COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Holdings Corporation

3167

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FISCO Ltd. Analyst
Yuzuru Sato

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Record-high profits expected in FY3/19 based on growth in the number of Group customers and steady progress with M&A strategy

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, 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. FY3/19 1H results

Looking at consolidated results for FY3/19 1H (April to September 2018), net sales increased 4.6% year on year (YoY) to ¥88,840mn and operating profit rose 11.6% to ¥3,475mn. The Company delivered record-high net sales for a six-month period. This result was due partly to the effects of M&As implemented in the previous fiscal year, as well as a steady increase in the number of Group customers to 2,893,000 as of the end of FY3/19 1H, up 66,000 from the end of FY3/18 1H. Profits decreased in the LP gas business due to an increase in purchase costs and a decline in sales volume to households. However, this decrease was covered by increases in profits in other business segments, primarily the CATV business. Consequently, the Company posted double-digit growth in operating profit. Operating profit in the LP gas business was ¥400mn below the initial forecast, but this shortfall was partly offset by higher-than-forecast profits in the CATV, information and communications services, and Aqua businesses. As a result, operating profit was only about ¥200mn below forecast.

2. FY3/19 earnings outlook

Looking at the outlook for consolidated results for FY3/19, the Company has left its initial forecasts unchanged, with net sales forecast to increase 5.1% YoY to ¥195,600mn, and operating profit to increase 27.2% to ¥13,960mn. Net sales and operating profit are both expected to reach record highs. In FY3/19 2H, profitability is expected to improve as higher prices of LP gas for homes penetrate the market. With sales and profits in the CATV and information and communications services businesses expected to continue growing, the Company remains on track to achieving its forecasts. The number of Group customers is projected to increase by 48,000 from the end of FY3/19 1H to 2,941,000 at the end of FY3/19, as the Company advances M&As and other initiatives.

3. Medium-term management plan (IP20)

In the medium-term management plan (IP20), the Company is targeting net sales of ¥339.3bn and operating profit of ¥22.5bn in FY3/21. Its strategy to achieve this will be to increase the number of Group customers to more than 4,320,000 (1.5 times the number at the end of March 2018) by utilizing M&As and also to grow sales and profits per customer by raising the current customer contract rate for multiple services* from about 14% to 20%. M&As will target not only CATV businesses, but also gas, information and communication services, and new businesses. The Company is currently in negotiations with target companies.

* Contract rate for multiple services = (total number of service contracts ÷ number of customers) -1

4. Strategy for the CATV business

In the CATV industry, the J:COM (Jupiter Telecommunications Co., Ltd.) Group holds a market share of just over 50% based on the number of subscribing households. The second-largest CATV company and smaller players have market shares in the single digits and are locked in a tight race for market share. Going forward, the largest companies are expected to swallow up the smaller players. Notably, the Company plans to actively advance M&As as a lifestyle infrastructure services company with strengths in providing a wide range of services such as LP gas and Internet services. These and other trends will be closely watched going forward.

5. Shareholder return policy

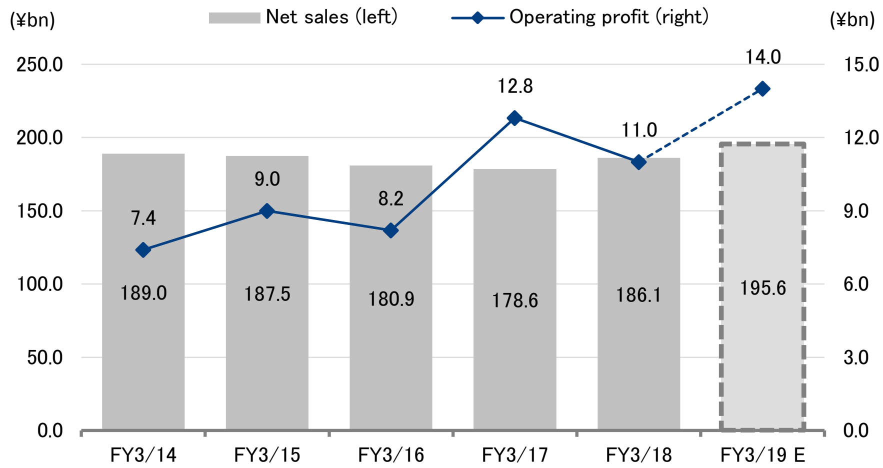
There has been no change to the policy of continuously and stably returning profits to shareholders. The forecast dividend per share for FY3/19 is ¥28.0 (dividend payout ratio, 46.3%), which is unchanged from the previous fiscal year. Going forward, the Company intends to pay dividends while observing 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 among several possible choices, such as an Aqua product, a QUO card, and points for a TLC member service worth ¥1,000. 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 ¥947 on November 13, 2018), it is in the range of 4% to 7%*.

