# Innovation Plan 2020 “JUMP”

## ～Aiming for further progress through FY03/21～

May 9, 2017

TOKAI Holdings Corporation (Code: 3167)

Katsuhiko Tokita, President & CEO

# Ⅰ. Overview of Past Six Years Since Changing to Holding Company Structure

# FY03/17 results summary

- Sharp 4.5 billion yen (54.6%) operating profit growth from 8.2 billion yen in FY03/16, with all profit indicators posting historic highs. Results surpassed upward revision announced in October 2016. Net increase of customer numbers continued.
- Further progress with financial position improvement: interest-bearing debt reduced to 54.1 billion yen and capital ratio up to 34.5%
- Annual dividend increases two fiscal years in a row, doubling in FY03/17 (including 6 yen commemorative dividend for attaining medium-term plan target)

| | FY03/16 | Forecast | Result |
|---|---|---|---|
| Operating profit | 8,245 million yen | 12,750 million yen | 12,750 million yen |
| Net income | 3,458 million yen | 6,500 million yen | 7,337 million yen |
| Customer numbers | 2,558 ,000 | — ,000 | 2,564 ,000 |
| Interest-bearing debt | 71.4 billion yen | — billion yen | 54.1 billion yen |
| Equity ratio | 25.6 % | — % | 34.5 % |
| Annual dividend | 14 yen/share | 28 yen/share | 28 yen/share |



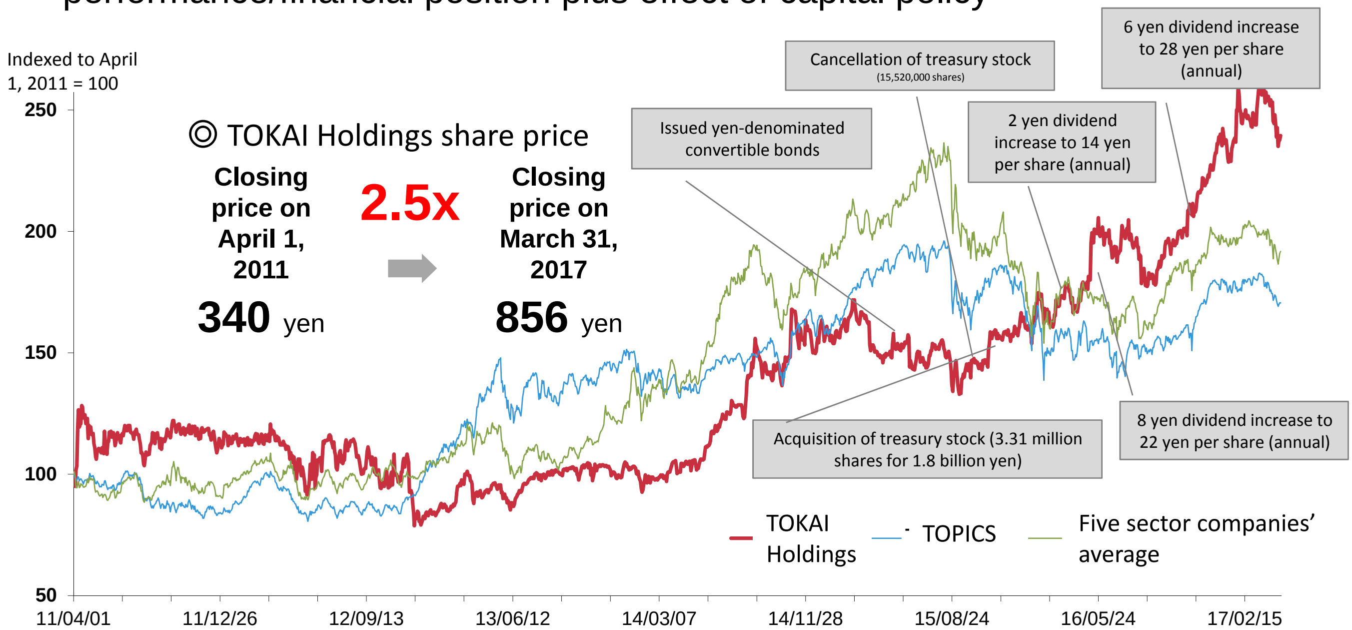
# Results of IP13 and IP16 challenges

- Transitioned from managing individual companies to group management as holding company
- Substantial gains from financial position improvement in first medium-term plan IP13 and strengthened earnings capability in second plan IP16 “Growing”
- Sales up in real terms to 193.3 billion yen on increased retail customers, but offset by 11.4 billion yen negative effect of lower gas procurement prices

| | | | |
|---|---|---|---|
| Interest-bearing debt | 124.0 billion yen<br>At end-March 2011 | ➡ | 54.1 billion yen<br>At end-March 2017 |
| Equity ratio | 7.7 %<br>At end-March 2011 | ➡ | 34.5 %<br>At end-March 2017 |
| EPS | 27.17 yen<br>At end-March 2012 | ➡ | 64.46 yen<br>At end-March 2017 |
| Market capitalization (includes treasury stock) | 52.7 billion yen<br>April 1, 2011 | ➡ | 119.0 billion yen<br>March 31, 2017 |
| Consolidated sales | 181.9 billion yen<br>At end-March 2012 | ➡ | 178.6 billion yen<br>At end-March 2017 |

