

TOKAI Holdings Corporation

3167

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Summary

Is entering a phase of fully-fledged profit growth from the increase in customer numbers in the mainstay businesses

Based in Shizuoka Prefecture, TOKAI Holdings <3167> (hereafter, also “the Company”) is a comprehensive lifestyle-infrastructure company that is developing “energy and lifestyle-related services,” primarily the provision of liquefied petroleum gas (LP gas), and “information and communications services.” In addition to realizing the Total Life Concierge (comprehensive services for living) concept*1, from FY3/19 it has started measures for a new theme, ABCIR+S*2, and it is aiming to take a further leap forward while advancing an M&A strategy.

*1 Total Life Concierge concept: a vision that aims to improve customer satisfaction by providing comprehensive and detailed support for customers’ comfortable lifestyles through the various services provided by the TOKAI Group.

*2 ABCIR+S: the TOKAI Group’s strategy for technological innovation. It is the acronym of AI (A), Big Data (B), Cloud (C), IoT (I), Robotics (R), and Smart Phone (S), and the Group will focus on creating and developing new services related to them.

1. FY3/20 1H results

In the FY3/20 1H (April to September 2019) consolidated results, net sales increased 4.7% year-on-year (YoY) to ¥93,015mn and operating profit rose 58.3% to ¥5,500mn, which were new record highs for a 1H and also above the Company forecasts (net sales of ¥92,500mn and operating profit of ¥4,410mn). The main factors were the increases in the number of customers in the mainstay LP gas and CATV businesses, and in the Aqua business, and the rise in monthly revenue, and also as customer acquisition and maintenance costs decreased and the corporate information and communication services business performed well. At the end of FY3/20 1H, the number of continuous-transaction customers was up by 16,000 on the end of the previous fiscal period to 2,918,000 customers, while the customer contract rate for multiple services* also rose from 17.8% to 18.1%.

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

2. FY3/20 earnings outlook

For the FY3/20 consolidated results, the Company has left the initial forecasts unchanged, of net sales to increase 4.8% YoY to ¥200,800mn and operating profit to grow 8.5% to ¥14,170mn. The number of continuous-transaction customers at the end of the period is forecast to grow by 100,000 on the end of the previous fiscal period to 3mn customers. But the progress made in the 1H was a little behind schedule, so it is thought that going forward, it plans to achieve the forecast by measures including increasing customer-acquisition costs and progressing the M&A strategy. The progress made for the profit forecasts is ahead of schedule, and if the winter temperatures trend the same as in an average year, at FISCO we think that it is highly likely that the results will exceed the Company forecasts. In October 2019, the Company and TEPCO Energy Partner, Inc. (hereafter, TEPCO EP) established a joint venture to conduct a city gas retail business in the Tokai area. It is aiming to acquire 10,000 new customers by March 2021, and it has also clarified that it intends to look into providing the Company Group’s various services and developing its business into areas other than the Tokai area.

Summary

3. Medium-term management plan (IP20)

In the medium-term management plan (Innovation Plan 2020 “JUMP”), the targets set for FY3/21 are net sales of ¥339.3bn and operating profit of ¥22.5bn. The target is also to increase the number of Group customers to more than 4.32mn by progressing the M&A strategy. The Company also intends to raise the customer contract rate for multiple services from 17.8% at the end of the previous fiscal period to 20% and to work to maximize earnings per customer. For M&A, all of the 10 projects it implemented up to FY3/20 1H are starting to produce results, and at the present time as well, it is negotiating deals worth a total of more than ¥100bn, including some large-scale projects. It is also working to utilize ABCIR+S to expand the new customer base and strengthen competitiveness, and to develop new services. It has completed the DMP (Data Management Platform)* that will serve as the foundation for this. Going forward, it is considered that it will accumulate customers’ Big Data and utilize AI technologies in order to propose to customers the optimal services on the optimal timing and to realize the TLC concept.

* DMP refers to the platform for the integrated management and analysis of data on the Internet, including Big Data accumulated on the various services and log-in data for its own website, to ultimately realize the optimization of the action plan, including the distribution of advertisements.

4. Shareholder return policy

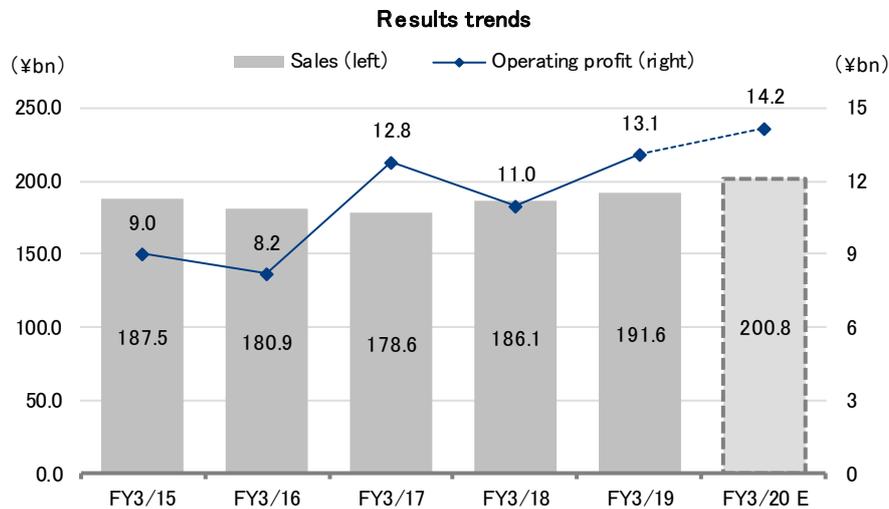
There has been no change to the policy of continuously and stably returning profits to shareholders. The forecast dividend per share for FY3/20 is ¥28.0 (dividend payout ratio, 44.6%), which is unchanged from the previous fiscal year. Going forward, the Company intends to pay dividends while observing 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 ¥1,082 on November 21, 2019), it is in the range of 3.5% to 6.3%*.

