Financial Review

Operating Results

Overview

In the fiscal year ended March 31, 2017, 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 4.9%, or ¥47.8 billion, to ¥1,031.3 billion. Principal factors behind this result were the inclusion of a full year of results for subsidiary Asahi Security, consolidated on December 1, 2015, and higher revenue from on-line security systems. Bolstered by increased net sales and operating revenue and a decrease in impairment loss on long-lived assets, among others, operating income advanced 9.5%, or ¥11.3 billion, to ¥130.2 billion. Increases in operating income and gain on private equity investments and other factors pushed net income attributable to SECOM CO., LTD., up 8.7%, or ¥7.3 billion, to ¥91.4 billion.

Net Sales and Operating Revenue

Net sales and operating revenue was up 4.9%, or ¥47.8 billion, to ¥1,031.3 billion. The security services, real estate and other services, medical services, insurance services, and information and communication related services segments reported increases, while the fire protection services and geographic information services segments posted declines. (For further details, please see Segment Information below.)

Costs and Expenses

Total costs and expenses rose 4.2%, or ¥36.6 billion, to ¥901.1 billion. Cost of sales, at ¥710.0 billion, was up 5.3%, or ¥35.4 billion, and was equivalent to 68.8% of net sales and operating revenue, compared with 68.6% in the previous fiscal year, owing mainly to the inclusion of a full year of results for subsidiary Asahi Security, for which the costs of sales ratio is comparatively high.

Selling, general and administrative (SG&A) expenses, at ¥184.5 billion, were up 4.7%, or ¥8.2 billion. SG&A expenses were equivalent to 17.9% of net sales and operating revenue, level with the previous fiscal year.

Impairment loss on long-lived assets amounted to ¥2.7 billion, as the Company recognized losses on certain business assets in the geographic information services segment. This represented a decline of ¥9.1 billion from ¥11.8 billion in the previous fiscal year, which reflected, among others, losses on certain business assets in the information and communication related services segment and on certain real estate assets, the use of which it had reconsidered. The Company also recognized an impairment loss on goodwill of ¥1.2 billion, owing to, among others, a decrease in projected cash flows of a previously acquired security services subsidiary. Additionally, loss on sales and disposal of fixed assets, net, rose ¥845 million, to ¥2.8 billion.

Operating Income

Operating income advanced 9.5%, or ¥11.3 billion, to ¥130.2 billion, equivalent to 12.6% of net sales and operating revenue, up from 12.1% in the previous fiscal year. This was due to increased net sales and operating revenue and a decrease in impairment loss on long-lived assets, among others. The Company's segments, in order of size of contribution to operating income, were security services, fire protection services, insurance services, information and communication related services, real estate and other services, and medical services. (For further details, please see Segment Information below.)

Other Income and Expenses

Other income rose ¥10.5 billion, to ¥18.1 billion, while other expenses declined ¥1.0 billion, to ¥3.1 billion, resulting in net other income of ¥15.0 billion, up ¥11.5 billion from the previous fiscal year. Principal factors behind this result include a ¥12.2 billion increase in gain on private equity investments, to ¥13.9 billion.

Income from Continuing Operations before Income Taxes and Equity in Net Income of Affiliated Companies

Income from continuing operations before income taxes and equity in net income of affiliated companies advanced 18.6%, or ¥22.8 billion, to ¥145.2 billion, bolstered by increases in operating income and net other income.

Income Taxes

Income taxes amounted to ¥47.0 billion, an increase of ¥6.7 billion, and were equivalent to 32.4% of income from continuing operations before income taxes and equity in net income of affiliated companies, compared with 32.9% in the previous fiscal year.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies, at ¥5.2 billion, was down ¥2.0 billion. This result primarily reflected decreases in equity in net income of certain affiliated companies overseas.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests amounted to ¥12.0 billion, up ¥6.8 billion from the previous fiscal year, reflecting increases in gain on private equity investments and operating income in the information and communication related services segment.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD. advanced 8.7%, or ¥7.3 billion, to ¥91.4 billion, equivalent to 8.9% of net sales and operating revenue, compared with 8.5% in the previous fiscal year. Net income attributable to SECOM CO., LTD. per share was ¥418.71, up from ¥385.19.