# Share price far outperformed TOPIX

- Shares far outperformed TOPIX (benchmark) thanks to improved earnings performance/financial position plus effect of capital policy

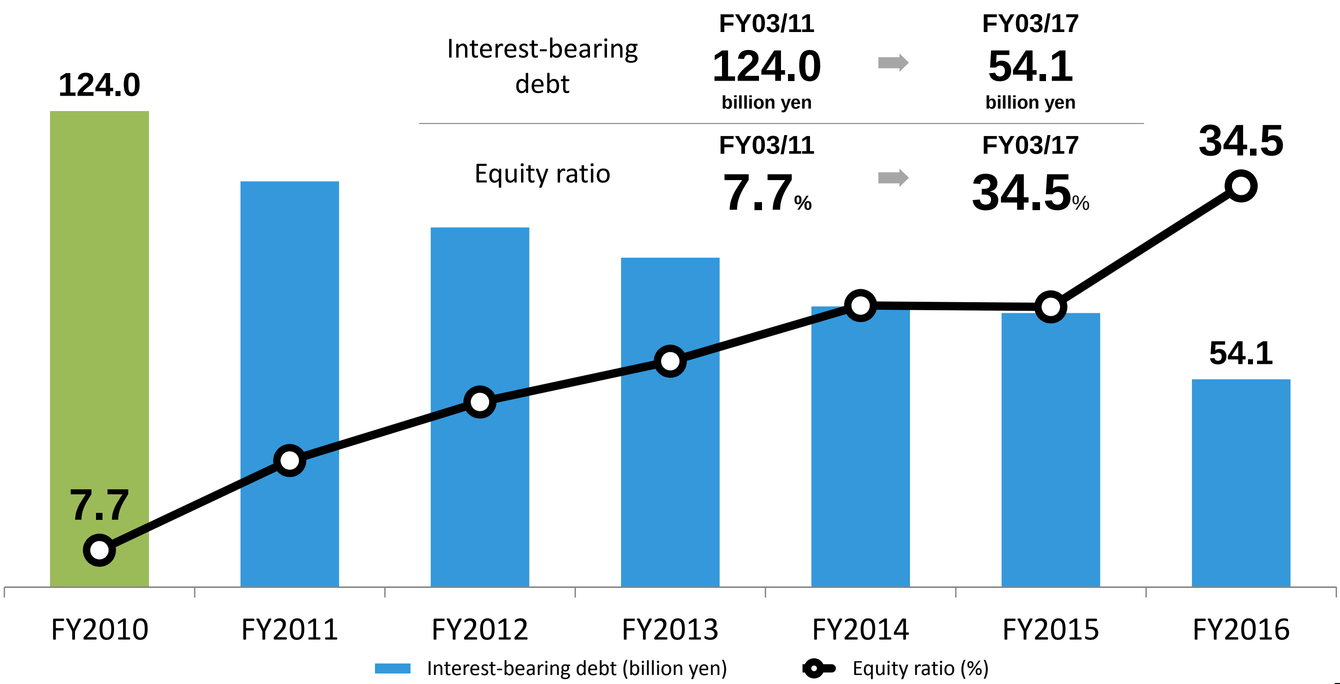



| Innovation Plan 2013 | Innovation Plan 2016 "Growing" |
|---|---|



# Achieved average financial soundness performance among listed companies in six years

- Big improvement from critical levels of interest-bearing debt thanks to strict cash flow management; groundwork laid for strategy of investment for growth



# Ⅱ. Four Key Messages of **IP20 “JUMP”**



# 1. From Defensive to Proactive Management

- Switch from defensive to proactive management stance, making topline growth the main priority
- Invest 100 billion yen cash over four fiscal years on strategic M&A and alliances
- Implement growth strategies that make the most of M&A and alliances using leveraged investments

# 2. Progress M&A

- As top priority, expand earnings base (customer numbers) of core Gas, CATV, and Information and Communications businesses through M&A
- Acquire monthly-fee-based, daily life-related services that harness the strengths of the group business model to increase cross-selling



# 3. Prioritize profit growth and ROE

- Double sales and roughly double operating profit and net income versus FY03/17 over four years
- Maintain high level of **ROE** at 13%

