Financial Review

Operating Results

Overview

In the year ended March 31, 2013, SECOM CO., LTD. and its subsidiaries (collectively, "the Company") sought to provide high-quality products and services that respond to the needs of customers in the core security services segment, as well as in the fire protection services, medical services, insurance services, geographic information services, real estate development and sales, and information and communication related and other services segments.

Consolidated net sales and operating revenue rose 11.6%, or ¥89.4 billion, to ¥861.9 billion. This result was due primarily to contributions of two newly acquired subsidiaries in Japan—Nittan, a major domestic provider of fire protection services, and At Tokyo, a leading data center services firm, which were consolidated April 1, 2012, and October 31, 2012, respectively. This result also reflected higher net sales and operating revenue in the Company's core electronic security services business and in sales of merchandise, and the delivery of newly completed large-scale condominium complexes, beginning in the second quarter of the period. Operating income grew 43.1%, or ¥33.9 billion, to ¥112.8 billion, as the advance in net sales and operating revenue exceeded increases in cost of sales and selling, general and administrative expenses and write-down on real estate inventories and impairment loss on long-lived assets declined. Net income attributable to SECOM CO., LTD. climbed 71.2%, or ¥29.3 billion, to ¥70.6 billion, owing mainly to the operating income gain.

Net Sales and Operating Revenue

Consolidated net sales and operating revenue rose 11.6%, or ¥89.4 billion, to ¥861.9 billion, bolstered by increases in all segments. (For further details, please see Segment Information below.)

Costs and Expenses

Total costs and expenses increased 8.0%, or ¥55.5 billion, to ¥749.1 billion. Cost of sales, at ¥583.1 billion, was up 8.7%, or ¥46.8 billion, and was equivalent to 67.7% of net sales and operating revenue, an improvement from 69.4% in the preceding period due primarily to the impact in the previous fiscal year of a ¥20.7 billion write-down on real estate inventories, which arose from a dramatic reorganization of the Company's real estate business in response to dwindling demand in the condominium market.

Selling, general and administrative (SG&A) expenses increased 10.6%, or ¥15.6 billion, to ¥162.2 billion. SG&A expenses were equivalent to 18.8% of net sales and operating revenue, an improvement from 19.0% in the previous fiscal year. In the preceding period, the Company recognized an impairment loss on long-lived assets, principally real estate, of ¥8.1 billion, in light of flagging economic conditions.

Operating Income

Operating income advanced 43.1%, or ¥33.9 billion, to ¥112.8 billion, equivalent to 13.1% of net sales and operating revenue, up from 10.2% in the previous period. This result was due largely to higher net sales and operating revenue and decreases in write-down on real estate inventories and impairment loss on long-lived assets, which countered the negative impact of increases in cost of sales and SG&A expenses. The Company's segments, in order of size of contribution, are security services, fire protection services, information and communication related and other services, medical services, insurance services, geographic information services and real estate development and sales. (For further details, please see Segment Information below.)

Other Income and Expenses

Other income increased ¥2.5 billion, to ¥10.0 billion, while other expenses fell ¥2.1 billion, to ¥3.2 billion, resulting in net other income of ¥6.8 billion, up ¥4.5 billion from the previous fiscal year. Principal factors behind this result included a ¥1.6 billion increase in gain on private equity investments, to ¥5.1 billion, and a decrease in loss on other-than-temporary impairment of investment securities.

Income before Income Taxes and Equity in Net Income of Affiliated Companies

Income before income taxes and equity in net income of affiliated companies rose 47.4%, or ¥38.5 billion, to ¥119.6 billion, reflecting gains in operating income and net other income.

Income Taxes

Income taxes rose ¥8.6 billion, to ¥46.8 billion, equivalent to 39.2% of income before income taxes and equity in net income of affiliated companies, compared with 47.1% in the preceding period. This result was due mainly to a decline in the statutory tax rate in Japan and a corresponding write-down of certain components of net deferred tax assets in the previous fiscal year, a consequence of changes to Japanese tax regulations in the previous period.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies slipped ¥1.0 billion, to ¥3.9 billion, owing primarily to a decline in equity in the net income of an overseas affiliated company.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests amounted to ¥6.1 billion, down ¥498 million.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD. climbed 71.2%, or ¥29.3 billion, to ¥70.6 billion, equivalent to 8.2% of net sales and operating revenue, compared with 5.3% in the previous period. Net income attributable to SECOM CO., LTD. per share was ¥323.36, up from ¥188.97. Subsequent to the fiscal year ended March 31, 2013, a proposal to pay cash dividends of ¥105.00 per share, an increase of ¥15.00 per share from the previous period, was approved at the general shareholders' meeting held on June 25, 2013.