At the Ordinary General Meeting of Shareholders held on June 27, 2017, a proposal to pay a year-end dividend of ¥75.00 was approved. As a consequence, cash dividends for the period—which also included an interim dividend of ¥70.00 approved at the Board of Directors' meeting held on November 9, 2016—rose ¥10.00, to ¥145.00 per share. However, because both the ¥70.00 per share year-end dividend for the year ended March 31, 2016, approved at the Ordinary General Meeting of Shareholders held on June 24, 2016, and the ¥70.00 per share interim dividend for the previous fiscal year, determined by the Board of Directors and paid to shareholders of record as of September 30, 2016, were paid during the period, cash dividends paid to shareholders in the period under review—the figure that appears in the financial statements—amounted to ¥140.00 per share.

Segment Information

(For further information, please see Note 27 of the 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 advanced 7.6%, or ¥38.4 billion, to ¥546.5 billion. Excluding intersegment transactions, net sales and operating revenue in this segment amounted to ¥543.5 billion, representing 52.7% of overall net sales and operating revenue, up from 51.4% in the previous fiscal year.

In addition to on-line commercial and home security 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, fire department or other authorities, 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, marketing, security planning, installation, monitoring, emergency response services and equipment maintenance. Net sales and operating revenue from electronic security services rose 2.4%, or ¥7.9 billion, to ¥338.7 billion, primarily reflecting expanded sales of value-added services that respond to diverse security needs, which bolstered sales of on-line security systems, and an increase in revenue from installation attributable to higher sales of large-scale security systems.

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 ¥56.4 billion, up 0.9%, or ¥510 million. 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 ¥57.9 billion, up 75.4%, or ¥24.9 billion, owing principally to the inclusion of a full year of results for Asahi Security, consolidated on December 1, 2015.

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 advanced 6.1%, or ¥5.2 billion, to ¥90.5 billion, owing to the robust sales of access control systems and the inclusion of a full year of results for Kumalift, consolidated on August 31, 2015.

Operating income in the security services segment rose 1.6%, or ¥1.8 billion, to ¥112.7 billion. The operating margin was 20.6%, compared with 21.8% in the previous fiscal year. Higher operating income primarily reflected the inclusion of a full year of results for Asahi Security and higher net sales and operating revenue for on-line security systems and merchandise. The decline in the operating margin was due to an impairment loss on goodwill—attributable to a decrease in projected cash flows of a previously acquired security services subsidiary—and an increase in advertising and promotional costs.

Fire Protection Services

The fire protection services 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. In the period under review, Nohmi Bosai and Nittan, two of Japan's leading domestic fire protection services providers, sought to leverage their respective business foundations and product development capabilities to secure orders for fire protection systems.

Net sales and operating revenue in this segment amounted to ¥129.7 billion, down 4.3%, or ¥5.8 billion, from the previous period, which benefited from a number of major orders. Operating income declined 3.8%, or ¥525 million, to ¥13.1 billion, while the operating margin remained level at 10.1%.

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 3.2%, or ¥5.3 billion, to ¥169.0 billion. The principal factors behind this result were the consolidation of a hospital management company in India, and increases in sales and operating revenues of the aforementioned variable interest entities and from pharmaceutical dispensing services. Operating income fell 40.7%, or ¥1.2 billion, to ¥1.7 billion, while the operating margin declined to 1.0%, from 1.8% owing mainly to the expansion and modification of hospitals managed by variable interest entities and an increase in impairment loss on long-lived assets.