# 4. Shareholders are always a priority

- Maintain shareholder returns policy of sharing business returns in the form of stable, consistent dividends to reward shareholders
- Shareholder returns plan: 28 yen per share ordinary dividend in FY03/18 (first year of IP20), same as FY03/17 (28 yen including 6 yen commemorative dividend)
- Dividend increase a possibility in FY03/19 onward in view of outlook for consolidated net income growth



# Ⅲ. Numerical targets of IP20 “JUMP”

# Numerical targets include doubling sales in FY03/21 versus FY03/17

- Target sales of 274.3 billion yen and operating profit of 18.5 billion yen for established businesses, plus M&A to attain FY03/21 sales of 339.3 billion yen and operating profit of 22.5 billion yen (up 90% and 80%, respectively, versus FY03/17). Target 70% increase in customer count to 4.32 million over the same period.
- Target interest-bearing debt/EBITDA ratio of 2.8x, equity ratio of 31.6%, and ROE of 13% by management focused on capital efficiency.

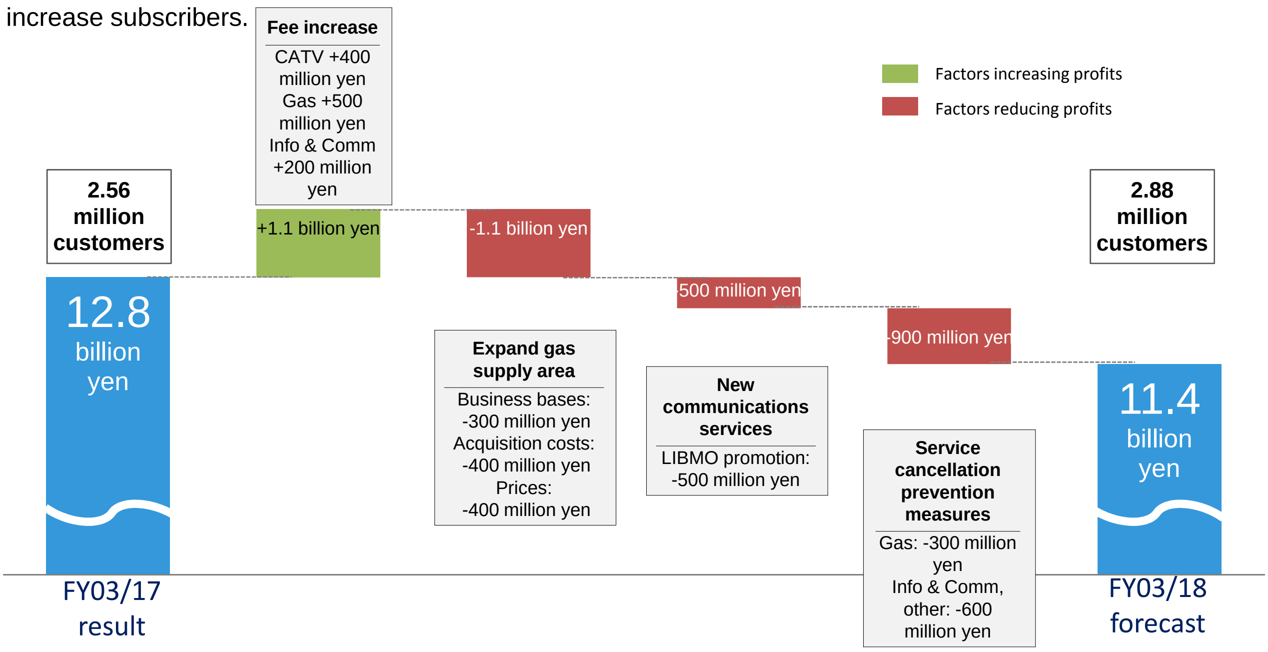
| (Billions of yen) | FY03/17 | FY03/18 | FY03/19 | FY03/20 | FY03/21 |
|---|---|---|---|---|---|
| | Result | Target | Target | Target | Target |
| Sales | 178.6 | 189.4 | 202.0 | 224.4 | (+90%) 393.3 |
| Operating profit | 12.8 | 11.4 | 14.0 | 16.2 | (+80%) 22.5 |
| Net income | 7.3 | 6.4 | 7.9 | 8.7 | (+60%) 11.5 |
| Total assets | 161.1 | 169.8 | 173.8 | 191.2 | (+80%) 283.5 |
| Interest-bearing debt/EBITDA ratio | 2.0x | 2.4x | 2.2x | 2.0x | 2.8x |
| Equity ratio | 34.5% | 33.9% | 35.6% | 34.9% | 31.6% |
| ROE | 15.2% | 11.1% | 12.8% | 13.0% | 13.0% |
| Customer numbers (millions) | 2.56 | 2.88 | 2.99 | 3.72 | (+70%) 4.32 |

Note: () denotes increase versus FY03/17



# Begin aggressive investment to attain 18.5 billion yen target in FY03/18

- Operating profit of established businesses must grow to 18.5 billion to attain the FY03/21 operating profit target of 22.5 billion yen. This requires additional investment in future growth.
- To this end, the Company shall invest 2.5 billion yen for further expansion of the gas business supply area, introduction of new communications services, and implementing service cancellation prevention measures to increase subscribers.