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

Key Points

- Results were driven by higher earnings in the LP gas business and the corporate information and communication services business
- In the FY3/20 1H results, achieved record highs for the second consecutive fiscal period and profits may be above forecast
- Intends to accelerate earnings growth through progressing M&A and the ABCIR+S strategy

Summary



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

Business overview

Embraced “Total Life Concierge” for providing various lifestyle infrastructure services such as LP gas, information and communications, and CATV services

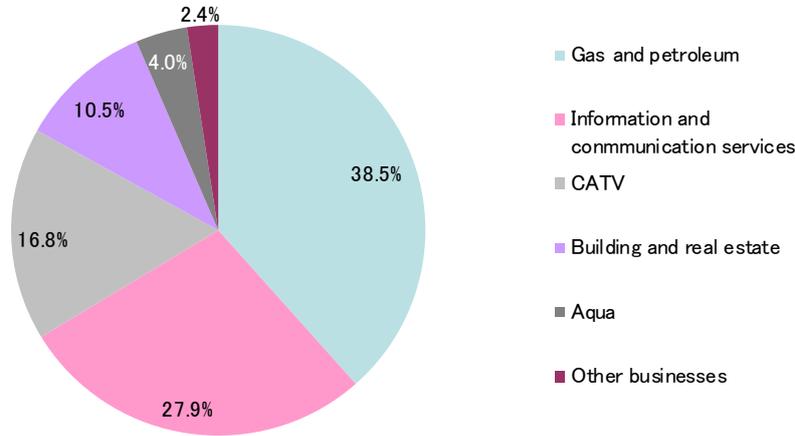
Based in Shizuoka Prefecture, Japan, the Company is expanding its businesses, “energy and lifestyle-related services,” primarily the provision of liquefied petroleum (LP) gas, and “information and communications services,” and it is aiming to achieve its management vision of being a “Total Life Concierge” (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 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 for FY3/20 1H results, the Company’s original business, the gas and petroleum business accounted for 38.5% of sales, the information and communications services business for 27.9%, and the CATV business for 16.8%. These three mainstay businesses accounted for over 80% of sales. The details by business segment are as follows.

We encourage readers to review our complete legal statement on “Disclaimer” page.

Business overview

Sales structure by segment(FY3/20 1H)



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

1. Gas and petroleum business

In this business, approximately 82% of net sales are provided by the LP gas business and around 18% 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 2019, it had 639,000 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.

Conversely, in the city gas business, Tokai Gas Co., Ltd., had been providing city gas in Yaizu City, Fujieda City, and Shimada City in Shizuoka Prefecture, but in response to the liberalization of gas retail sales in April 2017, the Company has been progressing a sales area expansion strategy through M&A. As the first phase of this, it acquired the city gas business of Shimonita Town, Gunma Prefecture, and started sales in April 2019, while it is also scheduled to acquire the city gas business of Nikaho City, Akita Prefecture, and start sales in April 2020. The number of contracts at the end of September 2019 was 56,000 contracts. Nationwide, there are 203 city gas operators, and of these, apart from the 4 major companies, most are regional, medium- to small-scale operators. Therefore, the Company intends to expand its sales areas through M&A in the future also.

2. Information and communication 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 (mobile phone sales agencies), and a business to provide communication lines and systems development for corporations. Looking at the percentages of total net sales in FY3/20 1H, the consumer business contributed approximately 56% and the corporate business around 44%.

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Business overview

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 of approximately 23% within Shizuoka Prefecture. 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 2019, the Company had 403,000 customers using its existing ISP service and 324,000 customers using its Hikari Collaboration service and customers are shifting toward Hikari Collaboration. The two services have a total of 727,000 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 services, making use of NTT’s wholesale optical line business.

The mobile business operates 12 mobile phone stores (4 exclusive dealership stores and 8 stores selling multiple products), mainly in Shizuoka Prefecture, as a sales agency of Softbank Corp <9434>, and as of the end of September 2019, it had 215,000 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 43,000 at the end of September 2019.

* 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, 2019, the number of customers stood at 794,000 for broadcasting services and 282,000 for communications services, bringing the total to 1,076,000 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. In September 2019, Nissan Tri Star Construction Inc., which mainly conducts a public engineering works business in Gifu Prefecture, was made a consolidated subsidiary, and synergies with it are expected in the future.

5. Aqua business

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. The Company had 159,000 customers at the end of September 2019. The overall industry had 3,950,000 customers as of the end of 2018, 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 2019, 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

In FY3/20 1H, results were new record highs for a fiscal half year, as customer numbers increased and costs were kept down

1. Overview of the FY3/20 1H results

Sales and profits increased in the FY3/20 1H consolidated results, with net sales increasing 4.7% YoY to ¥93,015mn, operating profit rising 58.3% to ¥5,500mn, recurring profit growing 56.6% to ¥5,608mn, and net income attributable to owners of the parent climbing 101.1% to ¥3,492mn. Not only were sales and profits new record highs, net sales and each profit item were also all above the Company forecasts. The strong results were driven by the fact that at the end of FY3/20 1H, the number of continuous-transaction customers had grown by 25,000 on the end of the same period in the previous fiscal year to 2,918,000 customers, mainly in the LP gas and CATV businesses, and monthly revenue increased, and also as customer acquisition and maintenance costs decreased and the corporate information and communication services business performed well.

