Financial Review

Operating Results

Overview

In the fiscal year ended March 31, 2018, 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, BPO and ICT services, and real estate and other services segments.

Bolstered by a solid performance in the security services and fire protection services segments and the addition of results for new subsidiary TMJ, consolidated on October 2, 2017, consolidated net sales and operating revenue in the period under review rose 5.0%, or ¥51.5 billion, to ¥1,082.8 billion. Operating income increased 9.7%, or ¥12.7 billion, to ¥142.8 billion, bolstered by higher net sales and operating revenue in six segments, including security services. Despite a decline in gain on private equity investments, the increase in operating income pushed net income attributable to SECOM CO., LTD., up 5.7%, or ¥5.2 billion, to ¥96.6 billion.

Net Sales and Operating Revenue

Consolidated net sales and operating revenue were up 5.0%, or ¥51.5 billion, to ¥1,082.8 billion. The BPO and ICT services, security services, fire protection services, medical services and insurance services segments reported increases while the geographic information services and real estate and other services segments reported decreases. (For further details, please see Segment Information below.)

Cost and Expenses

Total costs and expenses, at ¥940.0 billion, rose 4.3%, or ¥38.9 billion. Cost of sales advanced 5.7%, or ¥40.5 billion, to ¥750.4 billion, and was equivalent to 69.3% of net sales and operating revenue, up from 68.8% in the preceding fiscal year. Principal factors behind this result were the acquisition of a newly consolidated subsidiary with a comparatively high cost of sales ratio and an increase in the cost of sales ratio in the insurance services segment as a consequence of typhoons.

Selling, general and administrative (SG&A) expenses were up 3.1%, or ¥5.7 billion, to ¥190.2 billion, improving to 17.6% of net sales and operating revenue, from 17.9% in the previous period.

Impairment loss on long-lived assets amounted to ¥841 million, down from the ¥2.7 billion in the preceding fiscal year when the company recognized losses on certain assets in the geographic information services segment. The Company also recognized an impairment loss on goodwill of ¥11 million in the medical services segment, while in the previous period it recognized an impairment loss on goodwill of ¥1.2 billion in the security services segment. Additionally, the Company reported a gain on sales and disposal of fixed assets, net, of ¥1.5 billion, reflecting increased income from real estate sales, compared with a net loss of ¥2.8 billion in the preceding fiscal year.

Operating Income

Operating income rose 9.7%, or ¥12.7 billion, to ¥142.8 billion, equivalent to 13.2% of net sales and operating revenue, up from 12.6% in the previous period. Principal factors behind this result included the increase in net sales and operating revenue, together with a gain on sales and disposal of fixed assets, net, compared with a loss in the preceding fiscal year, a decline in impairment loss on long-lived assets and impairment loss on goodwill. Segments, in order of contribution to operating income, were security services, fire protection services, BPO and ICT services, real estate and other services, insurance services, medical services and geographic information services. (For further details, please see Segment Information below.)

Other Income and Expenses

Other income decreased ¥7.4 billion, to ¥10.7 billion, owing primarily to a ¥8.0 billion decline in gain on private equity investments, to ¥5.9 billion, while other expenses were down ¥315 million, to ¥2.8 billion, reflecting a decline in net exchange losses, to ¥213 million, from ¥454 million in the preceding fiscal year. The result was net other income of ¥8.0 billion, a decrease of ¥7.1 billion.

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

Despite a decline in net other income, income from continuing operations before income taxes and equity in net income of affiliated companies rose 3.8%, or ¥5.6 billion, to ¥150.8 billion, bolstered by higher operating income.