Insurance Services

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 onsite support services provided by SECOM emergency response personnel should the policyholder be involved in an accident. Other offerings include MEDCOM, an unrestricted cancer treatment policy that covers the entire cost of medical treatment for cancer.

Net sales and operating revenue in this segment advanced 7.5%, or ¥3.3 billion, to ¥46.9 billion, spurred by favorable sales of the MEDCOM unrestricted cancer treatment policy and the fact that a decline in net premiums written—a consequence of the termination of sales of fire insurance policies with terms of 10 years or longer in October 2015—was exceeded by a decrease in provision for policy reserves. Operating income rose 6.5%, or ¥447 million, to ¥7.3 billion, while the operating margin edged down to 15.6%, from 15.7% in the previous fiscal year. The principal factor behind the increase in operating income was higher net realized investment gains.

Geographic Information Services

The geographic information services segment includes the collection of geographic data from satellite images, aerial photography, and vehicle/ground and other types of surveying, which are integrated, processed and analyzed to facilitate the provision of geospatial information services to public sector entities, including national and local governments, and private sector customers in Japan. The Company also extends geospatial information services to government agencies overseas.

Segment net sales and operating revenue decreased 1.7%, or ¥896 million, to ¥51.8 billion, owing to a decline in net sales and operating revenue from services for overseas customers. The segment reported an operating loss of ¥944 million, compared with an operating loss of ¥268 million in the previous fiscal year. The principal factor behind this result was an increase in impairment loss on long-lived assets arising from, among others, a greater risk of decline in the profitability of satellite operation software and the replacement of satellite signal receiving equipment.

Information and Communication Related Services

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

Net sales and operating revenue in this segment advanced 1.7%, or ¥1.0 billion, to ¥56.8 billion, bolstered by, among others, a full year of contributions from sales of the SECOM *Anshin* My Number service, launched in the previous fiscal year. Operating income climbed to ¥7.3 billion, from ¥308 million, while the operating margin rose to 12.8%, from 0.6% in the previous fiscal year. A decline in impairment loss on long-lived assets to ¥485 million, from ¥5.6 billion in the previous fiscal year, together with decreases in charges for electricity and rental expenses in the data center business—the former attributable to falling crude oil prices and latter to the purchase of certain previously rented facilities—were among factors contributing to the operating income result.

Real Estate and Other Services

The real estate and other services segment encompasses the development and sales of, among others, 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 rose 12.4%, or ¥5.5 billion, to ¥49.5 billion. Principal factors behind this result included an increase in the real estate development and sales business. Operating income, at ¥5.2 billion, was up 7.0%, or ¥341 million. The operating margin slipped to 10.6%, from 11.1% in the previous fiscal year. Higher operating income reflected an improvement in the profitability of construction and installation projects and an increase in net sales and operating revenue in the real estate development and sales business.

Financial Position

Total assets as of March 31, 2017, amounted to ¥1,763.3 billion, ¥81.9 billion higher than at the end of the previous fiscal year. Total current assets, at ¥773.9 billion, were up ¥68.3 billion, and accounted for 43.9% of total assets. The current ratio rose to 2.0 times, from 1.8 times in the previous fiscal year. Cash and cash equivalents totaled ¥299.6 billion, an increase of ¥70.6 billion, reflecting 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 declined ¥1.8 billion, to ¥134.8 billion. Notes and accounts receivable are affected by the fact that income in the fire protection services and geographic information services segments tend to be concentrated toward the end of the fiscal year. Cash deposits for armored car services rose ¥2.4 billion, to ¥130.6 billion, with contributing factors including an increase in service contracts at Asahi Security. Despite a ¥1.0 billion increase in real estate for sale, to ¥27.5 billion, inventories declined ¥1.1 billion, to ¥62.7 billion, owing to a ¥1.9 billion decline in security merchandise, to ¥7.0 billion, among others.