FY3/20 1H consolidated results

	FY3/19 1H		Forecast	FY3/20 1H			
	Results	% of sales		Results	% of sales	YoY	vs. forecast
Net Sales	88,840	-	92,500	93,015	-	4.7%	0.6%
Cost of sales	53,759	60.5%	-	55,850	60.0%	3.9%	-
SG&A expenses	31,605	35.6%	-	31,664	34.0%	0.2%	-
Operating profit	3,475	3.9%	4,410	5,500	5.9%	58.3%	24.7%
Recurring profit	3,580	4.0%	4,360	5,608	6.0%	56.6%	28.6%
Net income attributable to owners of the parent	1,736	2.0%	2,360	3,492	3.8%	101.1%	48.0%

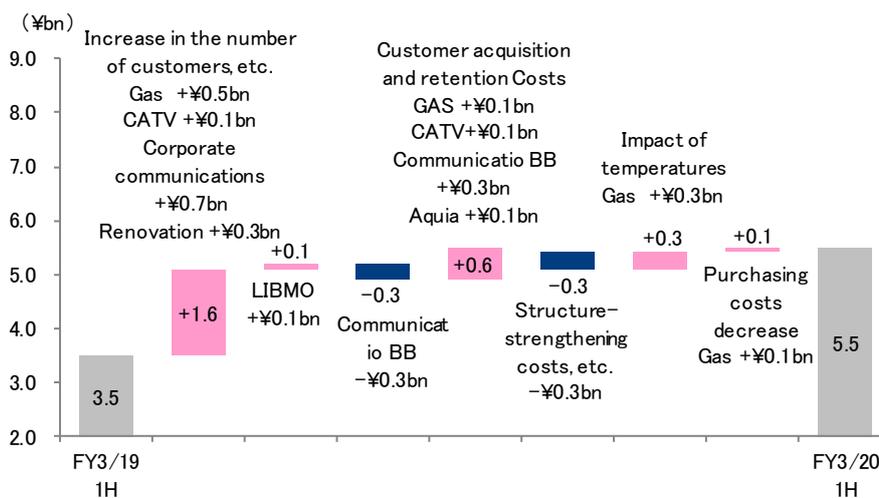
Source: Prepared by FISCO from the Company's financial results

Results trends

Looking at the factors causing operating profit to change, the increase factors were ¥1.6bn from the rise in the number of customers, ¥0.6bn from the decrease in customer acquisition and maintenance costs, and ¥0.3bn from the increase in the gas consumption volume due to the cool summer. These increases absorbed the profit-decrease factors, which were ¥0.3bn due to the decline in the number of broadband communication service customers and ¥0.3bn from an increase in costs, including to strengthen Group structures. Also, looking at the changes in operating profit by business segment, 70% of the increase amount was provided by the increases in the gas and petroleum businesses, of ¥0.8bn, and in the information and communication services business, of ¥0.6bn (of which, ¥0.7bn was from corporate services). However, the point to focus on is that sales and profits increased in the businesses as a whole, including in the CATV business, the building and real estate business, and the Aqua business.

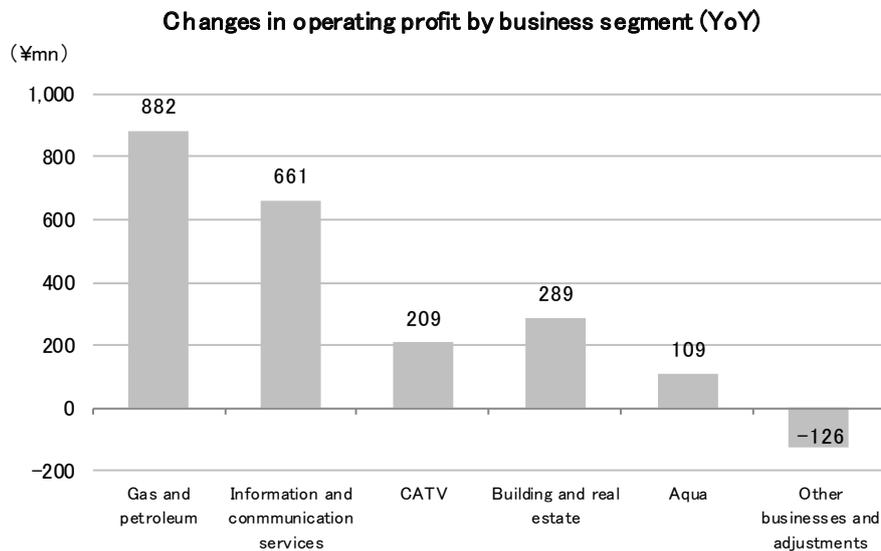
Compared to the Company forecast, operating profit was slightly less than ¥1.1bn above forecast. Breaking this down, the increase factors were ¥0.35bn as the effects of the higher sales in the businesses, including the corporate information and communication services business, the CATV business, and the building and real estate business; ¥0.24bn from the decrease in customer acquisition and maintenance costs, such as in the consumer information and communication services business and LP gas business; ¥0.22bn from the increase in gas consumed per household due to the cool summer; and ¥0.28bn from other factors.

