Financial Review

Operating Results

Overview

In the year ended March 31, 2014, 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 its core security services segment, as well as in its fire protection services, medical services, insurance services, geographic information services, information and communication related services, and real estate and other services segments.

Consolidated net sales and operating revenue rose 7.3%, or ¥62.7 billion, to ¥921.2 billion. This result was attributable principally to increases in net sales and operating revenue contributions from At Tokyo and certain subsidiaries providing security services, all of which were newly consolidated in the previous period, as well as to higher net sales and operating revenue in all segments except for real estate and other services. Operating income grew 5.8%, or ¥6.5 billion, to ¥120.1 billion, bolstered by an increase in net sales and operating revenue and a decline in cost of sales in the fire protection services segment, a full year of contributions from At Tokyo to results in the information and communication related services segment, and higher net sales and operating revenue in the security services segment. Net income attributable to SECOM CO., LTD., advanced 4.8%, or ¥3.4 billion, to ¥74.0 billion.

Effective from the period under review, losses attributable to certain businesses in the real estate and other services segment are reclassified and presented as "loss from discontinued operations, net of tax" in the consolidated statements of income. Certain segment results for previous fiscal years have been restated to conform with this change.

Net Sales and Operating Revenue

Consolidated net sales and operating revenue rose 7.3%, or ¥62.7 billion, to ¥921.2 billion, bolstered by increases in the security services, information and communication related services, medical services, fire protection services, geographic information services and insurance services segments. Net sales and operating revenue in the real estate and other services segment declined. (For further details, please see Segment Information below.)

Costs and Expenses

Total costs and expenses increased 7.5%, or ¥56.2 billion, to ¥801.1 billion. Cost of sales, at ¥628.9 billion, was up 8.4%, or ¥48.8 billion, and was equivalent to 68.3% of net sales and operating revenue, up from 67.6% in the previous fiscal year, an increase due primarily to outlays for the expansion and modification of hospitals, which pushed up cost of sales as a percentage of net sales and operating revenue in the medical services segment.

Selling, general and administrative (SG&A) expenses rose 3.1%, or ¥4.9 billion, to ¥166.0 billion. SG&A expenses were equivalent to 18.0% of net sales and operating revenue, an improvement from 18.8% in the previous fiscal year. The Company also recognized an impairment loss on certain long-lived assets in the medical services segment of ¥2.8 billion, ¥2.4 billion higher than in the preceding period, as well as a loss on sales and disposal of fixed assets, net, of ¥3.2 billion, an increase of ¥1.0 billion. In contrast, impairment loss on goodwill decreased ¥901 million, to ¥151 million.

Operating Income

Operating income grew 5.8%, or ¥6.5 billion, to ¥120.1 billion, although operating income as a percentage of net sales and operating revenue edged down to 13.0%, from 13.2% in the previous fiscal year. The Company's segments, in order of contribution to operating income, were security services, fire protection services, information and communication related services, real estate and other services, geographic information services, medical services and insurance services. (For further details, please see Segment Information below.)

Other Income and Expenses

Other income increased ¥1.7 billion, to ¥11.7 billion, while other expenses declined ¥148 million, to ¥3.0 billion, resulting in net other income of ¥8.7 billion, up ¥1.9 billion from the preceding period. Principal factors behind this result included increases in gain on sales of securities, net, which rose ¥785 million, to ¥935 million, and a gain on private equity investments, which advanced ¥469 million, to ¥5.6 billion.

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 7.0%, or ¥8.4 billion, to ¥128.8 billion, reflecting gains in operating income and net other income.

Income Taxes

Income taxes were up ¥3.0 billion, to ¥49.7 billion, equivalent to 38.6% of income before income taxes and equity in net income of affiliated companies, compared with 38.8% in the previous fiscal year. This result was due mainly to a decline in the statutory tax rate as a result of changes to Japan's tax regulations and a corresponding write-down of certain components of net deferred tax assets, which were offset by a reassessment of the recoverability of these assets and a reversal of valuation allowance.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies increased ¥122 million from the previous fiscal year, to ¥4.0 billion.

