Operating Results

Overview

In the year ended March 31, 2006, the parent company and its consolidated subsidiaries (collectively, "the Company") took a variety of steps aimed at enhancing their operations—which center on security services and also include medical, insurance, geographic information, information and communication related services, real estate development and sales, and real estate leasing—by improving services and expanding marketing and product development. Firm gains in revenue in all segments supported an increase in net sales and operating revenue of 5.1%, or ¥28.2 billion, to ¥580.5 billion. Operating income rose 8.4%, or ¥6.3 billion, to ¥81.9 billion, reflecting higher net sales and operating revenue and a decline in impairment loss on long-lived assets. Income from continuing operations totaled ¥51.2 billion, up 22.6%, or ¥9.4 billion, owing to such factors as improved operating income and a gain on the sale of the Company's stake in a cable television affiliate accounted for under the equity method. Despite an increase in income from continuing operations, net income declined 3.5%, or ¥1.8 billion, to ¥50.3 billion, owing to the absence of ¥9.9 billion in income from discontinued operations, net of tax, recorded in the previous period generated by the sale of the Company's education services business and certain real estate properties for lease.

During the period, the Company decided to disclose the geographic information services, which was previously included in the information and communication related and other services segment, separately from the segment due to an increase in importance of its business. Accordingly, segment information of all prior periods has been restated to conform to the presentation used for the year ended March 31, 2006.

Net Sales and Operating Revenue

Net sales and operating revenue amounted to ¥580.5 billion, an increase of 5.1%, or ¥28.2 billion. Net sales and operating revenue rose in all segments. (For more details, please see Segment Information below.)

Costs and Expenses

Costs and expenses were up 4.6%, or ¥21.8 billion, to ¥498.6 billion. Cost of sales rose 4.5%, or ¥15.7 billion, to ¥364.9 billion, equivalent to 62.9% of net sales and operating revenue, down from 63.2% in the previous period. The lower cost-of-sales ratio was primarily attributable to a decline in cost-of-sales ratio of the insurance services segment. This was mainly caused by an increase in gains on the sales of investment securities, included in net sales and operating revenue, in the segment.

Selling, general and administrative expenses rose 6.7%, or ¥8.0 billion, to ¥128.2 billion, equivalent to 22.1% of net sales and operating revenue, up from 21.8% a year earlier. This increase was largely due to an increase in the provision for the allowance for doubtful accounts in the medical services segment.

Impairment loss on long-lived assets shrank ¥3.7 billion, to ¥821 million. Losses on sales and disposal of property, plant and equipment, net, amounted to ¥2.2 billion, a decline of ¥646 million. In addition, the transfer of a portion of the cash balance pension plan maintained by the parent company and certain of its Japanese subsidiaries to a defined contribution pension plan resulted in recognition of a portion of an unrecognized actuarial loss, which was included as a settlement loss of benefit obligation on transfer to defined contribution pension plan of ¥2.5 billion.

Operating Income

Operating income rose 8.4%, or ¥6.3 billion, to ¥81.9 billion, and represented 14.1% of net sales and operating revenue, compared with 13.7% the previous year. Factors influencing the increase included increases in net sales and operating revenue and declines in the cost-of-sales ratio and impairment loss on long-lived assets, although the impact was partially offset by an increase in selling, general and administrative expenses. The insurance services segment and the information and communication related and other services segment recorded operating income, in contrast to the previous period, when both recorded operating losses. These improvements contributed to the overall increase in operating income. (For more details, please see Segment Information below.)

Other Income and Expenses

Other income rose ¥9.4 billion, to ¥15.9 billion, while other expenses advanced ¥250 million, to ¥8.1 billion, resulting in net other income of ¥7.8 billion, compared to net other expenses of ¥1.3 billion in the previous year. The increase in other income was primarily due to an increase in a net gain on sales of securities, a result of the sale of the Company's stake in a cable television affiliate accounted for under the equity method.

Income Taxes

Income taxes increased ¥6.0 billion, to ¥37.9 billion, owing to higher income from continuing operations before income taxes. Income taxes were equivalent to 42.2% of income from continuing operations before income taxes, down from 43.0% in the previous year.

Minority Interest in Subsidiaries and Equity in Net Income of Affiliated Companies

Minority interest in subsidiaries amounted to ¥3.9 billion, an increase of ¥1.0 billion, mainly as a result of improved income from insurance services. Equity in net income of affiliated companies also rose ¥964 million, to ¥3.3 billion, owing primarily to solid performances by equity-method affiliates in Taiwan and the ROK.