Segment Information (For further information, please see Note 26 of the accompanying Notes to the Consolidated Financial Statements.)

Security Services

The security services segment comprises electronic security services, other security services, and merchandise and other. In the period under review, net sales and operating revenue in this segment increased 4.2%, or ¥18.4 billion, to ¥454.9 billion. Excluding intersegment transactions, net sales and operating revenue in this segment amounted to ¥452.4 billion, representing 52.5% of overall net sales and operating revenue, down from 56.3% in the previous fiscal year.

Electronic security services include on-line commercial and home security systems (centralized systems) and large-scale proprietary security systems, which center on surveillance services at the subscriber's premises. On-line commercial and home security systems, the core of the Company's electronic security services, use sensors, controllers and other equipment installed at the subscriber's premises to detect events, including intrusions, fires and equipment malfunctions. Equipment is linked to a SECOM control center via telecommunications circuits to facilitate around-the-clock remote monitoring. Should an irregularity be detected, relevant information is relayed to the control center, where staff dispatch emergency response personnel to take appropriate measures. Control center employees also notify the police or fire department, if necessary. The Company has established an integrated approach, whereby it takes full responsibility for all aspects of its on-line commercial and home security systems, from R&D through to equipment manufacturing, sales, security planning, installation, around-the-clock monitoring, emergency response services and equipment maintenance. Net sales and operating revenue from electronic security services rose 2.4%, or ¥7.2 billion, to ¥311.6 billion, a consequence mainly of the expansion of the Company's lineup of value-added services that respond to diverse security needs.

Other security services include static guard services and armored car services. Static guard services, which are provided by highly trained professional security guards for situations requiring human judgment and flexible responsiveness, generated net sales and operating revenue of ¥47.9 billon, up 2.5%, or ¥1.2 billion, owing principally to the addition of the net sales and operating revenue of a subsidiary newly consolidated in the fourth quarter. Armored car services, which involve the safe transport of cash, securities and other valuables using specially fitted armored cars and security professionals, reported net sales and operating revenue of ¥20.5 billion, down 0.4%, or ¥77 million.

The merchandise and other category encompasses sales of a wide range of security products, including access control systems, CCTV surveillance systems, automated fire extinguishing systems and external monitoring systems, which can be freestanding or linked to on-line security systems. Net sales and operating revenue in this category increased 15.0%, or ¥9.4 billion, to ¥72.4 billion, reflecting ongoing efforts to expand sales of security systems for rental apartments and an increase in sales of CCTV surveillance systems.

Operating income in the security services segment rose 1.4%, or ¥1.4 billion, to ¥102.9 billion, owing to higher segment net sales and operating revenue. The operating margin edged down to 22.6%, from 23.2% in the preceding period, as the percentage increase in net sales and operating revenue for merchandise and static guard services exceeded that for on-line security systems, which have a comparatively higher operating margin.

Fire Protection Services

This segment focuses on tailored automatic fire alarm systems, fire extinguishing systems and other fire protection systems for a wide range of applications, including office buildings, plants, tunnels, cultural properties, ships and residences. On April 1, 2012, the Company enhanced this segment, which centers on the operations of fire protection services subsidiary Nohmi Bosai, by acquiring Nittan, a major domestic fire protection services provider. During the period, the two companies leveraged their respective business foundations and product development capabilities to secure orders for an extensive range of high-grade fire protection systems.

Net sales and operating revenue from the fire protection services segment advanced 39.7%, or ¥33.7 billion, to ¥118.4 billion, reflecting contributions from Nittan and active efforts to market systems that respond to market needs. Operating income was ¥6.0 billion, an increase of 34.6%, or ¥1.5 billion, from the previous fiscal year.

Medical Services

The medical services segment encompasses home medical services, which center on home nursing and pharmaceutical dispensing services, as well as the operation of residences for seniors, electronic medical report systems, sales of medical equipment, nursing care services, the leasing of real estate for hospitals and health care-related institutions and others. The segment also includes the operations of variable interest entities of which the Company is the primary beneficiary, which manage hospitals and health care-related institutions.