Factors behind changes in operating profit for FY3/20 1H (YoY change)



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

Results trends



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

Results were driven by higher earnings in the LP gas business and the corporate information and communication services business

2. Trends by business segment

Sales by segment

	(¥mn)				
	FY3/17 1H	FY3/18 1H	FY3/19 1H	FY3/20 1H	YoY
Gas and petroleum	32,496	32,777	33,948	35,766	5.4%
Information and communication services	23,750	24,906	25,154	25,911	3.0%
CATV	12,560	13,607	15,135	15,593	3.0%
Building and real estate	8,040	8,349	8,987	9,736	8.3%
Aqua	2,929	3,055	3,490	3,752	7.5%
Other businesses	2,423	2,214	2,123	2,255	6.2%
Total	82,201	84,911	88,840	93,015	4.7%

Operating profit by segment

	(¥mn)				
	FY3/17 1H	FY3/18 1H	FY3/19 1H	FY3/20 1H	YoY
Gas and petroleum	2,838	1,562	1,084	1,966	81.4%
Information and communication services	1,910	1,541	1,608	2,269	41.1%
CATV	1,451	1,769	2,330	2,539	9.0%
Building and real estate	324	388	554	843	52.2%
Aqua	201	135	291	400	37.5%
Other business and adjustments	-2,318	-2,282	-2,393	-2,519	-
Total	4,406	3,114	3,475	5,500	58.3%

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

Results trends

Customer numbers by key services

	End of FY3/17 1H	End of FY3/18 1H	End of FY3/19 1H	End of FY3/20 1H	YoY change
	(thousand)				
Gas	634	648	670	696	26
LP gas	580	594	615	639	24
City gas	54	54	55	56	1
Information and communication services	1,071	1,050	1,028	985	-43
Existing ISP and related services	565	492	440	403	-37
Hikari Collaboration	272	315	328	324	-4
LIBMO	-	13	36	43	7
Mobile	234	231	223	215	-8
CATV	722	995	1,046	1,076	30
Broadcasting services	503	748	781	794	13
Communication services	218	247	265	282	17
Aqua	135	141	156	159	3
Security	17	17	17	16	-1
Total	2,554	2,827	2,893	2,918	25
(Number of TLC members)	535	642	757	852	95
(Percentage of TLC members)	20.9%	22.7%	26.2%	29.2%	3.0pt

* The number of customers below a thousand is rounded to the nearest thousand. Information and communication services and CATV both offer communication services, so total figures avoid duplication.

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

(1) Gas and petroleum business

In the gas and petroleum business, net sales increased 5.4% YoY to ¥35,766mn and operating profit* rose 81.4% to ¥1,966mn. Of which, net sales in the LP gas business grew 3.5% to ¥29,240mn. The main reasons for the higher sales were that customers were acquired in both existing and new areas and the number of contracts increased by 24,000 on the end of the same period in the previous fiscal year to 639,000 contracts. However, there were delays in acquisitions in commercial areas, and this result was 13,000 below the Company forecast. In profits, in addition to the effects of the higher sales, the main factors behind the higher profits included the decrease in customer acquisition and maintenance costs, the increase in gas consumed per household due to the cool summer, and the decrease in purchasing costs. As a new area, the Company entered into Mie Prefecture for the first time in FY3/20 1H.

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

On the other hand, in the city gas business, in April 2019 the Company newly acquired the business of Shimonita Town, Gunma Prefecture, and started sales, so the number of customers increased 1,000 on the end of the same period in the previous fiscal year to 56,000 customers. Other factors included an increase in air conditioning construction projects for schools and a rise in sales unit prices due to the cost adjustment system, so net sales increased 14.8% YoY to ¥6,526mn. It has started sales of the Group's various services for the approximately 1,000 customers in Shimonita Town, and it has acquired approximately 100 contracts in total, including for electricity, water delivery, LIBMO, and ISP. It seems that the Company expects to be able to increase sales by a maximum of 2.5 times per customer by proposing to them multiple Group products, and it will continue to progress sales activities in the future also.

Results trends

(2) Information and communication services business

In the information and communication services business, net sales increased 3.0% YoY to ¥25,911mn and operating profit rose 41.1% to ¥2,269mn. Of which, sales in the consumer business declined 6.1% to ¥14,563mn as the number of contracts is continuing to decrease due to the intensified competition with major mobile carriers. Conversely, decreased profits due to the lower sales have been offset by the reduction in customer-acquisition costs and improvement in the profit-loss condition of LIBMO. Looking at the breakdown of the number of contracts, the Hikari Collaboration was down by 4,000 from the end of the previous fiscal year to 324,000 contracts, existing ISP and related services were down by 37,000 to 403,000 contracts, and mobile (mobile phone sales agencies) were down by 8,000 to 215,000 contracts, and only the inexpensive smartphone LIBMO saw an increase, up 7,000 to 43,000 contracts.

Conversely, in the corporate business, net sales were strong, increasing 17.6% YoY to ¥11,347mn. Against the backdrop of the high growth of the cloud services market, the number of data center communication line contracts grew by double digits, while outsourced system development sales also rose by double digits. Profits increased ¥0.7bn YoY due to the effects of the higher sales and were also ¥0.16bn above forecast.

(3) CATV business

In the CATV business, net sales increased 3.0% YoY to ¥15,593mn and operating profit grew 9.0% to ¥2,539mn. The main reasons for the higher sales were that, in addition to discount services for subscribing to a broadcast and communication set and to a discounted smartphone set through a collaboration with a major mobile carrier, the Company worked to prevent contract cancellations, including by strengthening the creation of programs on community channels based in local communities. As a result, the number of customers steadily increased, up 13,000 on the end of the same period in the previous fiscal year to 794,000 customers for broadcasting services, and up 17,000 to 282,000 for communication services. Operating profit increased approximately ¥0.2bn, but of this amount, slightly less than ¥0.1bn was due to the decreases in depreciation expenses and lease expenses. Compared to the Company forecasts also, both sales and profits were slightly above forecast.

(4) Building and real estate business

In the building and real estate business, net sales increased 8.3% YoY to ¥9,736mn, and operating profit rose 52.2% to ¥843mn. The main reasons for the higher sales and profits were the increases in equipment sales and renovation projects. The results were also slightly above the Company forecasts.