Loss from Discontinued Operations

Discontinued operations include any component of an entity with its own identifiable operations and cash flows that has been disposed of or is to be sold and in which the Company has no significant continuous involvement. The Company discontinued certain businesses in the real estate and other services segment in the previous fiscal year and has plans to sell these businesses in the fiscal year ending March 31, 2015. In the period under review the Company posted a loss from discontinued operations, net of tax, of ¥138 million, an improvement from ¥912 million in the preceding period.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests amounted to ¥9.0 billion, up ¥2.9 billion from the previous fiscal year. This result reflected an increase in net income in the fire protection services business and the inclusion of a full year of contributions from subsidiaries newly consolidated in the preceding period.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD. rose 4.8%, or ¥3.4 billion, to ¥74.0 billion, equivalent to 8.0% of net sales and operating revenue, compared with 8.2% in the preceding period. Net income attributable to SECOM CO., LTD. per share was ¥338.94, up from ¥323.36. Subsequent to the fiscal year ended March 31, 2014, a proposal to pay cash dividends of ¥115.00 per share, an increase of ¥10.00 per share from the previous fiscal year, was approved at the general shareholders' meeting held on June 25, 2014.

Segment Information

(For further information, please see Note 27 of the accompanying Notes to the Consolidated Financial Statements.)

Security Services

The security services segment comprises electronic security services, which center on on-line security systems; other security services; and merchandise and other. In the period under review, net sales and operating revenue in this segment increased 6.7%, or ¥29.7 billion, to ¥475.3 billion. Excluding intersegment transactions, net sales and operating revenue in this segment amounted to ¥472.4 billion, representing 51.3% of overall net sales and operating revenue, down slightly from 51.6% in the previous period.

In addition to on-line commercial and home security systems (centralized systems), electronic security services include large-scale proprietary security systems, which center on surveillance services for the subscriber's premises. On-line commercial and home security systems 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 staff 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, monitoring, emergency response services and equipment maintenance. Net sales and operating revenue from electronic security services rose 3.5%, or ¥10.6 billion, to ¥318.1 billion, owing to the expansion of the Company's lineup of value-added services that respond to diverse security needs and firm sales of on-line home security systems, as well as to the positive impact of yen depreciation and an increase in contract volume on the net sales and operating revenue of overseas subsidiaries.

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 ¥51.7 billon, up 7.9%, or ¥3.8 billion, owing principally to the inclusion of a full year of net sales and operating revenue in the static guard services business of a subsidiary acquired at the beginning of the fourth quarter of the previous fiscal year. Armored car services, which involve the transport of cash, securities and other valuables using specially fitted armored cars and security professionals, reported net sales and operating revenue of ¥20.8 billion, up 1.1%, or ¥235 million.

The merchandise and other category encompasses sales of a wide range of security products, including security camera systems, access control 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 21.6%, or ¥14.5 billion, to ¥81.9 billion, bolstered by the inclusion of a full year of results in this category of the aforementioned subsidiary acquired at the beginning of the fourth quarter of the previous fiscal year, and by an increase in sales of security camera systems.

Operating income in the security services segment edged up 1.7%, or ¥1.7 billion, to ¥104.1 billion, owing to higher segment net sales and operating revenue. The operating margin slipped to 21.9%, from 23.0% in the preceding period. This decrease was attributable to the fact that the business portfolio of the subsidiary acquired at the beginning of the fourth quarter of the previous fiscal year centers on static guard services and merchandise and other, margins for which are lower than those for electronic security services, as well as to an increase in costs and expenses accompanying forward-looking investments to revamp on-line security systems with the aim of securing future growth.

In light of the increasing significance of construction and installation services, these services—formerly included in the security services segment—have been reclassified and are included in the real estate and other services segment to facilitate more adequate disclosure and improve the effectiveness of segment information. Certain segment results for previous fiscal years have been restated to conform with this change.

Fire Protection Services

This segment focuses on high-grade, 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. During the period under review, Nohmi Bosai and Nittan, two of Japan's leading domestic fire protection services providers, leveraged their respective business foundations and product development capabilities to secure orders for fire protection systems.

Net sales and operating revenue in this segment advanced 7.4%, or ¥8.7 billion in the period under review, to ¥127.2 billion, owing to active efforts to market systems that respond to needs, particularly in the renovations market. Operating income was ¥10.5 billion, an increase of 75.0%, or ¥4.5 billion, thanks mainly to cost reductions. The operating margin improved to 8.2%, from 5.0%.