* In the case of selecting either a QUO card or an Aqua product as the shareholder gift

Key Points

- Embraced “Total Life Concierge” as a management vision for providing various lifestyle infrastructure services such as LP gas, Internet and CATV services
- Expected to deliver record-high profits for FY3/19 for the first time in two fiscal years, mainly based on growth in the customer base and a decrease in sales promotion costs
- Aim for more than 4,320,000 Group customers and consolidated operating profit of ¥22.5bn for FY3/21 by advancing the M&A strategy

Results trends



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

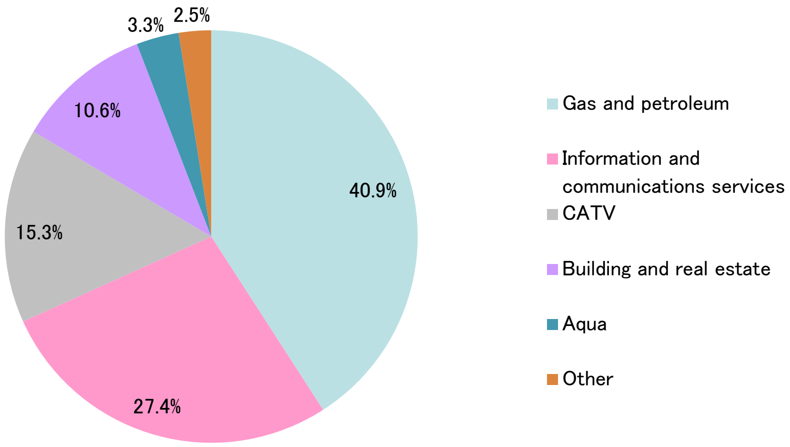
Business overview

Embraced "Total Life Concierge" as a management vision for providing various lifestyle infrastructure services such as LP gas, Internet and CATV 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) gas, and "information and communications services," and it is aiming to achieve its management vision of being a "Total Life Concierge" (TLC). It provides a complete range of services for everyday life under a one contract, one stop, and one call-center model and while deepening its connections with its customers, their local communities, society, and the global environment, 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 communications 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 business accounted for 40.9% of sales, the information and communications services business for 27.4%, and the CATV business 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 actively expanded into other areas including the south Tohoku, Chubu/Tokai, Chugoku, and Kyushu areas and has been focusing on increasing customer numbers. As of the end of September 2018, it had 615,000 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 still 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 September 2018, remains basically constant. Currently, there are 200 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 bringing regional operators on board as Group companies through 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

2. Information and communications services business

The information and communications 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 service area and the TOKAI Network Club (TNC) service for the Shizuoka Prefecture service area, and it has the leading share within Shizuoka Prefecture of approximately 23%. In addition, from February 2015 it launched the Hikari Collaboration service (@TCOM Hikari and TNC Hikari services), in which it receives wholesale provision of optical lines from NTT <9432> and provides its own optical (hikari) Internet connection service. As of the end of September 2018, the Company had 440,000 customers using its existing ISP service and 328,000 customers using its Hikari Collaboration service and customers are shifting toward Hikari Collaboration. The two services have a total of 768,000 customers. This number has steadily declined from 863,000 as of the end of March 2015, immediately after the Hikari Collaboration service was launched. This decline has occurred because customers have been leaving the service at a faster pace than new customers can be enrolled, as major mobile phone carriers conduct sales of service bundles at discounted prices, including mobile phone fees, making use of NTT’s wholesale optical line business.

The mobile business operates 12 mobile phone stores, mainly within Shizuoka Prefecture, as a sales agency of Softbank Corp <9434>, and as of the end of September 2018, it had 223,000 customers. The number of customers has continued to gradually decline from a peak of 236,000 as of the end of March 2016. Also, in February 2017 the Company began sales of LIBMO, which is a low-cost smartphone service, as an MVNO business*. The number of LIBMO customers had steadily increased to 36,000 at the end of September 2018.

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

3. CATV business

In the CATV business, the Company provides broadcasting and communications services (Internet access services) in Tokyo and five prefectures: Shizuoka, Kanagawa, Chiba, Nagano and Okayama. Currently, the CATV business is undertaken by nine Group companies. As of September 30, 2018, the number of customers stood at 781,000 for broadcasting services and 265,000 for communications services, bringing the total to 1,046,000 customers. In terms of the market share of CATV viewing households, the Company holds a market share of approximately 3%, making it the sixth largest player in Japan’s CATV industry. Going forward, the Company’s strategy is to continue increasing its market share through proactive M&As.

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. 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 156,000 customers at the end of September 2018. The overall industry had 3,700,000 customers as of the end of 2017, giving the Company a share at around 4%.

6. Other businesses

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 September 2018, it operated six day service facilities, a short stay facility, and a paid-for nursing home in Shizuoka Prefecture. In addition, it has opened two care plan centers. For its wedding ceremony business, it operates one facility in Shizuoka Prefecture.