(5) Aqua business

In the Aqua business, net sales increased 7.5% YoY to ¥3,752mn and operating profit grew 37.5% to ¥400mn. The Company worked actively to acquire customers at large-scale commercial facilities, etc., and the Aqua business was up 3,000 from the end of the previous fiscal year to 159,000 customers, showing a steady increase. In profits, the effects of the higher sales and the reduction in manufacturing and distribution costs contributed to increasing profits.

(6) Other business and adjustments

In other businesses, net sales increased 6.2% YoY to ¥2,255mn. Breaking this down, in the nursing care business, they increased 8.0% to ¥574mn alongside the rise in the number of facility users, while in the shipbuilding and repairs business, they grew 15.9% to ¥762mn on the increase in the volume of ship repair work. However, in the wedding ceremony business, sales fell 8.1% to ¥574mn because of the decline in the number of wedding ceremonies. The segment's operating loss, including internal adjustments, was ¥2,519mn (a loss of ¥2,393mn in the same period in the previous fiscal year).

Is enhancing the financial base alongside the revenue growth

3. Financial position

Looking at the financial position at the end of FY3/20 1H, total assets were down ¥1,990mn on the end of the previous fiscal year to ¥165,616mn. This decrease was primarily attributable to a decrease of ¥2,856mn in notes and accounts receivable-trade owing to seasonal factors, offsetting an increase of ¥1,146mn in cash and deposits, stemming from an increase of new consolidated subsidiaries by M&A.

Total liabilities were ¥100,633mn, down ¥3,078mn from the end of the previous fiscal year. The decline was mainly attributable to a decrease of ¥821mn in notes and accounts payable-trade owing to seasonal factors and a decrease of ¥1,784mn in accrued income taxes, offsetting an increase of ¥323mn in interest-bearing debt.

Total net assets rose ¥1,088mn from the end of the previous fiscal year to ¥64,982mn. The increase was mainly due to the recording of net income attributable to owners of the parent of ¥3,492mn. These factors were partly offset by the payment of dividends from surplus of ¥1,839mn.

The equity ratio, which indicates financial soundness, has been steadily increasing in the last few years, rising to 38.4% alongside the earnings growth. Net cash (cash and deposits – interest-bearing debt) has also continued to steadily improve, and in such ways the Company is strengthening its financial base. In the medium-term management plan that it is currently implementing, it sets out a policy of conducting growth investment of ¥100bn, including for M&A. Therefore, depending on the scale of the M&A and other factors, it is possible that the equity ratio may temporarily fall to in a range of 30% to 35%.

Consolidated balance sheets

	(¥mn)				
	FY3/17	FY3/18	FY3/19	FY3/20 1H	Change
Total assets	161,112	165,993	167,606	165,616	-1,990
(Cash and deposits)	3,239	3,143	4,164	5,310	1,146
Total liabilities	104,665	104,543	103,711	100,633	-3,078
(Interest-bearing debt)	54,137	50,980	50,604	50,927	323
Net assets	56,446	61,450	63,894	64,982	1,088
EBITDA	28,392	26,318	28,148	13,116	-
Net cash	-50,898	-47,837	-46,440	-45,617	823
Equity ratio	34.5%	36.3%	37.4%	38.4%	1.1pt

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

■ Outlook

In the FY3/20 results, achieved record highs for the second consecutive fiscal period and profits may be above forecast

1. FY3/20 earnings outlook

For the FY3/20 consolidated results, the Company has maintained its initial forecasts of net sales to increase 4.8% YoY to ¥200,800mn, operating profit to rise 8.5% to ¥14,170mn, recurring profit to climb 5.9% to ¥14,040mn, and net income attributable to owners of the parent to increase 5.9% to ¥8,230mn. From 3Q onwards, it is aiming to increase the number of continuous-transaction customers by 100,000 on the end of the previous fiscal period to 3mn by acquisitions in commercial areas in the LP gas business and by strengthening customer acquisition in the other businesses. However, the progress made for this up to the 1H was a little behind schedule, so achieving it will depend on the progress made for M&A in the near future.

Costs are expected to increase, including rises in customer acquisition and maintenance costs and ABCIR+S-related investment costs, and also in personnel costs to actively recruit human resources, mainly engineers. It seems that this has been incorporated conservatively into the forecasts. Therefore, if temperatures in the winter, which is the peak demand period for the LP gas business, trend as in a typical year, at FISCO we think that results on a profits basis are likely to exceed the Company forecasts. For reference purposes, the rates of progress up to the 1H for the full fiscal year results forecasts were 46.3% for net sales and 38.8% for operating profit, and operating profit in particular is progressing at a pace higher than the average rate of progress for the last three years (45.3% for net sales and 28.9% for operating profit).

Outlook for FY3/20 consolidated performance

	FY3/19		FY3/20			1H progress	Average rates of progress for the past 3 years
	Results	% of sales	Forecast	% of sales	YoY		
Net sales	191,600	-	200,800	-	4.8%	46.3%	45.3%
Operating profit	13,057	6.8%	14,170	7.1%	8.5%	38.8%	28.9%
Recurring profit	13,259	6.9%	14,040	7.0%	5.9%	39.9%	29.8%
Net income attributable to owners of the parent	7,772	4.1%	8,230	4.1%	5.9%	42.4%	26.0%
Net income per share (¥)	59.36		62.85				

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

Outlook

The results forecasts for the main businesses are described below.