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, personal care services, and support for the management of hospitals and health care-related institutions. 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 6.8%, or ¥9.6 billion, to ¥150.7 billion. The principal factor behind this result was an increase in contributions from operations of the aforementioned variable interest entities attributable to the expansion and modification of hospitals, and to robust sales of pharmaceuticals, among others. Operating income fell 50.4%, or ¥2.8 billion, to ¥2.7 billion, while the operating margin slipped to 1.8%, from 3.9%, primarily reflecting the recognition of impairment losses on certain real estate and the aforementioned expansion and refurbishment of hospitals.

Insurance Services

In addition to security services, which are preventative by nature, the Company offers non-life insurance, which looks after customers in the event of misfortune. The insurance services segment offers an extensive lineup that includes the 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—and SECOM *Anshin* My Car, a comprehensive automobile insurance policy that offers on-site support services provided by SECOM emergency response personnel should the policyholders be involved in an accident. Other offerings include MEDCOM, an unrestricted cancer treatment policy that covers the entire cost of medical treatment for cancer.

In the period under review, net sales and operating revenue in this segment increased 3.3%, or ¥1.3 billion, to ¥39.9 billion, primarily reflecting an increase in insurance premiums attributable to firm sales of fire insurance policies and the MEDCOM unrestricted cancer insurance policy and net realized investment gains. The segment reported operating income of ¥2.0 billion, a decline of 26.0%, or ¥705 million, and an operating margin of 5.0%, down from 7.0% in the previous fiscal year, owing mainly to a higher loss ratio resulting from claims related to snow damage, among others, which pushed up costs and expenses related to insurance contracts.

Geographic Information Services

The geographic information services segment includes the collection of geographic data from satellite images, aerial photography and vehicle-based ground surveying, which it integrates, processes and analyzes to provide a variety of geospatial information services to national and local governments and private sector customers in Japan. The Company also extends geospatial information services to government agencies overseas, including in emerging economies and developing countries.

Segment net sales and operating revenue rose 6.7%, or ¥3.4 billion, to ¥54.8 billion, spurred by firm sales to public-sector entities in Japan. Operating income rose 61.7%, or ¥1.4 billion, to ¥3.7 billion, while the operating margin improved to 6.8%, from 4.5%, reflecting improved margins in overseas markets and the absence of an impairment loss on goodwill reported in the preceding period, a consequence largely of the Eurozone crisis.

Information and Communication Related Services

Information and communication related services focus on data center services, as well as uniquely SECOM BCP support services, information security services and cloud-based services.

Net sales and operating revenue in the period under review climbed 53.3%, or ¥18.5 billion, to ¥53.4 billion, bolstered mainly by a full year of contributions from At Tokyo, one of Japan's leading data center services firms in terms of power supply stability and security level, which became a consolidated subsidiary on October 31, 2012. The inclusion of a full year of operating income from At Tokyo boosted segment operating income 62.8%, or ¥2.5 billion, to ¥6.4 billion. The operating margin improved to 11.9%, from 11.2% in the previous fiscal year.

In light of the increasing significance of information and communication related services, these services, formerly included in the information and communication related and other services segment, are now presented separately as the information and communication related services segment to facilitate more adequate disclosure of the Company's business activities and improve the effectiveness of segment information. Certain segment results for previous fiscal years have been restated to conform with this change.

Real Estate and Other Services

The real estate and other services segment encompasses the development and sales of condominiums equipped with sophisticated security and disaster-preparedness features, as well as real estate leasing, construction and installation and other services.

Segment net sales and operating revenue declined 19.7%, or ¥9.7 billion, to ¥39.7 billion, primarily as a consequence of falling sales of condominiums, which pushed down sales in the real estate development and sales business. Owing mainly to a decrease in write-downs on real estate inventories, operating income edged up 1.4%, or ¥63 million, to ¥4.7 billion, and the operating margin improved to 11.8%, from 9.4% in the previous fiscal year.

Previously, real estate development and sales were presented as a reportable segment. However, owing to a decrease in their significance, effective from the fiscal year ended March 31, 2014, these businesses were reclassified under the other services segment, which was renamed the real estate and other services segment. Certain segment results for previous fiscal years have been restated to conform with this change.