Income from Continuing Operations

As a consequence of the above factors, income from continuing operations rose 22.6%, or ¥9.4 billion, to ¥51.2 billion, and represented 8.8% of net sales and operating revenue, compared with 7.6% in the previous period.

Income from Discontinued Operations

Discontinued operations include any component of an entity with its own identifiable operations and cash flows which is disposed of or is classified as held for sale, and with which the Company will not have significant continuing involvement. In the previous period, the Company sold its education services operation, and its security services operations in the United States, as well as certain real estate properties for lease. This resulted in income from discontinued operations, net of tax, of ¥9.9 billion in that period. (For more information, please see Note 25 of the accompanying Notes to Consolidated Financial Statements.)

Net Income

Net income totaled ¥50.3 billion. Both basic and diluted net income per share were ¥223.69. Cash dividends per share of ¥60.00 were approved at the general shareholders' meeting held on June 27, 2006.

Segment Information

For detailed segment information, please see Note 27 of the accompanying Notes to Consolidated Financial Statements.

Security Services

This segment encompasses electronic security services, other security services and merchandise and other. Net sales and operating revenue in the security services segment rose 4.6%, or ¥17.6 billion, to ¥401.4 billion. Excluding intersegment transactions, segment net sales and operating revenue was ¥400.0 billion, equivalent to 68.9% of total net sales and operating revenue, down from 69.2% a year earlier.

Electronic security services include centralized systems (on-line commercial and home security systems) and large-scale proprietary systems, which center on surveillance services at the subscriber's premises. Commercial and home on-line security systems, the core of SECOM's electronic security services business, use sensors installed at the customer's premises to detect events, such as intrusions, fires and equipment malfunctions. Sensors are linked to a SECOM control center via telecommunications circuits to enable remote monitoring around the clock. Should an event be detected, the relevant information is relayed to the control center, where the staff dispatch emergency response personnel and take other appropriate measures, as well as notify the police or fire department if required. To ensure its ability to deliver the level of quality customers expect, the Company has established an integrated process that allows it to maintain control over every aspect of its electronic security services, from centralized systems research and development (R&D) to equipment manufacturing, sales, installation, 24-hour monitoring, dispatch of emergency response personnel and maintenance. In the period under review, net sales and operating revenue from electronic security services amounted to ¥277.9 billion, an increase of 2.2%, or ¥6.0 billion. During the period under review, we continued to market a number of security systems suited to the diverse needs of commercial customers. These include SECOM AX, a centralized system that employs advanced image monitoring; SECOM DX, a versatile system suitable for a wide range of users; and SECOM IX, a remote imaging system for retail premises that operate around the clock. Subscriptions for such services increased steadily, as did subscriptions for SECOM Home Security systems.

Other security services include static guard services, staffed by highly trained professionals, for security situations that require human judgment and flexible responses, and armored car services, for the transport of cash and valuables by specially fitted armored cars and security professionals. In the period under review, net sales and operating revenue from static guard services amounted to ¥41.5 billion, an increase of 8.3%, or ¥3.2 billion, while that from armored car services amounted to ¥19.4 billion, up 4.9%, or ¥907 million.

The merchandise and other category encompasses a wide range of security products, including access-control systems, CCTV surveillance systems, fire extinguishing systems, and external and internal monitoring systems, which can be used alone or connected to on-line security systems. In the period under review, these products and services generated net sales and operating revenue of ¥61.3 billion, an increase of 14.1%, or ¥7.6 billion. Increasing awareness of the need to ensure protection against crime, as well as to properly manage information assets, supported brisk sales of access-control systems and CCTV surveillance systems.

Operating income in the security services segment slipped 4.2%, or ¥3.8 billion, to ¥86.7 billion. The operating margin was 21.6%, compared with 23.6% for the previous period. This primarily reflected a settlement loss of benefit obligation on transfer to defined contribution pension plan and an increase in advertising expenses. The settlement loss of benefit obligation reflected the transfer of a portion of the cash balance pension plan maintained by the parent company and certain of its Japanese subsidiaries to a defined contribution pension plan, as described above.