(1) Gas and petroleum business

In the gas and petroleum business, sales and profits are expected to increase from the growth in the number of customers and the reduction in purchase costs. In the LP gas business, the number of customers is forecast to increase by 56,000 from the end of the previous fiscal year to 684,000 customers. Breaking down this increase, customers will increase by 32,000 in the existing sales areas and by 23,000 in the new sales areas, and the Company is acquiring customers while making acquisitions in commercial areas in both areas. At the end of 1H, the increases were only 3,000 in the existing areas and 8,000 in the new areas, so it is considered that it will aim to achieve the forecast by accelerating acquisitions in commercial areas in the 2H. In terms of the new sales areas, it began sales in Tsu City, Mie Prefecture, in April 2019, and continuing from this, it plans to enter-into Aisai City, Aichi Prefecture, from 4Q. Also, in Shimonita Town, Gunma Prefecture, where it has started a city gas business, it seems that there are some LP gas users, so it is working to acquire them as customers as well. The number of customers in the new sales areas is forecast to increase to 27,000 at the end of FY3/19, to 50,000 in FY3/20, and to 70,000 in FY3/21. Although the prices of LP gas raw materials may fluctuate in the future, for FY3/21, purchase prices (for households only) have already been reserved at prices below the levels in the previous period, which will be a factor increasing profits.

Meanwhile, in the city gas business, the Aqua business is forecast to increase by 5,000 from the end of the previous fiscal year to 61,000 customers. However, this increase of 5,000 customers will come from operations in Nikaho City, Akita Prefecture, which will start in April 2020 and will contribute to sales from FY3/21. For net sales in FY3/20, in addition to increases in sales unit prices due to the cost adjustment system, around 1,000 customers (about ¥140mn) in Shimonita Town, Gunma Prefecture will be factors increasing profits.

(2) Information and communication services business

In the information and communication services business, the outlook is that sales and profits will increase in a range of 1% to 5%. In the consumer business, the number of customers is forecast to decrease 1,000 on the end of the previous period to 1,003,000 (breaking this down, down 35,000 to 384,000 for existing ISP services, up 18,000 to 345,000 for the Hikari Collaboration, up 21,000 to 62,000 for LIBMO, and down 5,000 to 212,000 for mobile). However, at the end of FY3/20 1H, the number was down 19,000 on the end of the previous period (breaking this down, down 16,000 for existing ISP services, down 3,000 for Hikari Collaboration, up 3,000 for LIBMO, and down 2,000 for mobile). So the number of contracts for the Hikari Collaboration and for LIBMO were less than expected, and therefore, for the full-fiscal year, the single-digit decline in sales is expected to continue. Profits are forecast to be around the same level as in the previous fiscal period through keeping down customer acquisition and maintenance costs. As a measure to support the mobile business, the Company is moving the locations of stores selling multiple products, which it previously developed in suburban areas, to locations expected to attract customers, such as shopping malls. It is also aiming to improve profitability by changing to stores that are able to combine and provide various services, including LIBMO sales and iPhone repair services.

Conversely, for the corporate business, the forecasts are for double-digit increases in sales and profits for the full-fiscal year, mainly due to the increase in data-center demand as it continues to benefit from the growth of the cloud services market, and the rise in systems-development demand.

Outlook

(3) CATV business, Aqua business and Building and real estate business

In the CATV business, the number of customers is forecast to increase by 27,000 from the end of the previous fiscal year to 1,090,000 customers due to the measures for set sales through a collaboration with a mobile carrier. The progress made by the end of FY3/20 1H was basically as planned, rising 13,000 on the end of the previous period, and the outlook for results is for single-digit increases in sales and profits. The plan is for each Group company to invest in converting to fiber optics to respond to 4K/8K broadcasting (up ¥0.3bn YoY to ¥5.8bn). Due to the end of the decrease in depreciation expenses, which was a profit increase-factor up to the previous fiscal period, the profit margin is expected to be at the same level as in the previous fiscal year.

In the Aqua business, the number of customers is forecast to increase by 11,000 from the end of the previous fiscal year to 167,000 customers due to the in-store demonstration sales at large-scale commercial facilities and other locations in major regional cities, etc. At the end of FY3/20 1H, the increase was only 3,000 customers from the end of the previous fiscal year, so the Company's policy from 3Q onwards is to accumulate customer acquisition costs to achieve the forecast. Therefore, the outlook is for sales to increase in the high single-digit range YoY due to the rise in the number of customers, but for profits to stay at around the same level as in the previous fiscal year.

In the building and real estate business, an additional contribution is expected from Nissan Tri Star Construction, which was newly made a subsidiary in September 2019. Nissan Tri Star Construction's FY2/19 results were net sales of ¥2,046mn and operating profit of ¥197mn, so it is expected to contribute around half of these amounts.

Intends to accelerate earnings growth through progressing M&A and the ABCIR+S strategy

2. Outline of the medium-term management plan

In the 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. Up to March 2021, the Company actively progressed M&A and alliances, which will lead to the expansion of its customer base. Also, amid the progression toward a digital society, it is accelerating growth through advancing the ABCIR+S strategy, with the aim of realizing its management vision of the TLC concept.

The Company's numerical management targets for FY3/21 are consolidated net sales of ¥339.3bn, operating profit of ¥22.5bn, and net income attributable to owners of the parent of ¥11.5bn. It is aiming to achieve these targets by increasing earnings per customer through raising the contract rate for multiple services from 17.8% at the end of the previous period to 20%, and in addition, by increasing the number of continuous-transaction customers to more than 4.32mm through actively progressing M&A. When it initially formulated the plan, it aimed to increase the number of customers by implementing M&A with a total value of ¥100bn over the 4 years. But it is taking some time to conclude large-scale projects, so it is possible that the numerical targets for FY3/21 will be carried forward. Nevertheless, at the present time it continues to actively conduct M&A and is progressing negotiations for 41 projects with a total deal value of ¥116.8bn, and it seems there will be no change to the upward trend in earnings. In terms of M&A, it targets companies with customer bases in its core businesses, such as gas, CATV, and information and communication services, while it also targets fields peripheral to lifestyle-related services and new business fields.