Financial Position

Total assets as of March 31, 2014, amounted to ¥1,440.7 billion, ¥100.4 billion higher than at the end of the previous period. Total current assets, at ¥578.1 billion, advanced ¥12.1 billion, and accounted for 40.1% of total assets. Cash and cash equivalents totaled ¥230.8 billion, an increase of ¥8.1 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 ¥8.1 billion, to ¥128.0 billion, a consequence primarily of higher net sales and operating revenue in the fire protection services and geographic information services segments—both of which tend to see increases in net sales and operating revenue toward the end of the fiscal year—and an increase in security system installations. Inventories, at ¥51.9 billion, were down ¥6.2 billion, primarily reflecting a decline in real estate inventories, a consequence of the delivery of condominiums. With both current assets and current liabilities up, the current ratio was 2.0 times as of March 31, 2014, on level with the previous fiscal year-end.

Investments and long-term receivables rose ¥67.0 billion, to ¥324.7 billion, or 22.5% of total assets. Investment securities increased ¥49.5 billion, to ¥204.6 billion, owing principally to a review of investment assets in the insurance services segment, which resulted in the purchase of bonds, among others.

Investments in affiliated companies increased ¥10.6 billion, to ¥49.8 billion, pushed up mainly by firm earnings at overseas affiliated companies and by the depreciation of the yen.

Property, plant and equipment, less accumulated depreciation, advanced ¥9.1 billion, to ¥394.4 billion, equivalent to 27.4% of total assets. With the opening of new Secure Data Center facilities, buildings and improvements rose ¥11.7 billion, to ¥297.3 billion. Construction in progress amounted to ¥7.8 billion, up ¥4.2 billion, a result largely of the expansion and modification of hospitals managed by variable interest entities.

Other assets were up ¥12.1 billion, to ¥143.5 billion, and accounted for 10.0% of total assets. Prepaid pension and severance costs rose ¥10.5 billion, to ¥22.1 billion, bolstered primarily by robust returns on pension assets.

Total liabilities as of March 31, 2014, increased ¥19.6 billion, to ¥580.3 billion, and accounted for 40.3% of total liabilities and equity. Total current liabilities rose ¥7.6 billion, to ¥295.1 billion, and represented 20.5% of total liabilities and equity. Bank loans were up ¥13.5 billion, to ¥52.5 billion. Deposits received declined ¥7.7 billion, to ¥22.4 billion, largely because of a temporary shift in the balance of bank loans and deposits received for cash collection and deposit services. Notes and accounts payable, trade, at ¥50.0 billion, were up ¥5.0 billion, owing primarily to an increase in orders placed for the construction of security systems for lease near the fiscal year-end.

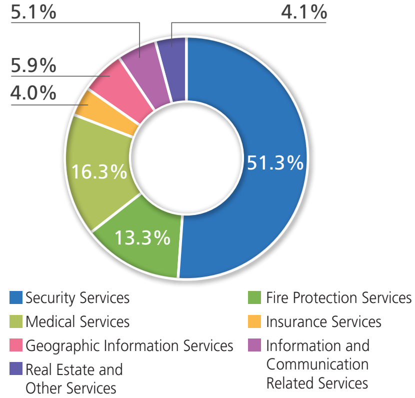
Total long-term liabilities increased ¥12.0 billion, to ¥285.2 billion, and represented 19.8% of total liabilities and equity. Higher sales of fire insurance policies led to an increase in the reserve for unearned premiums, pushing unearned premiums and other insurance liabilities up ¥8.3 billion, to ¥98.7 billion.

Interest-bearing debt, comprising bank loans, long-term debt and the current portion of long-term debt, advanced ¥10.7 billion, to ¥115.8 billion. This result was due largely to a temporary increase in bank loans for cash collection and deposit services.

Total SECOM CO., LTD. shareholders' equity rose ¥73.9 billion, to ¥753.1 billion, and was equivalent to 52.3% of total liabilities and equity. This was attributable to a ¥51.0 billion increase in retained earnings, to ¥674.6 billion, owing mainly to net income attributable to SECOM CO., LTD. and to the payment of cash dividends. Accumulated other comprehensive income was ¥1.7 billion, compared with an accumulated other comprehensive loss of ¥21.2 billion in the previous fiscal year, owing primarily to a decrease in the loss resulting from foreign currency translation adjustments which shrank to ¥1.9 billion, from ¥18.7 billion in the preceding period, due to yen depreciation. As a result, the equity ratio rose to 52.3%, from 50.7% at the end of the previous period.