# Allocate 100 billion yen to M&A

- To allocate 100 billion yen to investing in M&A and alliances to capture external growth
- Target ROI (operating profit basis) of around 8% as a measure of investment that prioritizes capital efficiency

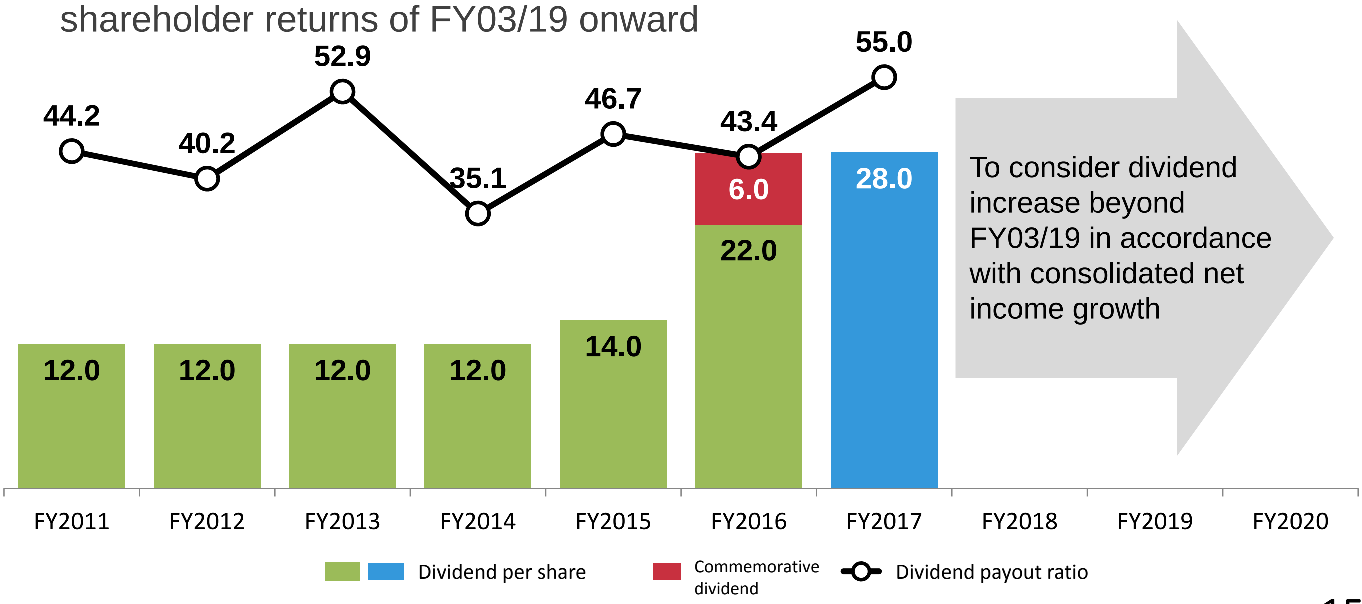
| | Total M&A budget |
|---|---|
| Investment | 100.0 Billion yen |
| Sales | 116.9 Billion yen |
| Operating profit before goodwill amortization | 8.4 Billion yen |
| ROI (operating profit basis) | 8.4 % |
| Goodwill amortization | 4.0 Billion yen |

Note: Investment is four-year total; earnings figures are FY03/21 assumptions



# Maintain annual dividend of 28 yen per share in FY03/18

- Reward shareholders by providing stable and consistent returns
- Ordinary dividend of 28 yen per share planned for FY03/18, same as FY03/17 total, which includes 6 yen commemorative dividend
- To consider dividend increase according to consolidated net income growth in shareholder returns of FY03/19 onward