Outlook

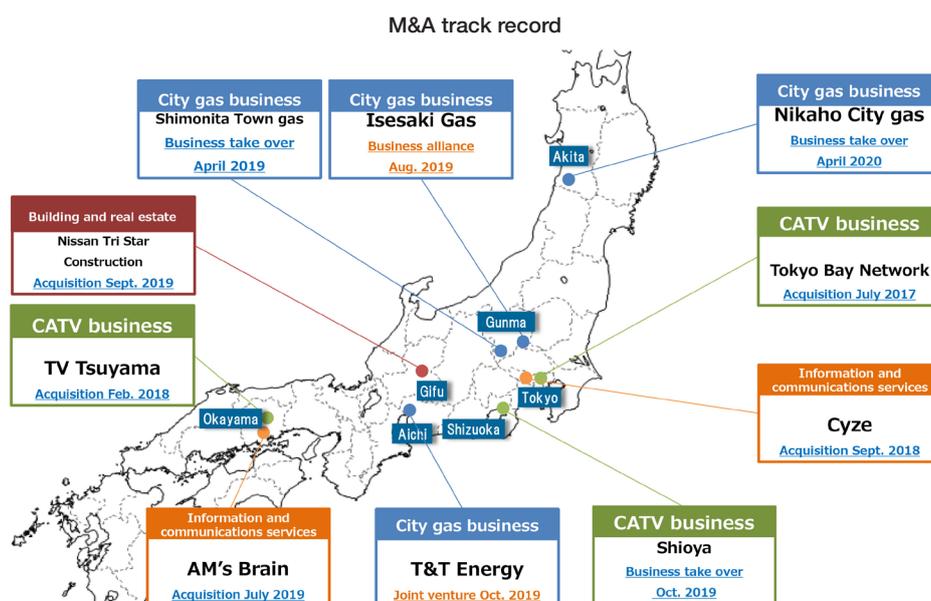
Results for FY3/19 and forecasts for FY3/20

	FY3/18 Results	FY3/19 Results	FY3/20 Plan	FY3/21 Targets
Net sales (¥bn)	1,861	1,916	2,008	3,393
Operating profit (¥bn)	110	131	142	225
Net income attributable to owners of the parent (¥bn)	66	78	82	115
Total assets (¥bn)	1,660	1,676	-	2,834
Interest-bearing debt/EBITDA rate (times)	1.9	1.8	-	2.6
Equity ratio (%)	36.3	37.4	-	31.6
ROE (%)	11.4	12.6	-	13.0
Number of customers (thousand)	287	290	300	432 or more

Source: Prepared by FISCO from the Company's materials

3. M&A track record

As the track record of its M&A strategy since 2017, the Company has completed 10 projects and their contributions to the FY3/20 results are expected to be net sales of ¥5.8bn and operating profit of ¥0.3bn (¥0.19bn after the amortization of goodwill). Of these, 4 M&A projects were completed in FY3/20: it took over the city gas business of Nikaho City, Akita Prefecture, in May 2019 (it will succeed the business from April 2020); it took over the CATV business managed by Shioya Limited, whose service covers certain areas of eastern Shizuoka Prefecture, in April of the same year (it started providing services in October 2019); it made a subsidiary of AM's Brain Inc., which conducts contracted development of software and system operation and maintenance business, in July of the same year; and it made a subsidiary of Nissan Tri Star Construction Inc., a comprehensive construction company, in September of the same year. Other than these, as alliance projects, in April of the same year it concluded a capital and business alliance agreement (investment stake, 20.7%) with Iseaki Gas Co., Ltd., a city gas operator that provides gas to Iseaki City, Gunma Prefecture, while in October of the same year, it established T&T Energy Co., Ltd., jointly with TEPCO EP (investment ratio, 50.0%). as a joint venture to conduct a city gas retail business in the Tokai area. The main points of each project are described below.



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

Outlook

(1) City gas business of Nikaho City

The city gas business of Nikaho City has approximately 5,000 customers and its most recent net sales were on a scale of ¥417mn, and it will contribute to results from FY3/21. This will be the first time that the Group has provided services in Akita Prefecture, and it plans to provide not only city gas, but also the other lifestyle-related services provided by the Group companies (including electricity, information and communication services, and water delivery). The movement toward privatizing publicly managed city gas services has been growing, and in the future also, the Company intends to actively participate in tenders and to expand its business area.

(2) CATV business of Shioya

The CATV business of Shioya has 3,000 contracts, while of these, the number of fee-paying contracts is unknown. But going forward, it will start providing communication services by progressing the conversion to fiber optics, while it will also work to increase net sales per customer by progressing the provision of 4K/8K high-definition broadcasting services, multi-channel services such as local community channels, and other lifestyle-related services

(3) Made a subsidiary of AM's Brain

AM's Brain has its head office in Okayama Prefecture, and it is engaged in contracted software development, mainly for a major correspondence education group company. The purposes of making it a subsidiary were to strengthen the development structure in the West Japan region to respond to the strong demand for systems development, and also to create synergies by combining mutual strengths and to further strengthen and expand the Group's information and communication business.

(4) Made a subsidiary of Nissan Tri Star Construction

Nissan Tri Star Construction is a comprehensive construction company in Gifu Prefecture that mainly conducts public civil engineering construction projects, and it employs around 100 qualified personnel. The purposes of making it a subsidiary were to utilize the technologies and expertise possessed by Nissan Tri Star Construction and to expand into new business areas of Shizuoka Prefecture and the Kanto region, as well as into the Chukyo region, as a comprehensive construction business. Synergies with the LP gas business are also expected.