Segment net sales and operating revenue rose 4.8%, or ¥6.4 billion, to ¥141.1 billion. The principal factors behind this result were the inclusion of a full year of net sales and operating revenue from a hospital, the operation of which was taken over by one of the aforementioned variable interest entities in October 2011. Operating income declined 30.8%, or ¥2.4 billion, to ¥5.5 billion. This was due principally to start-up costs related to the opening of new hospitals by variable interest entities.

Insurance Services

The Company continues to market a broad range of distinctive non-life insurance policies, including Security Discount Fire Policy, a commercial fire insurance policy, and SECOM *Anshin* My Home, a comprehensive fire insurance policy for homes—both of which offer discounts on premiums to customers who have installed on-line security systems, recognizing this as a risk-mitigating factor. Other offerings include SECOM *Anshin* My Car, a comprehensive automobile insurance policy that offers on-site support services—provided by emergency response personnel—should the subscriber be involved in an accident, and MEDCOM, an unrestricted cancer treatment policy that covers the entire cost of medical treatment for cancer.

Net sales and operating revenue in this segment increased 6.5%, or ¥2.4 billion, to ¥38.7 billion, primarily reflecting firm sales of fire insurance policies and the MEDCOM unrestricted cancer treatment policy, which strengthened revenue from net premiums written, and to a decrease in loss on other-than-temporary impairment of investment securities. The segment reported operating income of ¥2.7 billion, compared with an operating loss of ¥80 million in the preceding period, bolstered by a decline in loss on other than temporary impairment of investment securities, which pushed up net sales and operating revenue, and by a decline in selling, general and administrative expenses.

Geographic Information Services

The geographic information services segment includes the use of highly advanced measuring equipment and surveying technologies to provide a variety of GIS services to public service entities, including national and local governments, as well as to private-sector customers in Japan. The Company also provides geospatial information services to government agencies in foreign countries, including emerging economies and developing countries. In the period under review, the Company procured high-resolution satellite data and, leveraging its processing technologies, provided geographic information services that responded to a wide variety of customer needs in areas ranging from map production to environmental monitoring and fire and disaster preparedness.

Segment net sales and operating revenue edged up 1.9%, or ¥933 million, to ¥51.3 billion, owing to firm sales to public- and private-sector customers in Japan, as well as to customers in overseas markets. Operating income fell 33.3%, or ¥1.1 billion, to ¥2.3 billion. The segment's operating margin declined to 4.5%, from 6.8% in the previous fiscal year, reflecting increases in impairment loss on goodwill and impairment loss on long-lived assets, both due to the deterioration of results at overseas subsidiaries, a consequence mainly of the Eurozone crisis.

Real Estate Development and Sales

The real estate development and sales segment comprises the development and sales of condominiums equipped with advanced security and contingency planning systems. Amidst sluggish conditions in the condominium market, the Company continued to promote the careful selection of properties for development and sales. Bolstered by the delivery of newly completed large-scale condominium complexes, beginning in the second quarter, net sales and operating revenue in this segment soared 150.3%, or ¥18.4 billion, to ¥30.7 billion. The segment reported operating income of ¥1.6 billion, compared with operating loss of ¥21.6 billion in the previous period. This improvement was due primarily to a ¥20.7 billion write-down on real estate inventories in the preceding period, which arose from a dramatic reorganization of the Company's real estate business in response to dwindling demand in the condominium market.

Information and Communication Related and Other Services

This segment consists mainly of information and communication related services and real estate leasing. In the information and communication related services, the Company continued to provide a variety of uniquely SECOM services, focusing on data center services as well as business continuity support services, information security services and cloud-based services. Highlights included the acquisition on October 31, 2012, of At Tokyo, one of Japan's leading providers of data center services in terms of stability of power supply and security level, thereby strengthening the foundation of our information and communication related services business.

Segment net sales and operating revenue rose 40.0%, or ¥13.6 billion, to ¥47.5 billion, shored up by the acquisition of At Tokyo and by an increase in subscriptions for Secure Data Center services, which bolstered results in the information and communication related services business. The segment reported operating income of ¥5.8 billion, compared with an operating loss of ¥4.0 billion in the previous fiscal year. This improvement was attributable largely to an ¥8.1 billion impairment loss on long-lived assets, principally real estate—the result of a reassessment of the potential profitability of certain businesses in light of flagging economic conditions—in the preceding period and to the inclusion of At Tokyo in consolidated results, which boosted operating income in the information and communication related services business in the period under review.