Percentage of Consolidated Net Sales and Operating Revenue*

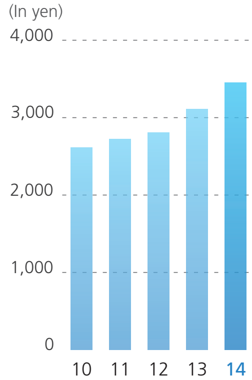
(Year ended March 31, 2014)



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

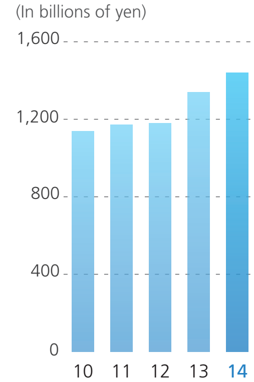
SECOM CO., LTD. Shareholders' Equity per Share

(In yen)



Total Assets

(In billions of yen)



Financial Review

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 ¥123.2 billion. Significant factors contributing to this result included net income of ¥82.9 billion and non-cash items, notably depreciation and amortization, including amortization of deferred charges, of ¥66.7 billion, which were partially offset by an increase in deferred charges of ¥16.4 billion, an increase in receivables and due from subscribers, net of allowances, of ¥10.2 billion. These charges consisted primarily of costs related to the installation of security equipment as part of on-line security systems. (For further details, please see Note 2 (12) of the accompanying Notes to Consolidated Financial Statements.) Net cash provided by operating activities was ¥34.2 billion lower than in the preceding period. Principal factors behind this result included an increase in income tax payments, owing to the fact that lower interim payments resulted in an increase in accrued income taxes at the previous fiscal year-end; a significant decline in real estate inventories as a result of the sale of major condominium complexes to customers in the preceding period; and a decrease in deposits received for cash collection and deposit services.

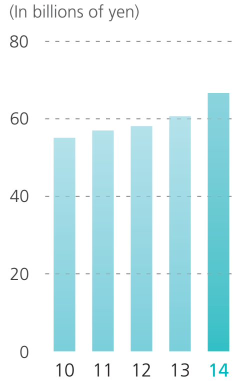
Net cash used in investing activities amounted to ¥95.3 billion. This result reflected payments for purchases of investment securities of ¥76.3 billion, a consequence of a review of investment assets in the insurance services segment; payments for purchases of property, plant and equipment of ¥56.3 billion, attributable to increases in the purchase of security equipment and control stations due to a greater number of security services subscribers and in the purchase of property, plant and equipment for the expansion and modification of hospitals managed by variable interest entities. These outlays were partially offset by proceeds from sales and redemptions of investment securities of ¥43.8 billion. Despite the increase in payments for purchases of investment securities, net cash used in investing activities was down ¥23.3 billion from the previous period, owing mainly to the use of cash for acquisitions, net of cash acquired, and to payments for purchases of property, plant and equipment related to the opening of new hospitals managed by variable interest entities, which pushed up net cash used in investing activities in the preceding period.

Net cash used in financing activities amounted to ¥21.9 billion. This included dividends paid to SECOM CO., LTD. shareholders of ¥22.9 billion. Net cash used in financing activities was down ¥8.5 billion from the previous period, owing largely to a temporary increase in bank loans for cash collection and deposit services, which were partially offset by an increase in dividends paid to SECOM CO., LTD. shareholders, and to higher 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 ¥230.8 billion, up ¥8.1 billion from net cash and cash equivalents at beginning of year, which were ¥222.7 billion.

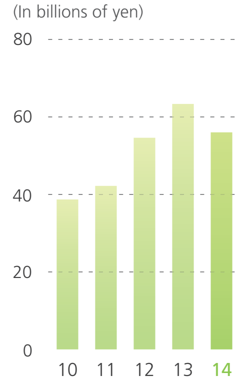
Depreciation and Amortization

(In billions of yen)



Capital Expenditures

(In billions of yen)



Cash Flows

(In billions of yen)