# Ⅳ. Main strategies of IP20 “JUMP”



# Pillars of M&A strategy

**Allocate 100 billion investment budget over four years**

**Purpose: To strengthen core businesses and acquire new services**

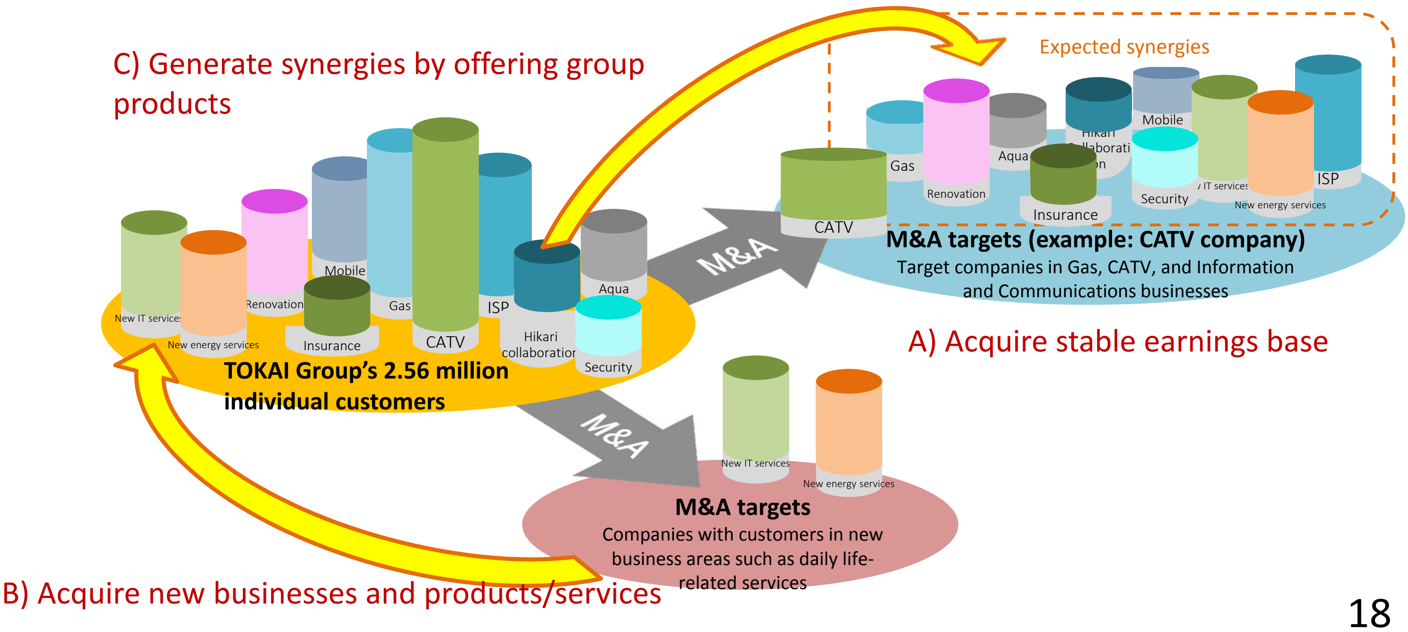
Invest in new services in addition to Gas, CATV, and Information and Communications services

**Establish section specializing in M&A**

Establish section dedicated to screening and executing investments and progressing business integration after acquisition. Responsibilities include collaborating with M&A specialists to gather information and searching for future M&A targets by strengthening ties with venture capital firms and buyout funds

# Expand customer base and services by M&A

- Aim to raise consolidated performance by M&A of companies with earnings base in addition to growth of TOKAI Group's established businesses (A)
- Plus, acquire monthly-fee-based, daily life-related services that harness the strengths of the group business model (B) to generate synergies from cross-selling (C)






# Generating synergies by acquiring earnings base

- Acquisition of CATV operator with sales of 1.5 billion yen and 50,000 customers enables sales of group's diverse daily life-related products and services to these new customers
- Based on the Company's track record, this would create synergies of around 300 million yen in sales and 60 million yen in operating profit just from the following three businesses:

Communications service sales

Ten percent of customers switch from CATV to TOKAI Group's FTTH

Annual sales **50** million yen | Operating profit **25** million yen

- Assume roughly 10% of CATV-FTTH customers switch to TOKAI Group's FTTH service (switch from CATVNET), adding 1,000 yen to monthly sales per customer (10% profit margin)
- CATV-FTTH has 30% market share in the Company's FTTH service area

Aqua service sales

Aqua service sold to three percent of customers

Annual sales **67** million yen | Operating profit **10** million yen

- Assume cross-selling potential of 3% of customers (50% of 6% diffusion rate), adding 3,800 yen to monthly sales per customer (15% profit margin)
- The Company's market share in the city gas service area is 6%.