Financial Position

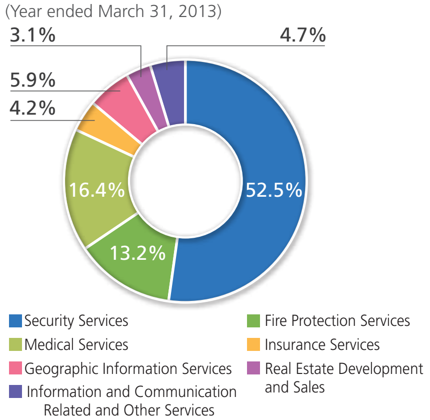
Total assets as of March 31, 2013, amounted to ¥1,340.4 billion, ¥160.5 billion higher than at the end of the previous fiscal year. Total current assets, at ¥565.9 billion, advanced ¥30.3 billion, and accounted for 42.2% of total assets. Cash and cash equivalents totaled ¥222.7 billion, an increase of ¥9.7 billion, owing to the fact that net cash provided by operating activities exceeded net cash used in investing and financing activities. (For further details, please see Cash Flows, which follows this section.) Notes and accounts receivable, trade, rose ¥20.2 billion, to ¥119.9 billion, pushed up primarily by the acquisition of Nittan. Inventories, at ¥58.0 billion, were down ¥9.1 billion, reflecting a decline in real estate for sale, a consequence of the delivery of newly completed condominiums, which was partially offset by an increase in inventories related to fire protection services resulting from the acquisition of Nittan. Short-term receivables amounted to ¥21.5 billion, up ¥6.8 billion, largely as a result of an increase in lease receivables related to security equipment belonging to another newly acquired consolidated subsidiary. With both current assets and current liabilities up, the current ratio was 2.0 times, compared with 2.1 times a year earlier.

Investments and long-term receivables rose ¥22.0 billion, to ¥257.7 billion, or 19.2% of total assets. Investment securities increased ¥15.1 billion, to ¥155.1 billion, mainly because of higher unrealized holding gains on securities—underscored by a buoyant stock market—and an increase in the fair value of private equity investments.

Property, plant and equipment, less accumulated depreciation, advanced ¥74.4 billion, to ¥385.3 billion, equivalent to 28.7% of total assets. Buildings and improvements, including depreciation, rose ¥92.4 billion, to ¥285.6 billion, while land increased ¥11.4 billion, to ¥114.5 billion, a result of the acquisition of At Tokyo.

Percentage of Consolidated Net Sales and Operating Revenue*

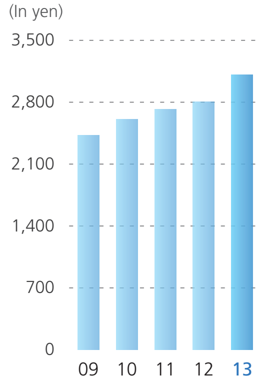
(Year ended March 31, 2013)



* Pie chart shows percentage of consolidated net sales and operating revenue (excluding intersegment transactions)

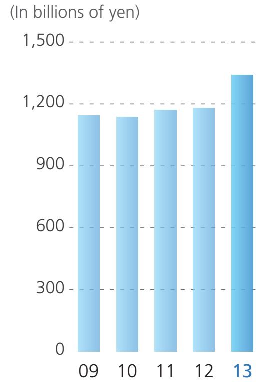
SECOM CO., LTD. Shareholders' Equity per Share

(In yen)



Total Assets

(In billions of yen)



Other assets were up ¥33.7 billion, to ¥131.4 billion, and accounted for 9.8% of total assets. Goodwill rose ¥18.5 billion, to ¥32.7 billion and other intangible assets increased ¥16.1 billion, to ¥38.4 billion, both owing principally to the acquisition of At Tokyo, which yielded goodwill of ¥17.5 billion and identifiable intangible assets of ¥15.2 billion.

Total liabilities increased ¥58.5 billion, to ¥560.7 billion, equivalent to 41.8% of total liabilities and equity. Total current liabilities rose ¥31.3 billion, to ¥287.5 billion, and accounted for 21.5% of total liabilities and equity. Notes and accounts payable, trade, at ¥45.0 billion, were up ¥11.8 billion, owing primarily to the acquisition of Nittan. Accrued income taxes climbed ¥15.5 billion, to ¥31.0 billion, owing to a debt-for-equity swap undertaken at the end of the previous fiscal year as part of a refinancing package aimed at restructuring the Company's real estate development and sales subsidiary, which resulted in a decline in accrued income taxes in the preceding period.

