increase for the second consecutive fiscal year and to achieve a record high for the first time in five fiscal years, while profits are also expected to achieve a record high for the first time in two fiscal years.

Operating profit will increase by approximately ¥3bn. Breaking this down, the effects of the higher sales from the increase in customer numbers in the previous fiscal period will contribute ¥2.1bn, and the reduction in upfront costs, including the customer-acquisition costs spent in the previous fiscal period, will contribute ¥800mn. The Company's policy for this fiscal year is to work to increase customer numbers and to create a foundation for growth toward FY20. The forecast for the number of customers at the end of this fiscal period is 2,941,000, which will be an increase of 65,000 customers on the end of the previous fiscal year.

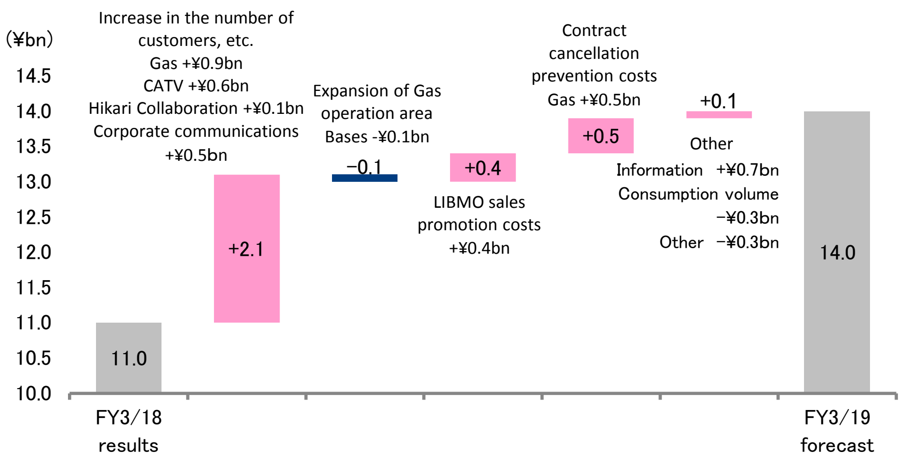
Outlook for consolidated FY3/19

(¥mn)

	FY3/18		FY3/19				
	Results	% of sales	Full-year forecast	% of sales	YoY	1H forecast	YoY
Net sales	186,069	-	195,600	-	5.1%	90,100	6.1%
Operating profit	10,971	5.9%	13,960	7.1%	27.2%	3,700	18.8%
Recurring profit	11,191	6.0%	13,880	7.1%	24.0%	3,650	16.1%
Net income attributable to owners of the parent	6,620	3.6%	7,920	4.0%	19.6%	1,890	51.6%
Net income per share (¥)	51.19		60.48			14.43	

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

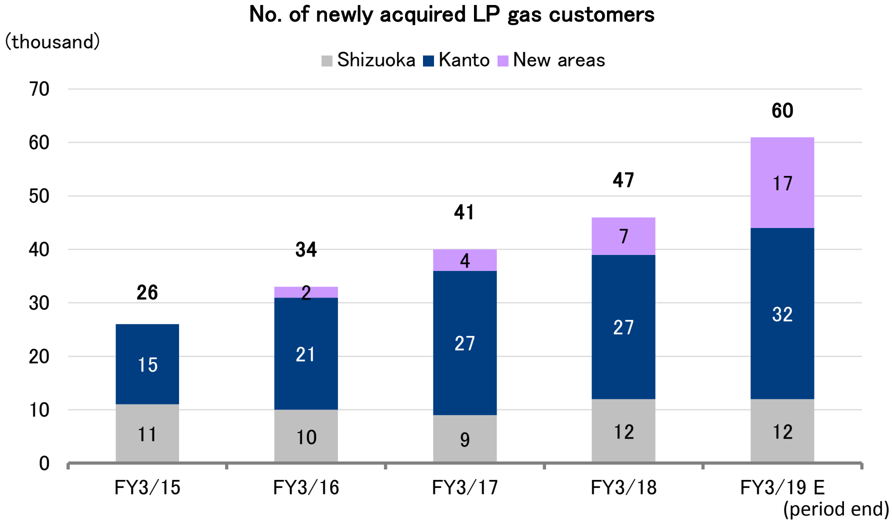
Factors expected to impact operating profit in FY3/19