Income Taxes

Income taxes totaled ¥48.1 billion, an increase of ¥1.1 billion. This was equivalent to 31.9% of income from continuing operations before income taxes and equity in net income of affiliated companies, compared with 32.4% in the previous period, owing to the inclusion of overseas income tax-related income.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies, at ¥7.2 billion, was up ¥2.0 billion. This result was due largely to the fact that equity in net income of certain affiliated companies overseas was down in the preceding fiscal year.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests amounted to ¥13.2 billion, up ¥1.2 billion from the previous period. Principal factors behind this result were a decline in gain on private equity investments and an increase in operating income in the fire protection services segment.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD., advanced 5.7%, or ¥5.2 billion, to ¥96.6 billion, equivalent to 8.9% of net sales and operating revenue, level with the previous period. Net income attributable to SECOM CO., LTD. per share was ¥442.70, up from ¥418.71.

At the Ordinary General Meeting of Shareholders held on June 26, 2018, a proposal to pay a year-end dividend of ¥80.00 was approved. As a consequence, cash dividends for the period—which also included an interim dividend of ¥75.00 approved at the Board of Directors' meeting held on November 9, 2017—amounted to ¥155.00 per share, an increase of ¥10.00. However, because both the ¥75.00 per share year-end dividend for the year ended March 31, 2017, approved at the Ordinary General Meeting of Shareholders held on June 27, 2017, and the ¥75.00 per share interim dividend for the preceding fiscal year, determined by the Board of Directors and paid to shareholders of record as of September 30, 2017, 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 ¥150.00 per share.

Segment Information

(For further details, please see note 26 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 3.5%, or ¥18.9 billion, to ¥565.4 billion. Excluding intersegment transactions, net sales and operating revenue in this segment amounted to ¥562.3 billion, representing 51.9% of overall net sales and operating revenue, compared with 52.7% 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 employs a rental format, whereby it maintains ownership of security equipment and provides it to subscribers on a rental basis. This minimizes initial costs for subscribers and guarantees the quality and stability of its services. The initial contract period for security services is five years, with contracts renewed automatically each subsequent year. Depreciation for security equipment is computed using the straight-line method principally over five years.

The Company 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. This integrated approach leverages the Company's half-century-plus of experience and know-how in providing electronic security services, together with its R&D team's ability to recognize and address false alarms, to ensure highly efficient operations.

In the period under review, net sales and operating revenue from electronic security services edged up 0.7%, or ¥2.4 billion, to ¥341.2 billion, despite a decline in installations of large-scale security systems, among others, thanks to expanded sales of value-added services that respond to diverse security needs, which bolstered sales of on-line 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 ¥59.0 billion, up 4.6%, or ¥2.6 billion, bolstered by solid demand and a change in the status of an overseas Group company from equity-method affiliate to consolidated subsidiary. 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 ¥61.1 billion, up 5.6%, or ¥3.2 billion, owing principally to firm sales in the area of collection and delivery services.

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 11.6%, or ¥10.5 billion, to ¥101.0 billion, owing to robust results for large-scale sales-type leases.

Operating income in the security services segment rose 3.5%, or ¥3.9 billion, to ¥116.6 billion. The operating margin remained level with the preceding fiscal year at 20.6%. These results primarily reflected higher sales in the area of on-line security systems and the absence of an impairment loss on goodwill reported in the previous period.

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 ¥140.7 billion, up 8.5%, or ¥11.0 billion, from the previous period, bolstered by contributions from major projects, a result of robust sales efforts. Operating income climbed 20.0%, or ¥2.6 billion, to ¥15.8 billion, as greater business efficiency led to an improved cost of sales ratio. The operating margin improved to 11.2%, from 10.1% in the previous period.

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 advanced 3.8%, or ¥6.5 billion, to ¥175.5 billion. The principal factors behind this result were increases in sales and operating revenues for variable interest entities, underpinned by the expansion and modification of hospitals and the opening of new wards in recent years, which boosted user numbers; the inclusion of a full year of results for a hospital management company in India that was consolidated in the preceding fiscal year; and an expanded number of users of our pharmaceutical dispensing services. Operating income soared 136.1%, or ¥2.4 billion, to ¥4.1 billion, while the operating margin rose to 2.3%, from 1.0%, owing mainly to an improvement in the profitability of hospitals managed by variable interest entities and an absence of an impairment loss on long-lived assets reported in the preceding fiscal year.