Results trends

Achieved double-digit profit growth as the decrease in profits in the LP gas business was outweighed by increases in profits in other business segments

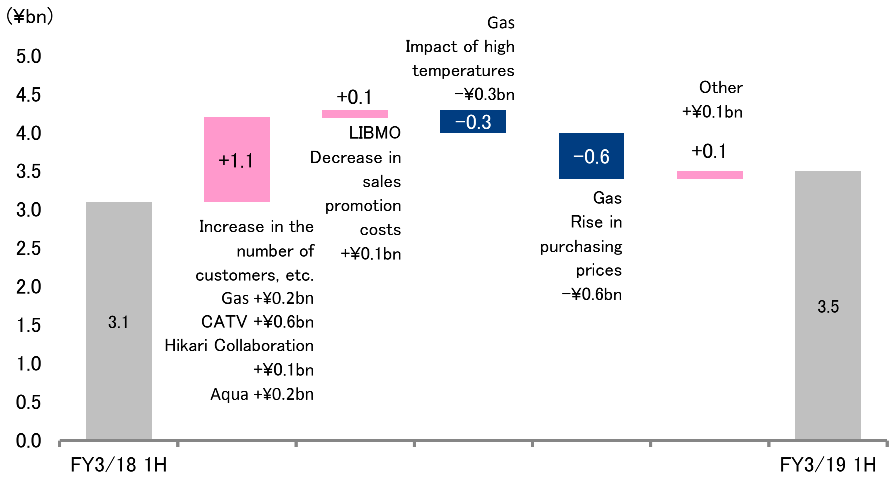
1. Overview of the FY3/19 1H results

Looking at consolidated results for FY3/19 1H, the Company posted higher sales and profit YoY. Net sales increased 4.6% YoY to ¥88,840mn, operating profit rose 11.6% to ¥3,475mn, recurring profit increased 13.9% to ¥3,580mn, and net income attributable to owners of the parent increased 39.3% to ¥1,736mn. The Company delivered record-high net sales for a six-month period, due partly to the effects of M&As implemented in FY3/18, as well as a steady increase in the number of Group customers, primarily in the LP gas and CATV businesses. Looking at the main factors behind changes in operating profit, there was a negative impact of ¥900mn from the gas business due to the impact of high temperatures and an increase in purchase prices. However, this drop in profits in the gas business was outweighed by a positive impact of ¥1,100mn primarily from monthly fee revenue due to an increase in the number of customers and a positive impact of ¥100mn due to a reduction in sales promotion costs for LIBMO, the Company's low-cost smartphone service.

The number of Group customers was 2,893,000 as of the end of FY3/19 1H, an increase of 17,000 from the end of FY3/18. The net increase in the number of Group customers was 13,000 YoY. In terms of the percentage rate of increase, the number of Group customers rose sharply by 34.9% on a net basis. Notably, the number of Group customers increased significantly in the LP gas and CATV businesses, where the Company is expanding its sales areas. (There were increases of 9,000 customers in the LP gas business and 14,000 customers in the CATV business.)

Net sales and operating profit were 1.4% and 6.1% below the Company's initial forecasts, respectively. The shortfall in operating profit mainly reflected lower-than-expected profits in the LP gas business, mainly because of lower-than-anticipated sales volume of LP gas for homes due to high temperatures and the rise in purchasing prices alongside high crude oil prices. Operating profit in the CATV, information and communications services, and Aqua businesses surpassed the Company's forecasts.

Factors behind changes in operating profit for FY3/19 1H



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

The CATV and Aqua businesses performed strongly, with double-digit increases in sales

2. Trends by business segment

Customer numbers by key services

(thousand)

	End of FY3/15 1H	End of FY3/16 1H	End of FY3/17 1H	End of FY3/18 1H	End of FY3/19 1H	YoY change
Gas	626	627	634	648	670	22
LP gas	573	573	580	594	615	21
City gas	53	53	54	54	55	1
Information and communications services	1,093	1,093	1,071	1,050	1,028	-22
Existing ISP	861	742	565	492	440	-52
Hikari Collaboration	-	117	272	315	328	13
LIBMO	-	-	-	13	36	23
Mobile	231	234	234	231	223	-8
CATV	690	698	722	995	1,046	51
Broadcasting services	496	494	503	748	781	33
Communications services	194	203	218	247	265	18
Aqua	132	132	135	141	156	15
Security	18	18	17	17	17	0
Total	2,535	2,543	2,554	2,827	2,893	66

* The number of customers below a thousand is rounded to the nearest thousand. Information and communications and CATV both offer communications services, so total figures avoid duplication.
Source: Prepared by FISCO from the Company's results briefing materials

(1) Gas and petroleum business

In the gas and petroleum business, net sales increased 3.6% YoY to ¥33,948mn while operating profit decreased 30.6% YoY to ¥1,084mn. Within this business, net sales in the LP gas business increased 2.9% YoY to ¥28,262mn, partly because the number of customers increased by 22,000 from the end of FY18/3 1H to 615,000 as of the end of FY19/3 1H, and the higher prices of raw materials pushed up sales prices. In the past few years, the Company has been strategically expanding its sales areas. In June 2018, the Company opened the Kyushu Office (Fukuoka Prefecture), thereby expanding its sales areas to Tokyo and 13 prefectures. The number of customers has increased by 9,000 on a net basis since the end of FY3/18. This figure breaks down into a net increase of 5,000 in new sales areas (Kitakanto, Minamitohoku, Aichi Prefecture, Gifu Prefecture, Okayama Prefecture, Fukuoka Prefecture) (including 1,500 in Fukuoka) and a net increase of 4,000 in existing sales areas (Shizuoka Prefecture, the Tokyo Metropolitan Area, and other areas), reflecting steady growth in each area. The Company has offered discounts to customers signing up for multiple contracts for other services within the Group, and has continuously taken steps to prevent contract cancellations in existing sales areas. These initiatives have proven highly effective in increasing the number of customers.