(5) Capital and business alliance with Iseaki Gas

Iseaki City, the business area of Iseaki Gas, is attracting attention as a region in which the population continues to increase, since it has many industrial and logistics zones with excellent transportation access. The content of this business alliance includes not only cooperation in the fields of the city gas business and the LP gas business but also promotion of the mutual use of services. In particular, in the LP gas business, the Company has two or three sales areas around Iseaki City, while a subsidiary of Iseaki Gas also conducts an LP gas business, so synergies are expected from their cooperation. Further, the Company will have the opportunity to sell its lifestyle-related services other than gas through Iseaki Gas to its (approximately 11,000) customers, which is expected to increase sales in the future.

(6) Establishment of T&T Energy

Leveraging TEPCO EP's strength of "expertise in the city gas business, starting with its ability to procure gas" and the Company's strength of "a sales network in the Tokai area," the joint venture T&T Energy is conducting a city gas retail business (for households) in the Tokai area. It is aiming to acquire 10,000 contracts by March 2021 and going forward, it also intends to look into providing electricity, information and communication, and other lifestyle-related services, such as water delivery, and to expand its business area to areas other than the three Tokai prefectures (Aichi, Gifu and Mei). With 2.32 million potential customers as the targets of the city gas retail business (the number of contracts of Toho Gas <9533>), it is a regional LP gas operator in terms of actually carrying out sales activities. These measures are expected to contribute to an increase in the number of customers in the Group as a whole in the future.

Outlook

Achievements of the M&A conducted in the past

Company name	Main achievements
Tokyo Bay Network (CATV business) Acquired in July 2017	Business development utilizing local characteristics (development of local BWA services) <ul style="list-style-type: none"> • Provides the infrastructure for free Wi-Fi services in wide urban areas • Provides Internet services for multiple-dwelling housing for which it is difficult to install fiber to the home (FTTH) • The number of contracts has increased by 15,000 since it was made a subsidiary. Net sales have also grown from ¥2,838mn in FY3/17 → ¥3,089mn in FY3/19.
TV Tsuyama (CATV business) Acquired in February 2018	Contributes to realizing an advanced information and communication society in local areas <ul style="list-style-type: none"> • Invests in the conversion to fiber optics (FTTH), which it uses to provide new services (Hikari de TV, Hikari de Net, and Hikari de Talk)
Cyze (Information and communications services) Acquired in September 2018	Utilizes the mutual customer bases and business expertise to create synergies <ul style="list-style-type: none"> • Is expanding the business area through actively conducting personnel exchanges
Shimonita Town gas business (City gas business) Transferred in April 2019	Established as a model case of an initiative for public-gas privatization <ul style="list-style-type: none"> · Is newly acquiring large customers by strengthening sales · Promotes TLC by utilizing the characteristics of the city gas business

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

4. ABCIR+S strategy

With ABCIR+S as a new theme, at the end of October 2019 the Company announced that it had built the important platform DMP (D-sapiens) to expand the customer base and strengthen competitiveness, and to develop new services. In the future, D-sapiens will centrally manage the 2.92 million items of Group-customer information that are accumulated daily as a marketing database, and it will use AI technologies to analyze these data (discovery of customer information → predictions of customer behavior → making visible potential customers), which will lead to the acquisition of contracts through proposing to customers the optimal services on the optimal timing. It will also be used to progress measures to prevent contract cancellations. As it is necessary to accumulate data, its effects are not expected to appear until FY3/21 at the earliest. But the operation of D-sapiens can be expected to improve the efficiency of marketing costs, increase the number of customers, and raise the customer contract rate for multiple services, which in turn can be expected to further improve profitability.

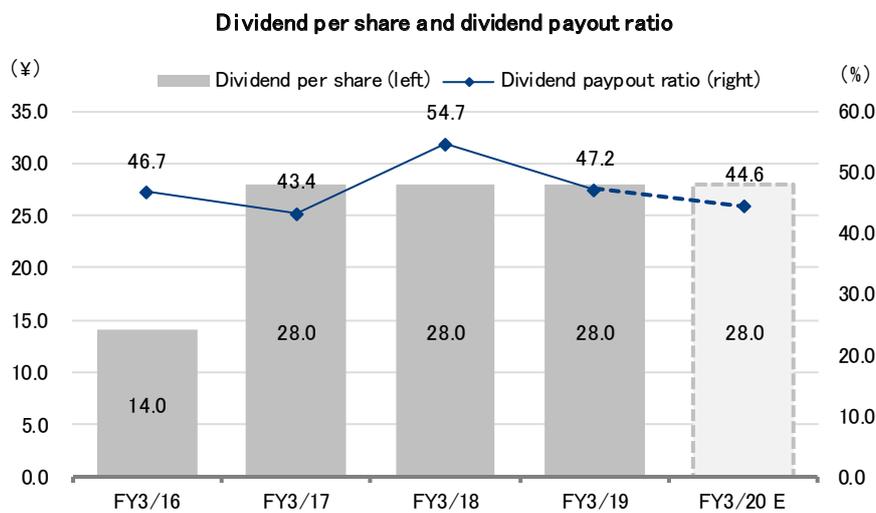
Shareholder return policy

Annual return on investment of 3% to 6% from the gifts to shareholders and dividends

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 FY3/20 dividend per share will be unchanged YoY at ¥28.0 (for a dividend payout ratio of 44.6%).

Shareholder return policy

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” (natural water from Mt. Fuji), etc.), a QUO card worth ¥500, meal coupons worth ¥1,000, ¥1,000 worth of TLC Membership Service points, or a ¥2,100 discount on LIBMO usage fees (¥350 a month x 6 months) 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. 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 ¥1,082 on November 21, 2019), it is in the range of 3.5% to 6.3% (depending on the selection of either a QUO card or an Aqua product as the gift).



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

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 also 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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