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

Looking at the results forecasts for the 3 main businesses, net sales in the gas and petroleum business are expected to increase 3% YoY from the rise in the number of customers. Operating profit is forecast to decline ¥100mn, as although profits will increase ¥900mn from the rise in customer numbers and ¥500mn from the decline in costs to prevent contract cancellations, they will fall ¥300mn from the reduction in the unit consumption volume and ¥100mn from the rise in base costs due to the area expansion. Overall, profits are expected to increase ¥1bn. The target for newly acquired customers is an increase from 47,000 in the previous fiscal year to 60,000 customers. Recently, in addition to acquiring new customers in the Kanto area, the Company has also been utilizing its price advantage and expanding its market shares in its new areas. At the end of the fiscal period, it began to newly enter-into the Fukuoka Prefecture and it is expected to acquire customers in this area. It also plans to enter-into Mie Prefecture and Nagano Prefecture in FY3/20.

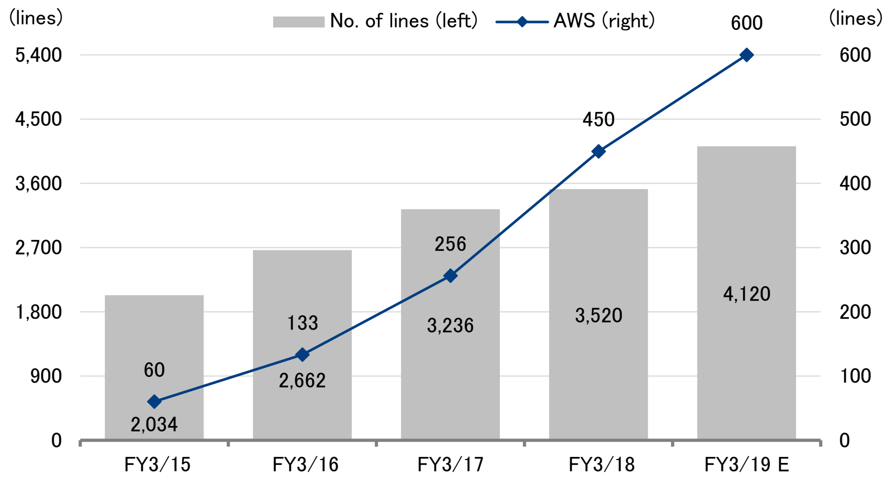
No. of newly acquired LP gas customers



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

In information and communication services, net sales are forecast to increase 3% YoY. The same as in the previous fiscal year, corporate sales will continue to be strong, but it seems that consumer sales will slump alongside the decline in customer numbers. However, operating profit for consumers is also expected to increase, by ¥400m. In terms of the factors behind this increase, profits will grow by ¥100mn from the rise in the number of Hikari Collaboration customers, by ¥400mn from the reduction in LIBMO sales-promotion costs, and by ¥700mn from the decline in sales-promotion costs for Hikari Collaboration and other services. It seems that these increases will cover the decrease in profits from the fall in sales of the existing ISP service and other services. Conversely, profits for corporations are forecast to rise ¥500mn from the effects of the higher sales, In particular, the AWS public Cloud connection service (the number of lines) is expected to trend strongly, up 33% YoY. For this, the Company is leveraging its strength, of its first acquisition of the AWS Networking Competency Certification in Japan in the previous fiscal year.

No. of communication service lines provided



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

In the CATV business, net sales are forecast to increase 7% YoY and operating profit to increase ¥600mn, including due to the rise in the number of customers. Profitability is expected to improve, as customer numbers will increase 29,000 on the end of the previous fiscal year, and in addition, the broadcasting and communication set contracts rate will rise. The outlook for this fiscal year is also for higher sales and profits in the building and real estate business and the Aqua business.

Considering 26 M&As to aim for more than 4,320,000 Group customers and consolidated operating profit of ¥22.5bn for FY3/21

2. 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. By the end of FY3/21, 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 communication 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.

The Company is working to create new businesses that utilize the advanced technologies of AI and Big Data, the Cloud, IoT, and robotics. It has taken the first letters of these keywords and combined them with the first letter of smartphone, which will be the device that utilizes these technologies, to create the term ABCIR+S. As a specialist organization, it intends to establish the Next Generation Management Strategy Headquarters and to investigate a model to utilize ABCIR+S horizontally across the Group (including to create new businesses, to enhance its customer contact points, and a strategy to utilize information). For these advanced technologies, it is investigating using M&A to acquire resources that it does not possess itself.