Meanwhile, in the city gas business, net sales rose 7.3% YoY to ¥5,686mn, partly due to a rise in sales prices, as well as a slight increase of 1,000 in the number of customers to 55,000.

The main reasons for the decline in operating profit were a decrease in sales volume per home LP gas customer due to the aforementioned higher-than-normal temperatures and a rise in purchasing prices of raw materials in connection with high crude oil prices. Generally, it is said that when the temperature is 1°C higher, the volume of gas consumed by homes decreases by 3%. The average temperature in FY3/19 1H was 1.4°C higher than in FY3/18 1H and it seems that the sales volume per customer decreased by around 4%.

(2) Information and communications services business

In this business, net sales increased 1.0% YoY to ¥25,154mn, while operating profit increased 4.3% to ¥1,608mn. Within these amounts, net sales in the consumer business suffered a downturn, decreasing 1.3% to ¥15,504mn. Although the number of customers for Hikari Collaboration, which has high monthly revenue, increased by 13,000 on the end of the same period in the previous fiscal year to 328,000, customer numbers for the existing ISP service and other services decreased sharply by 52,000 to 440,000 due to the intensification of competition with major mobile carriers. The Company has been competing with the major mobile carriers. In this environment, the Company has sought to stop the downward trend by creating a sense of better affordability through service bundle sales with LIBMO, its low-cost smartphone service, since FY3/17, but it continues to face an uphill battle on this front. The number of LIBMO customers increased by 23,000 on the end of the same period in the previous fiscal year to 36,000.

Conversely, the corporate business performed steadily, with net sales increasing 4.9% YoY ¥9,649mn. Sales of data communication services trended firmly against the backdrop of the expansion of the cloud services market, and also sales increased for outsourced systems development.

Operating profit in the corporate business decreased by approximately ¥40mn YoY due to the impact of price hikes in access service fees from NTT. However, operating profit in the consumer business rose by approximately ¥100mn due to the effects of reductions in sales promotion costs for LIBMO.

(3) CATV business

In the CATV business, net sales increased 11.2% YoY to ¥15,135mn and operating profit rose 31.7% YoY to ¥2,330mn, marking a strong performance trend. The Company converted Tokyo Bay Network Co., Ltd. and TV Tsuyama Inc. into subsidiaries in FY3/18 2Q and FY3/18 4Q, respectively. These M&A deals had the positive effect of increasing both sales and profit, lifting net sales by ¥1,000mn and operating profit by nearly ¥100mn. The number of customers increased steadily in both broadcasting and communications services. The number of customers increased by 33,000 YoY to 781,000 for broadcasting services and 18,000 YoY to 265,000 for communications services. The Company undertook sales initiatives such as providing discount services to customers signing up for both broadcasting and communications services and offering smartphone bundles at discounted prices through tie-ups with major mobile phone carriers, as well as steps to prevent contract cancellations. These initiatives led to an increase in the number of customers.

The operating profit margin rose from 13.0% YoY to 15.4%. The main factors behind this were the rise in the ratio of broadcasting and communications service bundle contracts in the existing areas, which resulted in the increase in earnings per customer, and the ongoing decrease in depreciation and goodwill amortization costs.

(4) Building and real estate business

In the building and real estate business, net sales increased 7.6% YoY to ¥8,987mn and operating profit rose 42.8% to ¥554mn. The higher sales were due to the increase in projects for the renovation business and for building work. In particular, in the renovation business, the effects of strengthening the sales structure in the Shizuoka area are being realized. Most of the rise in operating profit was provided by the increase in sales in the renovation business.

(5) Aqua business

In this business, net sales increased 14.2% YoY to ¥3,490mn, while operating profit increased 115.6% to ¥291mn, marking the first increase in operating profit in two fiscal years. The Company worked actively to acquire customers, including those at large-scale commercial facilities, and the customer numbers had increased by 15,000, over 10% YoY, on the end of the same period in the previous fiscal year to 156,000 customers, which was the main reason for the higher sales and profits.

(6) Other businesses and adjustments

In the other businesses, net sales decreased 4.1% YoY to ¥2,123mn. Breaking this down, in the nursing care business, sales increased 5.2% to ¥532mn alongside the increase in the number of facility users, and its operating loss continued to improve. In the wedding ceremony business, the number of wedding ceremonies declined and net sales fell 7.1% YoY to ¥624mn, while in the shipbuilding business, the volume of ship repair work fell and net sales decreased 8.6% to ¥627mn and operating profit also declined. This segment's operating loss, including internal adjustments, was ¥2,393mn (a loss of ¥2,282mn in the same period in the previous fiscal year).