Long-term debt, at ¥48.8 billion, was up ¥11.7 billion. Accrued pension and severance costs totaled ¥29.3 billion, an increase of ¥7.9 billion, reflecting an increase in the scope of consolidation. Higher sales of fire insurance polices led to an increase in the reserve for unearned premiums, pushing unearned premiums and other insurance liabilities up ¥6.4 billion, to ¥90.4 billion.

Interest-bearing debt, comprising bank loans, long-term debt and the current portion of long-term debt, advanced ¥5.2 billion, to ¥105.1 billion. This result was due largely to the acquisition of new subsidiaries, including Nittan and At Tokyo and was despite efforts to reduce interest-bearing debt through the effective use of available funds.

Total SECOM CO., LTD. shareholders' equity rose ¥66.3 billion, to ¥679.2 billion, and was equivalent to 50.7% of total liabilities and equity. This was attributable to a ¥50.9 billion increase in retained earnings, to ¥623.6 billion, owing mainly to net income attributable to SECOM CO., LTD. and to the payment of cash dividends. Accumulated other comprehensive loss, at ¥21.2 billion, was down ¥16.1 billion. The loss resulting from foreign currency translation adjustments declined ¥9.7 billion, to ¥18.7 billion, a consequence of the yen correction that began in late 2012. As a result, the equity ratio decreased to 50.7%, from 51.9% at the end of the previous fiscal year.

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 strategic investments with cash generated by its operating activities.

In the period under review, net cash provided by operating activities amounted to ¥157.4 billion. Significant factors contributing to this result included net income of ¥76.6 billion and non-cash items, notably depreciation and amortization—including amortization of deferred charges—of ¥60.7 billion and a decrease in inventories of ¥20.7 billion. Net cash provided by operating activities was ¥45.2 billion higher than in the previous period, reflecting higher net income and an increase in accrued income taxes, compared with a decrease in the preceding period.

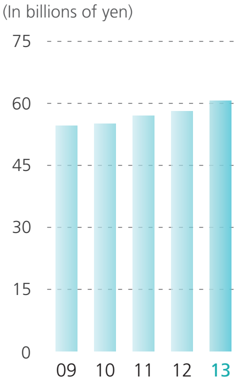
Net cash used in investing activities came to ¥118.6 billion. Principal items behind this result were acquisitions, net of cash acquired, of ¥63.7 billion, that is, payments for the acquisition of new subsidiaries, including Nittan and At Tokyo, and payments for purchases of property, plant and equipment of ¥64.3 billion—namely, the purchase of security equipment and control stations, dictated by a greater number of security services subscribers, and of buildings and improvements, as well as equipment, for new hospitals managed by variable interest entities. Owing to a review of investment assets in the insurance services segment, and to gains attributable to private equity investments in the United States, net proceeds from the sales and redemption of short-term investments and investment securities rose ¥10.3 billion. Net cash used in investing activities was up ¥73.6 billion from the previous fiscal year, attributable to the greater application of cash to acquisitions, net of cash acquired, and to purchases of property, plant and equipment.

Net cash used in financing activities amounted to ¥30.4 billion. This included dividends paid to SECOM CO., LTD. shareholders of ¥19.6 billion, net repayments of long-term debt of ¥4.9 billion and a decrease in bank loans, net, of ¥3.6 billion. Net cash used in financing activities was down ¥17.3 billion from the previous period, owing to decreases in investment deposits by policyholders, bank loans, net and net repayments of long-term debt.

The Company's operating, investing and financing activities in the period under review resulted in net cash and cash equivalents at end of year of ¥222.7 billion, up ¥9.7 billion from net cash and cash equivalents at beginning of year, which were ¥213.0 billion.

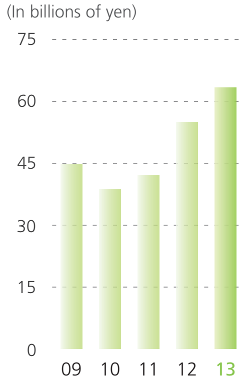
Depreciation and Amortization

(In billions of yen)



Capital Expenditures

(In billions of yen)



Cash Flows

(In billions of yen)