(2) The progress made in M&A

In FY3/18, the Company conducted two M&As in the CATV business, and newly in the city gas business also, it announced that it has decided on one business transfer. In April 2019, it will acquire the gas business operated by Shimonita Town in Gunma Prefecture. It has 1,336 customers and although its FY16 net sales were small, at ¥143mn, going forward the Company’s policy will be to expand earnings per customer by proposing the Group’s various services, and it is thought that it plans to further expand the area of the city gas business by using this acquisition as a successful case study.

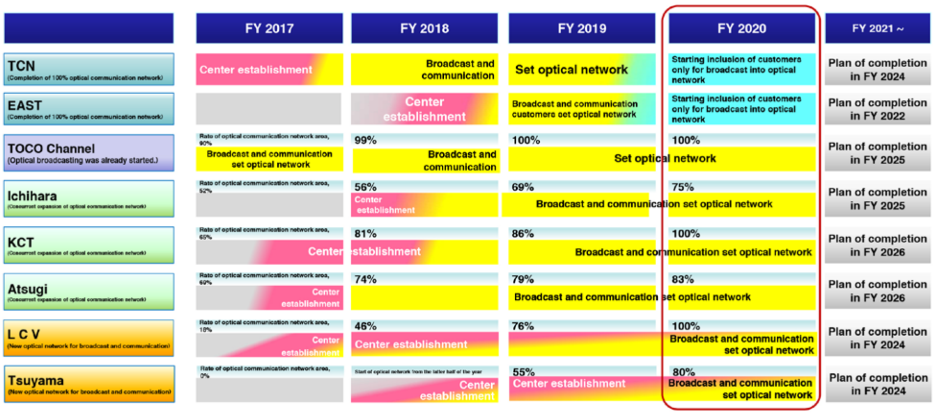
Other than this, the Company is also currently investigating 26 M&A candidates worth ¥190bn. By business, it is investigating 6 city gas companies, 7 LP gas companies, 8 information and communication service companies, 3 CATV companies, and 2 companies in new business fields. The candidate companies for the gas business are those that are expanding their service areas nationwide and that complement the Company in terms of their specialty areas, and for the corporate communication services business, the candidates are AWS certified partner companies that not only develop systems, but also, for example, that are involved in management and maintenance. Other than these, the candidates include local community-centered companies that can provide new lifestyle-related services to the Company’s close to 3 million customers. It is also investigating candidates with an ROI (operating profit before amortization of goodwill ÷ investment amount) on a level of approximately 8% as the investment standard. Within the companies it is investigating, there are deals on the scale of billions of yen, so we shall be paying attention to developments in the future.

(3) Targets for management indicators

The management numerical targets set in the medium-term management plan for FY3/21 are consolidated net sales of ¥339.3bn, operating profit of ¥22.5bn, net income attributable to the owners of the parent of ¥11.5bn, and ROE of 13.0%. Looking at the levels of these targets compared to FY3/17, they are increases of 1.9 times of net sales, 1.8 times of operating profit, and 1.6 times of net income attributable to the owners of the parent. It is considered that, while utilizing M&A, the Company is aiming to achieve these targets by increasing the number of Group customers by more than 1.7 times to over 4,320,000, and also by raising the cross-selling rate. It has made a strong start in FY3/18, which is the Plan's first year.

Financially, interest-bearing debt is expected to increase through the Company conducting investment of ¥100bn, including for M&A and alliances. Looking at the interest-bearing debt / EBITDA (operating profit + amortization expenses, including goodwill expenses) ratio, although it will increase slightly, from 1.9 times in FY3/18 to 2.6 times in FY3/21, the equity ratio will be kept at the 30% level and financial soundness will be maintained. The Company plans normal capital investment excluding M&A expenses of ¥12.6bn in FY3/18 and then at an annual level of ¥14bn from FY3/19 onwards. Within the capital investment, it will invest around ¥6bn to convert to a fiber-optics infrastructure in its CATV business. Its strategy is to maintain and improve the competitiveness of the CATV business by establishing an infrastructure that makes possible 4K and 8K high-definition broadcasting services.