3. Financial position

Looking at the financial condition at the end of FY3/19 1H, total assets were down ¥1,073mn on the end of the previous fiscal year to ¥164,920mn. This decrease was primarily attributable to a decrease of ¥2,403mn in notes and accounts receivable-trade owing to seasonal factors, offsetting an increase of ¥729mn in "Others" in current assets, stemming from an increase in derivative valuation assets.

Total liabilities were ¥102,493mn, down ¥2,049mn from the end of the previous fiscal year. The decline was mainly attributable to a decrease of ¥2,295mn in notes and accounts payable-trade owing to seasonal factors and a decrease of ¥3,271mn in “Others” in current liabilities due to capital expenditure-related payments, offsetting an increase of ¥3,950mn in interest-bearing debt.

Total net assets rose ¥976mn from the end of the previous fiscal year to ¥62,426mn. The increase was mainly attributable to the recording of net income attributable to owners of the parent of ¥1,736mn and an increase of ¥1,106mn in deferred gains on hedges. These factors were partly offset by dividend payments of ¥1,839mn.

The equity ratio, which indicates financial soundness, stood at 37.1%, as a result of steadily rising in the past few years. Under the medium-term management plan currently under way, the Company plans to proactively execute growth investments including M&As. The Company expects to keep the equity ratio at the 30% level.

Consolidated balance sheets

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19 1H	Change
Total assets	165,702	160,303	161,112	165,993	164,920	-1,073
(Cash and deposits)	2,861	4,077	3,239	3,143	3,435	292
Total liabilities	122,234	118,332	104,665	104,543	102,493	-2,049
(Interest-bearing debt)	73,114	71,410	54,137	50,980	54,930	3,950
Net assets	43,467	41,970	56,446	61,450	62,426	976
Equity ratio	25.7%	25.6%	34.5%	36.3%	37.1%	0.8pt

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

Outlook

Expected to deliver record-high profits for FY3/19 for the first time in two fiscal years, mainly based on growth in the customer base and a decrease in sales promotion costs

1. Outlook for consolidated FY3/19

For consolidated FY3/19, the Company has left its initial forecasts unchanged at 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 record highs at every level for the first time in two fiscal years.

The main reasons for the increase in profits will be an increase of ¥2,100mn in profits from an increase in monthly revenue atop an increase in the number of Group customers by 65,000 to 2,941,000 as of the end of FY3/19, as well as reduced costs for measures to win new customers and prevent contract cancellations implemented in FY3/18. Most of the increase in the number of customers will come from the LP gas and CATV businesses. The number of customers is expected to increase by 35,000 (26,000 in 2H) for the LP gas business and by 28,000 (14,000 in 2H) for the CATV business from the end of the previous fiscal year. By segment, profits in the gas and petroleum business are expected to swing from a decline in FY3/19 1H to an increase on a full year basis. In addition, following on from FY3/19 1H, the CATV and Aqua businesses are expected to continue to perform favorably.

Outlook for consolidated FY3/19

(¥mn)

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

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

Looking at profit forecasts in core businesses, profit in the LP gas business had declined in FY3/19 1H. However, the Company will increase prices from FY3/19 3Q, so profitability will likely increase from FY3/19 2H. Based on this outlook, profit in the LP gas business is forecast to increase by double digits on a full-year basis. One risk factor is temperature trends in the winter. If winter temperatures are higher than normal, sales volume of LP gas could decrease. The Company will work to further increase the number of customers in existing areas by acquiring new customers. It is expected to acquire customers in Okayama Prefecture and Gifu Prefecture, which it newly entered in FY3/18, and Fukuoka Prefecture, which it newly entered in June 2018. It also plans to enter the new areas of Mie Prefecture and Nagano Prefecture in FY3/20. Going forward, the Company will continue to working to increase the number of customers with the aim of achieving growth in profits.

In the information and communications services business, net sales are forecast to grow by only single digits due to sluggish growth in the number of customers in the consumer business. However, profits are forecast to turn upward and increase by double-digits. Profits in the corporate business, which had declined in FY3/19 1H, are also expected to turn upward as a result of growth in sales from data communications services, system development projects and other areas, thereby contributing positively to profits. Another contributing factor will be a decrease in sales promotion costs for LIBMO and Hikari Collaboration. In data communications services, at the end of August 2018, the Company began mutual connectivity with the network of Telstra Japan K.K., a member of the Telstra Group, which has one of the largest networks in the Asia-Pacific region, and started offering data communications access services to overseas customers. This will serve as another driver of profit growth in FY3/19 2H.

In the CATV business, the Company will work to increase the number of customers by continuing to sell service bundles based on tie-ups with mobile phone carriers. In addition, the Company will raise the multiple contract rate for broadcasting and communications services based on its strengths in being able to provide high-speed communications services leveraging its proprietary optical fiber network. Through these measures, the Company is forecasting a double-digit increase in operating profit in the CATV business.