Renovation service sales

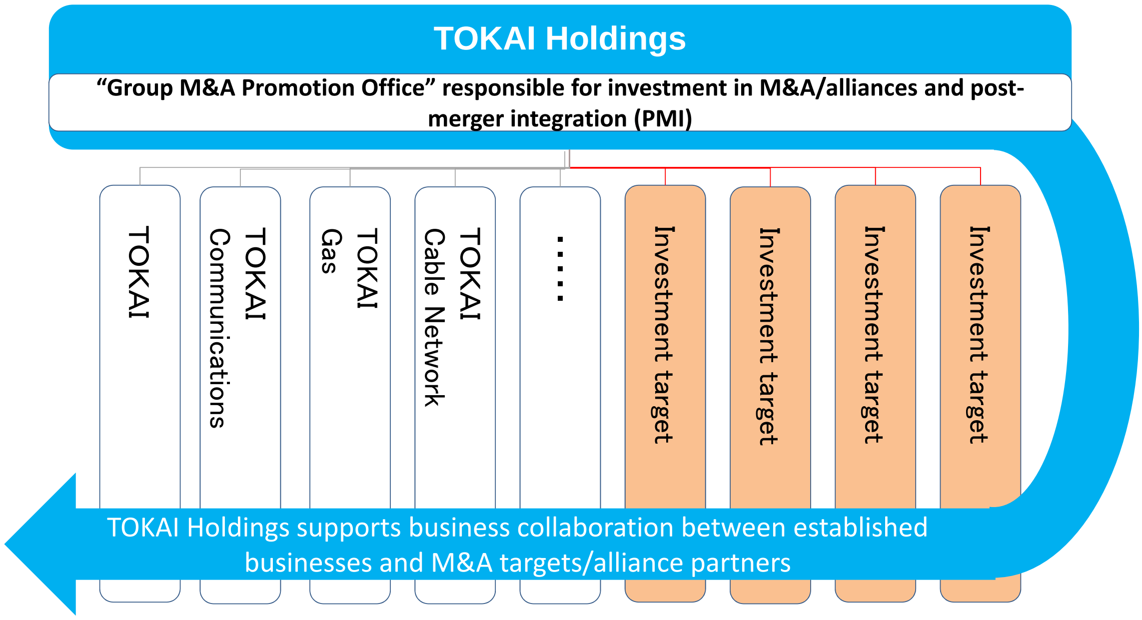
Renovation service sold to 10% of market share

Annual sales **150** million yen | Operating profit **25** million yen

- Assume the Company captures 10% renovation demand at average sales per customer of 30,000 yen
- The Company has sold renovation services to 12% of customers in its city gas service area (average sales per customer: 30,000 yen; profit margin: 17%)

# Establish section dedicated to M&A

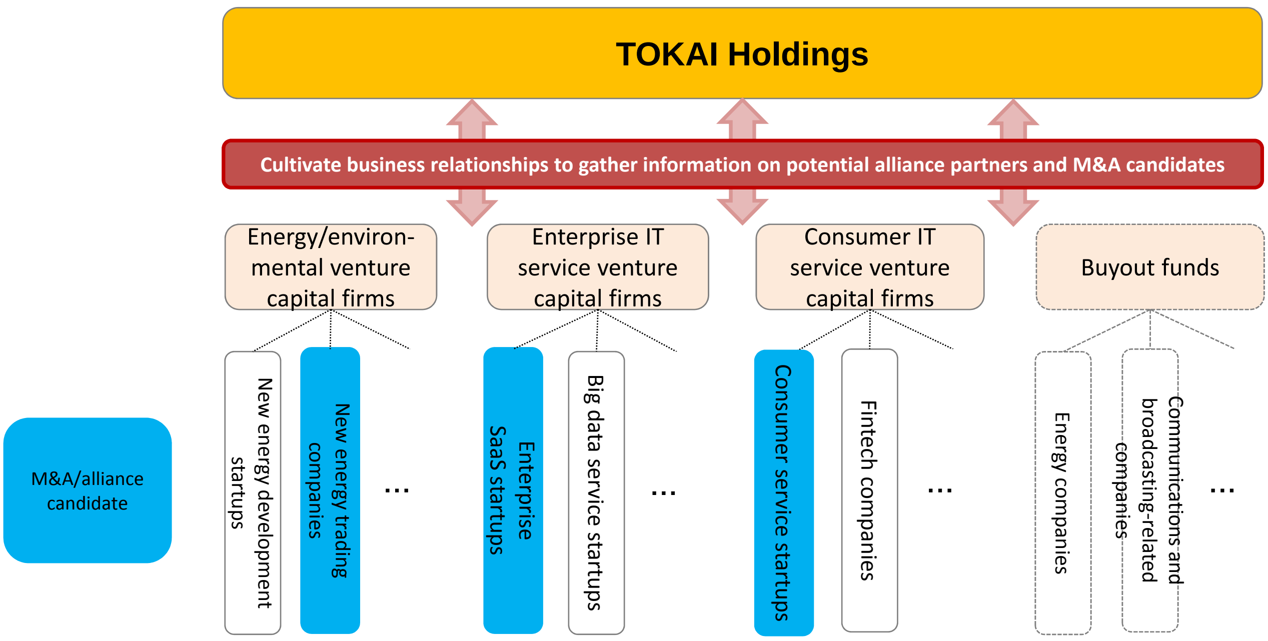
- Establish department dedicated to M&A and alliances in TOKAI Holdings
- The new department will play a leading role in screening investments, executing acquisitions/investments, and progressing subsequent business integration