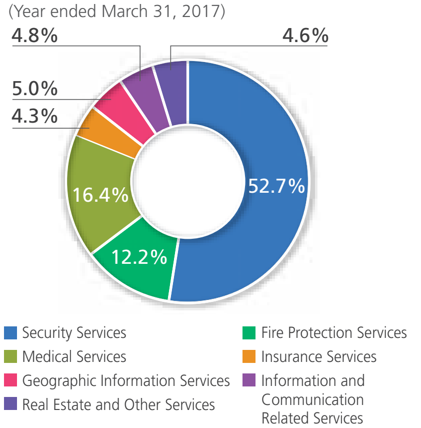
Investments and long-term receivables rose ¥13.2 billion, to ¥349.6 billion, equivalent to 19.8% of total assets. Investment securities advanced ¥14.8 billion, to ¥227.2 billion, a consequence of higher unrealized gains on securities and other factors.

Property, plant and equipment, less accumulated depreciation, decreased ¥84 million, to ¥414.1 billion, representing 23.5% of total assets. Buildings and improvements increased ¥13.1 billion, to ¥329.6 billion, owing to the expansion and modification of hospitals managed by variable interest entities and the acquisition of information and communications assets, including the purchase of certain previously rented data center facilities. In contrast, machinery, equipment and automobiles declined ¥11.0 billion, to ¥143.8 billion. These factors led to an increase in property, plant and equipment before the deduction of accumulated depreciation of ¥3.8 billion, to ¥913.7 billion. Accumulated depreciation rose ¥3.9 billion, to ¥499.6 billion.

Other assets totaled ¥225.8 billion, up ¥529 million, and accounted for 12.8% of total assets. Impairment losses, among others, resulted in a ¥1.3 billion decline in goodwill, to ¥89.0 billion. Amortization and other factors pushed other intangible assets down ¥3.2 billion, to ¥50.7 billion. In contrast, prepaid pension and severance costs rose ¥4.5 billion, to ¥35.3 billion, reflecting increases in the fair value of plan assets.

Percentage of Consolidated Net Sales and Operating Revenue*

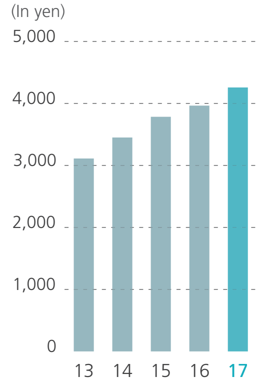
(Year ended March 31, 2017)



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

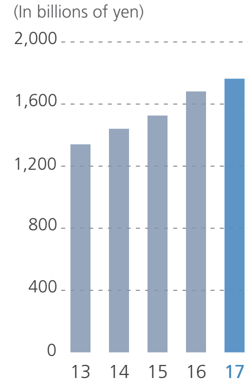
SECOM CO., LTD. Shareholders' Equity per Share

(In yen)



Total Assets

(In billions of yen)



Financial Review

Total current liabilities amounted to ¥393.9 billion, an increase of ¥6.1 billion, and accounted for 22.3% of total liabilities and equity. Deposits received rose ¥7.1 billion, to ¥112.1 billion, as an increase in service contracts at Asahi Security pushed up cash deposits for armored car services. Bank loans declined ¥13.6 billion, to ¥42.1 billion, while notes and accounts payable rose ¥3.4 billion, to ¥46.3 billion, and accrued income taxes advanced ¥5.2 billion, to ¥27.6 billion.

Total long-term liabilities, at ¥317.9 billion, were up ¥928 million, representing 18.0% of total liabilities and equity. Unearned premiums and other insurance liabilities advanced ¥4.4 billion, to ¥110.0 billion. Long-term debt, at ¥54.1 billion, was down ¥7.5 billion, owing to the shift of certain debt to the bank loans category, among others. An increase in unrealized gains on private equity investments in the United States was one of several factors contributing to a ¥7.8 billion increase in deferred income taxes, to ¥33.8 billion.