In the Aqua business, double-digit growth in operating profit is projected based on measures to increase the number of customers through continued sales activities at stores such as large shopping centers in FY3/19 2H. In addition, as a new initiative, the Company announced that it had concluded a business alliance agreement with TOELL <3361>, a peer company in the bottled water delivery industry (November 8, 2018), with the aim of streamlining delivery operations and enhancing service quality in the home water delivery business in the Kanto area. Specifically, TOELL's delivery system will be used to deliver the Company's Aqua products in the Kanto area, in order to streamline delivery operations, reduce costs, and strengthen customer contacts. The aim is to drive further growth in the Aqua business. Previously, in the Kanto area, the Company had outsourced delivery operations to a major freight company. However, freight costs had risen due to the recent shortage in drivers and the Company had passed some of the freight costs on to customer fees. Through this business alliance, the Company expects to generate cost savings by utilizing TOELL's delivery system. TOELL serves 250,000 customers in the home water delivery business in the Kanto area.

As one of its digital marketing strategies, the Company launched a smartphone app called "TLC Points App" in October 2018. The TLC Membership Service is a membership program for customers using the services provided by the TOKAI Group. Designed for TLC members, the new smartphone app enables members to confirm, redeem and otherwise make use of their TLC points. It also facilitates the timely distribution of information to members, including information on various services, as well as campaigns and events, from the Group. Looking ahead, the Company will analyze the big data (user activity history) gathered from the smartphone app, websites for various services, and other sources and use the findings to implement optimal digital marketing initiatives according to customer attributes and preferences. By doing so, the Company plans to build a platform that successfully maximizes revenue per customer. The number of TLC members stood at 757,000 as of the end of September 2018.

Aim for more than 4,320,000 Group customers and consolidated operating profit of ¥22.5bn for FY3/21 by advancing the M&A strategy

2. Medium-term management plan

(1) Basic policy and M&A activities

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.

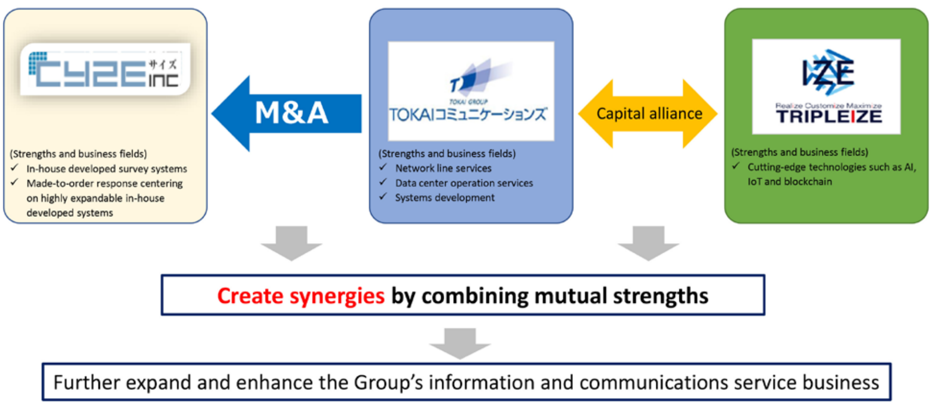
The candidates for M&A are companies that have a customer base in its core businesses, including gas, CATV, and information and communications services, and it is also targeting companies in areas peripheral to its existing lifestyle-related services. The Company is currently investigating and negotiating with several candidate companies. The Company is also 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 has established the Next Generation Management Strategy Headquarters 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 companies that have technologies and expertise that it does not possess itself.

Looking at the Company's recent history of prominent M&As, in the CATV business, the Company converted Tokyo Bay Network Co., Ltd. (Koto-ku and Chuo-ku, Tokyo) and TV Tsuyama Inc. (Tsuyama-shi, Okayama Prefecture) into subsidiaries. In October 2018, the Company obtained approval for the transfer of a city gas business operated by Shimonita-machi, Gunma Prefecture from the Director-General of the Kanto Bureau of Economy, Trade and Industry. With this approval, the Company has decided to succeed to this city gas business from April 2019. Previously, the Company had conducted the city gas business only within Shizuoka Prefecture. This decision marks the first time that the Company will operate a city gas business outside the prefecture. Based on this track record, the Company plans to further expand its city gas business to cover a wider region.

In the information and communications services field, the Company converted Cyze Inc.* into a consolidated subsidiary in September 2018. Cyze develops and provides online survey systems as its core business. In addition, the Company concluded a capital and business alliance with Tripleize Co., Ltd., a startup with strengths in cutting-edge technologies such as IoT, AI and blockchain. The purpose of converting Cyze into a subsidiary is to strengthen the Group's digital marketing strategy using Cyze's data collection solutions. With regard to Tripleize, the Company intends to expand the systems development business and create synergies in areas such as the development of new businesses and services by working to further strengthen its relationship with Tripleize by forming a capital alliance. Previously, the Company had partnered with Tripleize in the system development business.