# Discover promising investment targets

- Work closely with well-established venture capital firms and buyout funds to build networks for gathering information on "seeds of growth" and discovering potential M&A targets



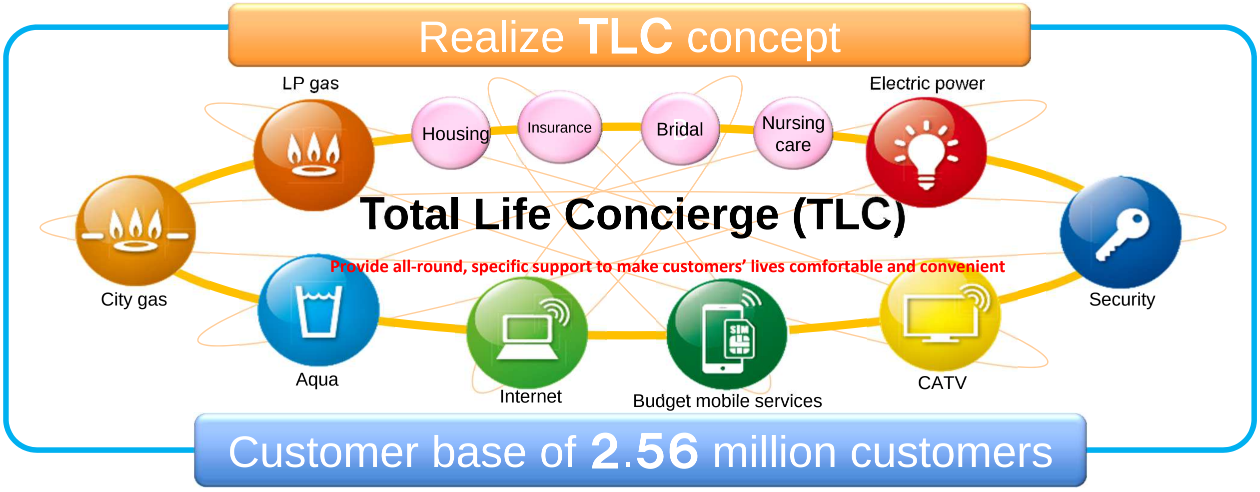
# Raise cross-selling rate to 20% by FY03/21

**Progress group-wide effort to complete the TLC (Total Life Concierge) concept, i.e., providing a one-stop, one-contract, one-call-center structure for various services that support customers' daily lives**

◆Engage in more cross-selling to customer base of 2.56 million customers to raise the cross-selling rate to 20% by FY03/21 and expand operating profit base by 1.7 billion yen by measures to prevent service cancellation and increase ARPU per customer

◆Support group sales capability by upgrading infrastructure for cross-selling, e.g., utilizing customer information and improving customer service by shift to omni-channel/single call center structure and integrated billing system

◆Increase presence of TLC concept by offering TLC loyalty points that offer bigger savings on more transactions and strengthen measures that offer various advantages to being a customer of the TOKAI Group






# 1) LP gas business

LP gas business is mature and the household/commercial markets are shrinking
(by an estimated 7.1% in next four years)
Household unit consumption is trending down
(by around 2% per year amid population decline and shift toward energy-saving equipment and lifestyles)

(Source: Materials from METI Working Group on oil market trends research, April 3, 2017)

**<Position in industry>**
**LP gas company with third-largest customer base in Japan**

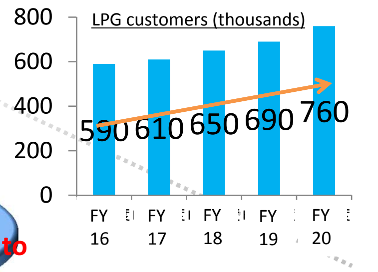
- Top market share in Shizuoka Prefecture (22.5%) with 180,000 customers
- Established market share (8.1%) in Kanto region with 410,000 customers

(Source: *LP Gas Annual Report* 2017, Sekiyu Kagaku Shinbun Sha)

**Increase customers by 30% to 760,000 to expand market share**
**Ninefold increase in customers in new areas**

**<Main medium-term goals>**

- Increase customers numbers by 30% (including new areas) to 760,000 over four years
- Target increase in customers in new areas from 8,000 in FY16 to 70,000 in FY20




**Move into new supply areas**
**(add five new business bases for a total of 10)**
**Actively engage in M&A in new and established areas to stabilize customer base further**

Expand supply area (mainly in areas where other group businesses are established) to attract new customers

# 2) City gas business

**Gas system reforms: Liberalization of gas retailing starts**
**Competition initially centered in major cities where major EPCOs will enter the market**
**Like LP gas, household unit consumption is turning down**