Total SECOM CO., LTD. shareholders' equity advanced ¥64.0 billion, to ¥929.2 billion. Retained earnings rose ¥60.7 billion, to ¥832.8 billion, with contributing factors including an increase in net income attributable to SECOM CO., LTD. and the payment of dividends. Unrealized gains on securities rose ¥4.4 billion, to ¥22.5 billion, underpinning a ¥3.2 billion increase in accumulated other comprehensive income, to ¥20.1 billion. As a result, the equity ratio was 52.7%, compared with 51.5% as of March 31, 2016.

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 ¥178.6 billion. The principal components of this were net income of ¥103.4 billion and depreciation and amortization, including amortization of deferred charges, of ¥78.2 billion, a non-cash item.

Net cash provided by operating activities was ¥35.8 billion higher than in the previous fiscal year. Factors behind this increase included an increase in receivables and due from subscribers, net of allowances of ¥1.3 billion, down from ¥9.7 billion in the previous fiscal year; a decrease in accrued consumption tax of ¥879 million, compared with a decrease of ¥7.0 billion in the preceding period due to a consumption tax rate hike; and other, net, which provided ¥9.3 billion, compared with the previous period, when this item used ¥473 million. Cash provided in the other, net, category primarily reflected the receipt of payments from the Company's principal partner in a joint condominium development and sales project, which served as lead manager.

Net cash used in investing activities amounted to ¥47.2 billion. This result was due primarily to payments for purchases of property, plant and equipment of ¥51.2 billion, reflecting outlays for security equipment and control stations—attributable to an increase in the number of security services subscribers—and the purchase of certain previously rented data center facilities, and other business assets in the information and communication related services segment; payments for purchases of investment securities of ¥32.6 billion, primarily in the insurance services segment and through private equity investments in the United States; and payments for purchases of intangible assets of ¥7.3 billion. These outlays were partially offset by proceeds from sales and redemptions of investment securities of ¥43.3 billion.

Net cash used in investing activities was ¥85.5 billion lower than in the preceding period. Factors contributing to this result included a decline in outlays for acquisitions, net of cash acquired, to ¥167 million, from ¥73.5 billion in the previous period, a figure that reflected factors such as the acquisition of Asahi Security.

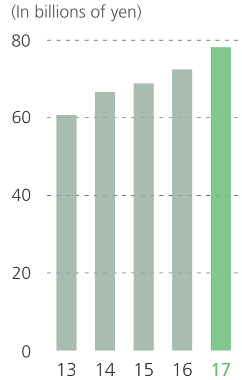
Net cash used in financing activities amounted to ¥59.8 billion. This result reflected dividends paid to SECOM CO., LTD. shareholders of ¥30.6 billion, repayments of long-term debt of ¥20.1 billion and a decrease in bank loans, net, of ¥13.5 billion, which were partially offset by proceeds from long-term debt of ¥8.4 billion.

Net cash used in financing activities was ¥30.8 billion higher than in the preceding period. Factors contributing to this result include the ¥13.5 billion decrease in bank loans, compared with an increase of ¥8.7 billion in the previous fiscal year, owing to the repayment of loans undertaken in the previous period to boost working capital.

The Company's operating, investing and financing activities in the period under review yielded net cash and cash equivalents at end of year of ¥299.6 billion, up ¥70.6 billion from net cash and cash equivalents at beginning of year, which were ¥229.0 billion.

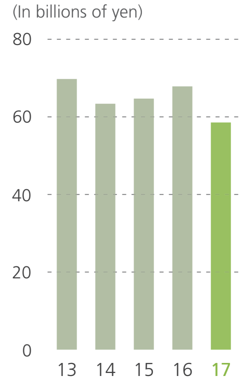
Depreciation and Amortization

(In billions of yen)



Purchases of Property, Plant and Equipment and Intangible Assets

(In billions of yen)



Cash Flows

(In billions of yen)