* Cyze posted net sales of ¥179mn and operating profit of ¥36mn in FY11/2017. The Company's shareholding ratio in Cyze is 100%.

Creation of synergies in the information and communications services field



Source: The Company's results briefing materials

In other areas, in August 2018 the Company entered into a capital and business alliance with Minna-Denryoku, Inc., a power producer and supplier (PPS). With this move, the Company has started to explore possibilities for entering the renewable energy field in earnest. In April 2019, the Company plans to establish a wholly owned subsidiary to conduct electricity sales and related activities. From 2019, this business will purchase electric power generated using photovoltaic power generation facilities, for which the purchase period for the Feed-in-Tariff (FIT) scheme will expire. It will also utilize sales agencies, including Group companies and local construction companies, for the actual sales. The Company is expected to first sell electric power to corporations, individuals, public facilities and other customers in Shizuoka Prefecture, and subsequently expand sales to areas in which the Company provides services. Demand for purchasing renewable energy is projected to increase among companies strengthening their efforts in ESG (Environment, Society, Governance), RE100 member companies* and local governments that have a high environmental awareness. The Company's initiatives in this field will warrant close attention from FY3/20 onward.

* RE100: An international consortium in which member companies are committed to use electricity generated from 100% renewable energy. As of September 2018, it had 132 member companies from around the world, of which, 8 are from Japan, including Ricoh <7752>, AEON <8267>, and ASKUL <2678>.

(2) Strategy for the CATV business

The CATV business is one of the Company's core businesses, accounting for around 15% of net sales, and around 33% of operating profit, and around 36% of the number of customers. Notably, the number of customers in the CATV business is the highest among the Group's businesses (the information and communications services business has the second highest number of customers, representing around 35% of the total). The CATV business began when the Company made an investment in a fixed-line television equipment company in Shizuoka Prefecture in 1988. Thereafter, the Company expanded its CATV sites through M&A initiatives. It currently conducts business in Tokyo and five prefectures: Shizuoka, Kanagawa, Chiba, Nagano and Okayama.

In the CATV industry, the J:COM Group holds a dominant share of more than 50% of the entire market. The second-largest CATV company and smaller players have market shares in the single digits and are locked in a tight race for market share. Looking at the ranking of broadcasting service providers in terms of net sales, the TCN Group (TCN: TOKAI Cable Network Corporation) is ranked third place in the industry. In terms of the number of subscribing households, the TCN Group comes in at sixth place. Currently, there are more than 300 companies providing CATV services in Japan. Going forward, the largest companies are expected to swallow up the smaller players. Notably, the Company has announced plans to actively push ahead with alliances and M&As as a lifestyle infrastructure services company with strengths in providing a wide range of services such as LP gas and Internet services.

Net sales in Japan's CATV industry

Service provider	Area	Net sales (¥mn)
J:COM Group	Tokyo G	246,359
CNCi Group	Aichi G	23,930
TCN Group	Shizuoka G	14,838
its communications	Tokyo, Kanagawa	13,094
KNC	Nara, Osaka	11,476
ZTV	Mie, Shiga, Wakayama	11,119
Bay Communications	Osaka	6,644
CCJ Group	Mie G	6,514
Total (315 operators)		-

* Excluding Internet services, installation, and subsidies, etc.
Source: "Nikkei MJ," Nikkei Inc. (November 8, 2017)

Total number of CATV subscribing households

Service provider	Area	Number of subscribing households (thousand)	Share
J:COM Group	Tokyo G	13,601	53.9%
CNCi Group	Aichi G	1,454	5.8%
its communications	Tokyo, Kanagawa	899	3.6%
K-Opticom	Osaka, Kyoto, Hyogo, etc.	820	3.3%
Bay Communications	Osaka	797	3.2%
TCN Group	Shizuoka G	774	3.1%
CCJ Group	Mie G	304	1.2%
Total (315 operators)		25,237	100.0%

* The number of subscribing households is as of the end of June 2017 (except for the TCN Group, whose number of subscribing households is as of the end of March 2018)
Source: "Cable Yearbook 2018," SATEMAGA BI Inc.

In the broadcasting industry, new 4K and 8K ultra high-definition satellite broadcasting services will begin in December 2018. Investment in the conversion of standard cable to fiber-optics infrastructure will be needed to allow CATV customers to view these broadcasting services without any problems. If a customer's incoming line is coaxial cable, a set-top box (STB) is needed to view CATV. With a fiber-optic line, CATV can be viewed using the pass-through method without an STB. Therefore, the Company plans to actively invest in the conversion to fiber-optics infrastructure, with a view to completing the conversion of almost all of its infrastructure to fiber optics by FY20. The Company has already made progress on the conversion to fiber-optics infrastructure. With this in mind, the Company is budgeting for capital expenditures of around ¥6,000mn per year. Progress on the conversion to fiber-optics infrastructure will enable the Company to provide faster and more user-friendly communications services. Even better communications services are expected to lead an increase in the number of communication service customers and to a rise in the multiple contract rate. The Company also plans to simultaneously conduct M&As targeting CATV companies that do not have the financial strength needed to invest in the conversion to fiber-optics infrastructure. The Company has laid around 6,000 km of fiber-optic cable in areas ranging from Kanto to Okayama. Its return on investment will be higher when undertaking M&As targeting companies in its fiber-optic service areas. However, without limiting itself to these areas, the Company plans to expand the scope of M&As nationwide as it advances M&A initiatives.