Medical Services

Medical services encompasses home medical services, including pharmaceutical dispensing and delivery and home nursing services; remote image diagnosis support services; electronic medical report systems; sales of medical equipment; the operation of nursing homes; personal care services; and the leasing of real estate for medical institutions. Net sales and operating revenue in the medical services segment amounted to ¥39.4 billion, an increase of 13.0%, or ¥4.5 billion. During the period under review, sales in the home medical services area expanded, while a newly consolidated subsidiary that manages dispensing pharmacies also contributed to an increase in net sales and operating revenue.

The medical services segment posted an operating loss of ¥1.3 billion for the period under review, down from operating income of ¥1.6 billion in the previous period. This was attributable to a provision for the allowance for doubtful accounts as a result of loans extended to health care facilities. This reflected changes in the business environment prompted by amendments to Japan's health care system, including a reduction of remuneration for medical treatment.

Insurance Services

This segment includes a variety of unique offerings that complement security services, which provide prior protection, with non-life insurance, which looks after customers in the event of misfortune. For example, Security Discount Fire Policy, a commercial fire insurance policy, and SECOM *Anshin* My Home, a comprehensive fire insurance policy for residences, offer a discount on premiums to subscribers who have installed on-line security systems, recognizing this as a risk-lowering factor. Other products include New SECOM *Anshin* My Car, a comprehensive automobile insurance policy that offers on-site support services—provided by our emergency response personnel—in the event of an accident, and MEDCOM, an unrestricted cancer treatment policy that covers the entire cost of medical treatments for cancer. The insurance services segment generated net sales and operating revenue of ¥32.0 billion, up 9.5%, or ¥2.8 billion. In addition to expanding the marketing of non-life insurance during the period under review, the Company took advantage of a favorable investment environment, recording gains from the sales of investment securities.

The insurance services segment registered operating income of ¥5.1 billion, up from an operating loss of ¥3.0 billion in the previous period. This improvement primarily reflected the aforementioned gains on sales of investment securities, as well as the fact that the loss ratio had worsened in the previous period due to damages sustained in typhoons.

Geographic Information Services

This segment encompasses a variety of GIS services tailored to the needs of the public and private sector, as well as surveying and measuring and construction consulting services. Net sales and operating revenue in this segment edged up 0.6%, or ¥216 million, to ¥35.4 billion. During the period under review, efforts included the provision of high-precision national spatial data to government and municipal offices using digital aerial cameras, laser scanners and other aerial surveying technologies. The Company also provided GIS services for private-sector customers, mainly companies, and cultivated markets for these services overseas, particularly in developing countries.

Segment operating income declined 27.2%, or ¥336 million, to ¥900 million. This was primarily a consequence of the inclusion of devaluation losses on inventories and an increase in loss on disposal of software.

Information and Communication Related and Other Services

This segment includes information and communication related services, including cyber security and information network system operation services, real estate development and sales, and real estate leasing. In the information and communication related and other services segment, net sales and operating revenue rose 5.2%, or ¥4.1 billion, to ¥82.9 billion. During the period under review, the real estate development and sales business performed well, bolstered by brisk sales of condominiums.

Solid results in the real estate development and sales business, together with a decline in impairment loss on long-lived assets, supported segment operating income of ¥5.6 billion, compared with an operating loss of ¥816 million in the previous period.

Financial Position

Total assets of the Company as of March 31, 2006, stood at ¥1,225.2 billion, up 5.2%, or ¥61.0 billion, from the previous fiscal year-end.

Total current assets rose 10.0%, or ¥52.5 billion, to ¥578.6 billion. This mainly reflected increases in cash and cash equivalents (for more details, please see Cash Flows below) and real estate for sale, which boosted inventories. Current assets were outpaced by current liabilities, however, reflecting such factors as an increase in the current portion of long-term debt. As a consequence, the current ratio was 1.8 times, compared with 2.0 times a year earlier.

Investments and long-term receivables declined 1.0%, or ¥3.3 billion, to ¥310.7 billion, owing largely to an increase in public and corporate bonds redeemable within one year, which boosted current assets and resulted in a decline in investment securities.

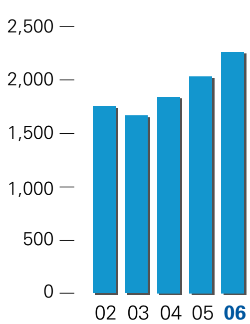
Property, plant and equipment, less accumulated depreciation, rose 5.0%, or ¥11.7 billion, to ¥243.1 billion. This was primarily attributable to an increase in real estate for lease and, in the medical services business, an increase in real estate for medical facilities, which contributed to an increase in buildings and improvements and construction in progress.