Schedule for introduction of broadcast optical network



Source: The Company's results briefing materials

Financial targets in Innovation Plan 2020

	FY3/17 results	FY3/18 forecast	FY3/18 results	FY3/21 targets	vs. FY3/17
Net sales (¥bn)	178.6	189.4	186.1	339.3	1.9x
Operating profit (¥bn)	12.8	11.4	11.0	22.5	1.8x
Net income attributable to owners of the parent (¥bn)	7.3	6.4	6.6	11.5	1.6x
Total assets (¥bn)	161.1	169.8	166.4	283.4	1.8x
Interest-bearing debt/EBITDA (ratio)	1.9	2.0	1.9	2.6	
Equity ratio (%)	34.5	33.9	36.3	31.6	
ROE (%)	15.2	11.1	11.4	13.0	
Number of customers (million contracts)	2.56	2.88	2.88	Over 4.32	Over 1.7x

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

Financial position

Plans to keep the equity ratio in a range of 30% to 39% even while conducting strategic investment of ¥100bn

Looking at the financial condition at the end of FY3/18, total assets were up ¥5,279mn on the end of the previous fiscal year to ¥166,391mn. The main increase factor was that tangible fixed assets rose ¥3,162mn, mainly due to Tokyo Bay Network and TV Tsuyama being made consolidated subsidiaries. In addition, there were increases in notes and accounts receivable of ¥967mn, and in “Others” in current assets of ¥945mn, including due to a rise in the refund-claim amount for withholding income tax.

Total liabilities were up ¥274mn on the end of the previous fiscal year to ¥104,940mn. This was because while interest-bearing debt decreased ¥3,157mn, there were increases of ¥1,596mn in “Others” in current liabilities, including due to higher payments relating to capital investment; of ¥891mn in trade notes and accounts payable; and of ¥823mn in lease obligations. Total net assets rose ¥5,004mn to ¥61,450mn, as although they decreased ¥4,001mn due to dividends from surplus, they increased ¥6,620mn from the recording of net income attributable to the owners of the parent and ¥2,400mn on 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 1.8 of a percentage point from the end of the previous fiscal year to 36.3%. The interest-bearing debt / EBITDA ratio was 1.94 times, which is about the same level as in the previous fiscal year. But it has continued to improve over the past few years and is 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 depending on the scale of M&A deals, 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	Change
Total assets	173,620	165,702	160,303	161,112	166,391	5,279
Total liabilities	135,291	122,234	118,332	104,665	104,940	274
Net assets	38,329	43,467	41,970	56,446	61,450	5,004
Balance of interest-bearing debt	85,843	73,114	71,410	54,137	50,980	-3,157
EBITDA	24,965	26,233	24,980	28,392	26,318	-2,074
Equity ratio	21.6%	25.7%	25.6%	34.5%	36.3%	1.8pt
Interest-bearing debt/EBITDA ratio	3.44	2.79	2.86	1.91	1.94	0.03pt

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

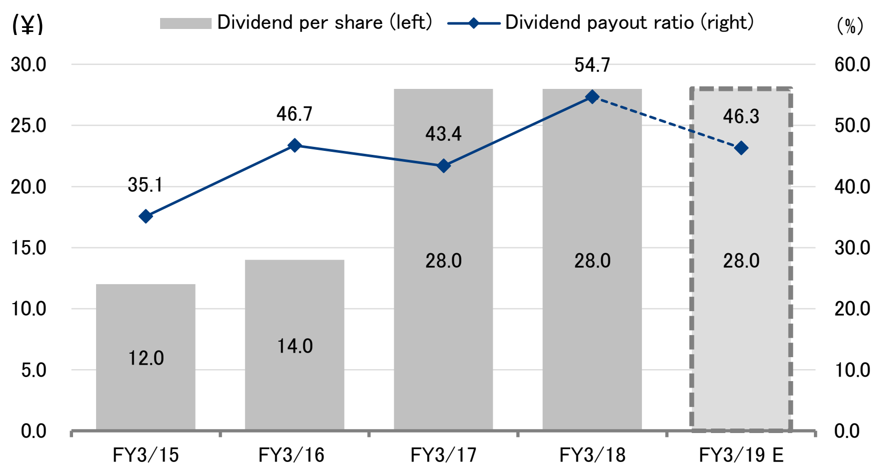
Shareholder return policy

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%.The FY3/19 dividend per share will be unchanged YoY at ¥28.0 (for a dividend payout ratio of 46.3%). But the Company will also determine the dividend while considering trends in results and its demand for capital.

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 ¥2,050 (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 2017 and March 2018 can also select a special course for LIBMO, the inexpensive smartphone 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 (¥1,190 on May 21, 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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