(3) Targets for management indicators

The numerical management 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 owners of the parent of ¥11.5bn, and ROE of 13.0%. Looking at the levels of these targets compared to FY3/18, the Company is targeting increases of 1.8 times in net sales, 2.0 times in operating profit, and 1.7 times in net income attributable to 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 1.5 times to over 4,320,000, and also by raising the multiple contract rate from around 14% as of the end of FY3/18 to around 20%.

Financially, interest-bearing debt is expected to increase as the Company conducts investment of ¥100bn to accelerate 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 conducted normal capital investment excluding M&A expenses of ¥12.6bn in FY3/18 and plans an annual level of ¥14bn from FY3/19 onwards.

Financial targets in Innovation Plan 2020

	FY3/18 results	FY3/19 forecast	FY3/20 forecast	FY3/21	
				Targets	vs. FY3/18
Net sales (¥bn)	1,861	2,020	2,244	3,393	1.8x
Operating profit (¥bn)	110	140	162	225	2.0x
Net income attributable to owners of the parent (¥bn)	66	79	87	115	1.7x
Total assets (¥bn)	1,664	1,738	1,912	2,834	1.7x
Interest-bearing debt/EBITDA (ratio)	1.9	1.7	1.8	2.6	
Equity ratio (%)	36.3	35.6	34.9	31.6	
ROE (%)	11.4	12.8	13.0	13.0	
Number of customers (million contracts)	288	299	372	Over 4.32	Over 1.5x

Source: Prepared by FISCO from the Company's results briefing materials and the Company's Medium-Term Management Plan (May 9, 2017)

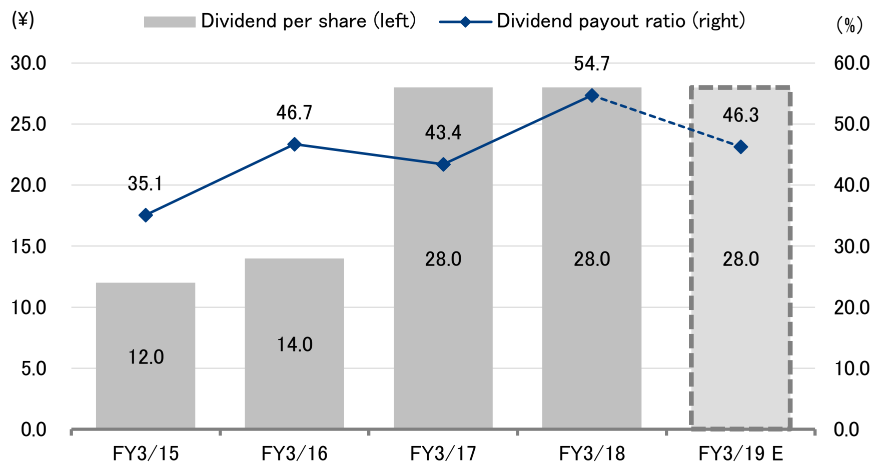
Shareholder return policy

Remaining firmly committed to continuously paying a stable dividend

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, ¥1,000 worth of TLC Membership Service points, or a ¥2,100 discount on LIBMO usage fees. When including the gifts to shareholders in an estimate of the total investment yield per share unit from the current share price level (¥947 on November 13, 2018), it is in the range of 4% to 7% (depending on the selection of either a QUO card or an Aqua product as the gift).

Dividend per share and dividend payout ratio



* Including a commemorative dividend of ¥6 in FY3/17
Source: Prepared by FISCO from the Company’s financial results

Shareholder gifts

Shareholders on record at the end of March and September are presented with their choice of one of the following five type of gifts, as well as a 10% discount coupon for a standard wedding service at the Group's wedding halls and a dining certificate and 20% discount coupon for the Beau Ciel and Aoi restaurants.

Shares held	100-299 shares	300-4,999 shares	Over 5,000 shares
Aqua product	¥2,050 worth	¥4,100 worth	¥8,200 worth
QUO card	¥500 worth	¥1,500 worth	¥2,500 worth
Beau Ciel dining certificate	¥1,000 worth	¥3,000 worth	¥5,000 worth
TLC Points	¥1,000 worth	¥2,000 worth	¥4,000 worth
LIMBO monthly usage fee	¥2,100 worth	¥5,100 worth	¥11,280 worth

Source: Prepared by FISCO from the Company website

Information security measures

In terms of 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, the Company has established a Group-wide expert committee in order to share information between all the Group companies and at the same time, to heighten awareness of its security measures.

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