Other assets increased 0.2%, or ¥159 million, to ¥92.8 billion.

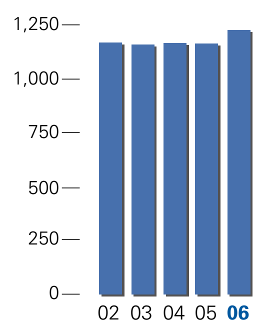
Total liabilities of the Company amounted to ¥680.6 billion, up 1.0%, or ¥6.7 billion, from a year earlier. Total current liabilities advanced 22.6%, or ¥60.4 billion, to ¥328.1 billion, mainly owing to the shift of long-term debt due within one year to current liabilities, which pushed the current portion of long-term debt up ¥34.2 billon, to ¥44.7 billion. As a consequence, long-term debt declined ¥30.0 billion, to ¥35.8 billion. Investment deposits by insurance policyholders declined ¥39.9 billion, to ¥187.8 billion, and accounted for 15.3% of total liabilities and shareholders equity.

Total shareholders' equity increased 11.1%, or ¥50.9 billion, to ¥508.7 billion. Retained earnings were ¥386.6 billion, up ¥39.0 billion. Accumulated other comprehensive income amounted to ¥10.7 billion, compared to an accumulated other comprehensive loss of ¥1.3 billion a year earlier, reflecting a ¥5.5 billion increase in unrealized gains on securities, to ¥11.1 billion, and an accumulated loss from foreign currency translation adjustments of ¥80 million, compared with a loss of ¥6.4 billion in the previous period. The equity ratio rose to 41.5%, from 39.3%.

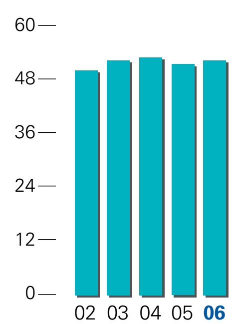
Shareholders' Equity per Share
(In yen)



Total Assets
(In billions of yen)



Depreciation and Amortization
(In billions of yen)



Cash Flows

The Company is committed to maintaining sufficient liquidity to allow flexibility in its operations and ensure a solid financial foundation. To the best of its ability, the Company is also firmly committed to financing related strategic investments with cash generated by its operating activities.

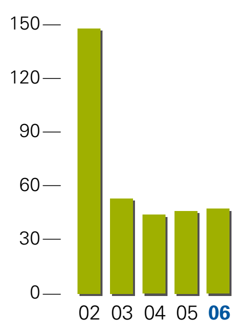
In the period under review, net cash provided by operating activities amounted to ¥78.5 billion. Important items contributing to this total included net income of ¥50.3 billion and depreciation and amortization, including amortization of deferred charges, of ¥52.3 billion. Cash used in operating activities included inventories of ¥24.1 billion, owing to an increase in real estate for sale. Operating activities provided ¥6.7 billion less cash than in the previous period, primarily a consequence of the increase in inventories.

Net cash provided by investing activities was ¥3.9 billion. Significant factors were a decrease in short-term investments and net proceeds from sales of investment securities of ¥32.2 billion, proceeds from sales of property, plant and equipment of ¥11.0 billion and net proceeds from short- and long-term receivables of ¥10.1 billion. Payments for purchases of property, plant and equipment totaled ¥44.3 billion, partly a result of the purchase of security equipment and control stations, prompted by growth in the number of security service subscribers. The fact that investing activities, which used ¥24.0 billion in the previous period, provided net cash of ¥3.9 billion in the period under review, was largely due to a decrease in short-term investments and net proceeds from sale of investment securities, which were used to fund the payout of investment deposits by insurance policyholders.

Net cash used in financing activities amounted to ¥48.8 billion. This amount reflected a ¥39.9 billion decrease in investment deposits by insurance policyholders and dividends paid of ¥11.3 billion. Financing activities used ¥8.2 billion less than in the previous period, reflecting a net increase in debt, that is, of long-term debt and bank loans, of ¥3.6 billion, compared with a net outlay of ¥43.2 billion for repayment of debt, that is, net repayments of long-term debt and decrease in bank loans, in the previous period.

As a consequence of the operating, investing and financing activities of the Company during the period under review, cash and cash equivalents at end of year amounted to¥231.0 billion, up ¥34.0 billion from ¥197.0 billion a year earlier.

Capital Expenditures
(In billions of yen)



Cash Flows
(In billions of yen)