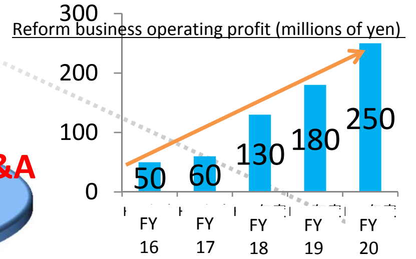
**<Overview of supply area>**

- Yaizu and Fujieda, Shizuoka Prefecture
  - ・Number of users: 54,000
  - ・Sales volume: 140 million m3
  - (Large-lot users: 120 million m3; small-lot users: 20 million m3)

Most advanced in terms of TLC strategy; working toward further progress.
Target fivefold growth of renovation business in four years

**<Main medium-term goals>**

- Strengthen price competitiveness by streamlining, etc., to secure profits. Target 230 million yen profit growth in gas business, including M&A effects
- Reform business boasts top-class sales per customer of 30,000 yen. Target fivefold operating profit increase in four years from 50 million yen to 250 million yen




**Aggressively pursue area expansion by M&A and alliances with industry peers**

Expand supply area by M&A and target synergies through alliances with industry peers. Invest in gas pipeline extensions to attract new industrial demand.



# 3) Broadband business

**Growth of broadband market to slow, but continue modest uptrend (+2.3% per year from current 29.19 million households)** (Source: MM Research Institute forecast as of December 31, 2016)
**Outlook for strong growth of MVNO market on easing of SIM unlock (from 8.8 million to 19.5 million contracts in four years)** (Source: Seed Planning forecast as of December 2016)

- New players including mobile carriers enter broadband market on start of NTT's wholesale sales of fiber-optic networks
- Major mobile carriers under pressure to compete with fast-growing MVNO companies

**<Position in industry>**
**ISP company ranking fourth in Japan in terms of sales**

(Source: Article in *Nikkei Marketing Journal*, November 5, 2014)

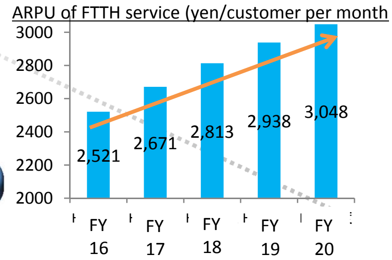
- Top market share (23.1%) in Shizuoka Prefecture with 240,000 customers
- Kanto area market share of 4.1% with 500,000 customers

(Source: MIC Information and Communications Statistics Database as of December 31, 2016)

Promote Hikari Collaboration
Increase ARPU/AMPU by providing own MVNO service and packages with new services

**<Main medium-term goals>**

- Target 85.1% of FTTH customers switching to Hikari Collaboration by end-FY20. This should raise ARPU per customer to 3,048 yen per month (+20.9% from end-FY16)
- Further increase sales by adding 140,000 MVNO（LIBMO）customers by end-FY20




**Add more services with value added**
**Improve own-brand services**

Increase ARPU by encouraging long-term broadband use in packages with LIBMO and TOKAI SAFE (security service) and developing new, own-brand IT-related services such as IT insurance

# 4） CATV business

**Demand for 4K broadcasts likely to grow by 2020 with government policy support.**
**CATV has dominant share of pay TV market (subscriber households), far exceeding satellite and IPTV**

●CATV companies at advantage in terms of viewing 4K broadcasts, which will likely spread in the next few years

●Differentiating service from major telecommunication companies remains a challenge

**<Position in industry>**
**Third-largest urban CATV sales in Japan**

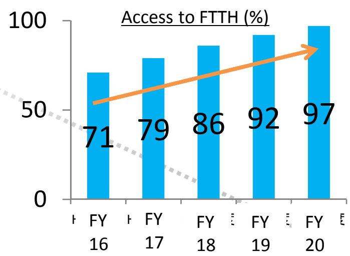
(Source: Article in *Nikkei Marketing Journal*, November 9, 2016

- Group broadcasting customers: 510,000 (48% of home path)
- Group communications customers: 230,000

Deploy services that maximize own fiber-optic network for net increase of 90,000 broadcasting and communications customers

**<Main medium-term goals>**

- Target close to 100% access to FTTH in service area (versus 25.7% in FY16)
- Target net increases of broadcasting and communications customers of 30,000 and 60,000, respectively, in four years




**Expand broadcasting customer base by grasping ideal opportunity of growing demand for 4K broadcasts**

Expand customer base by launching competitively priced services that combine 4K broadcast with internet. Improve convenience by broadcasting disaster-prevention and other local information in partnership with government. Also work with municipalities to supply FTTH to areas without high-speed broadband infrastructure and build infrastructure for regional BWA, etc.





Please contact us with any questions regarding these materials.

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うれしいをつなぐ。ひろげる。

TOKAI GROUP