Insurance Services

The insurance services segment continued to expand sales of an extensive lineup of distinctive products, including 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 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.

Despite a ¥310 million decline in net realized investment gain, net sales and operating revenue in this segment rose 1.8%, or ¥843 million, to ¥47.7 billion, with contributing factors including favorable sales of MEDCOM and fire insurance policies. Operating income fell 14.5%, or ¥1.1 billion, to ¥6.2 billion, while the operating margin dipped to 13.1%, from 15.6% in the previous fiscal year, owing to an increase in losses incurred as a result of typhoons.

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 it integrates, processes and analyzes to provide a variety 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 1.5%, or ¥758 million, to ¥51.1 billion, owing to a decline in net sales and operating revenue from services for overseas customers. The segment reported operating income of ¥1.9 billion, compared with an operating loss of ¥944 million in the previous fiscal year. The principal factors behind this result were a ¥1.1 billion decrease in impairment loss on long-lived assets and the reversal of a provision against futures losses recorded in the previous period.

BPO and ICT Services

The BPO and ICT services segment encompasses data center services, as well as BCP support services, information security services, cloud-based services and BPO services. In October 2017, we acquired all shares in TMJ, which provides contact center and other BPO services, as a result of which the company became a consolidated subsidiary. With the aim of integrating TMJ's capabilities with our existing data center and other information and communications related services to further grow these businesses, we changed the designation of this segment—formerly "information and communication related services"—to BPO and ICT services. This change involved no reclassification of reporting segments.

Net sales and operating revenue in this segment soared 35.3%, or ¥20.0 billion, to ¥76.8 billion, bolstered chiefly by contributions from newly acquired subsidiary TMJ and higher revenue from data center services. Operating income rose 13.1%, or ¥1.0 billion, to ¥8.2 billion, although the operating margin declined to 10.7%, from 12.8% in the previous fiscal year. This reflected the addition of TMJ's operating income and the fact that TMJ has a comparatively lower operating margin.

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 declined 8.2%, or ¥4.1 billion, to ¥45.5 billion. Principal factors behind this result included a decrease in the real estate development and sales business. Operating income climbed 32.0%, or ¥1.7 billion, to ¥6.9 billion. The operating margin climbed to 15.2%, from 10.6% in the previous fiscal year. Higher operating income reflected increased income from real estate sales.

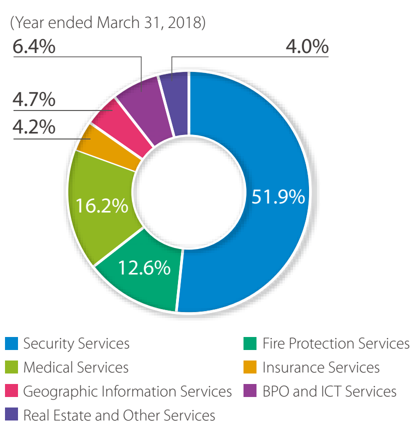
Financial Position

Total assets as of March 31, 2018, amounted to ¥1,838.9 billion, up ¥75.7 billion from the end of the previous fiscal year. Total current assets rose ¥34.0 billion, to ¥807.9 billion, and accounted for 43.9% of total assets. The current ratio was level at 2.0 times. Cash and cash equivalents totaled ¥316.7 billion, an increase of ¥17.1 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, trade, climbed ¥9.9 billion, to ¥144.7 billion, reflecting an increase in net sales and operating revenue in the fire protection services segment. 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 advanced ¥5.2 billion, to ¥135.8 billion, with contributing factors including an increase in service contracts. Real estate for sale, at ¥44.5 billion, was up ¥16.9 billion, as a consequence of which inventories rose ¥19.4 billion, to ¥82.1 billion.

Investments and long-term receivables increased ¥8.6 billion, to ¥358.2 billion. This represented 19.5% of total assets. Property, plant and equipment, less accumulated depreciation, fell ¥1.7 billion, to ¥412.3 billion, equivalent to 22.4% of total assets, with contributing factors including sales of real estate for lease.

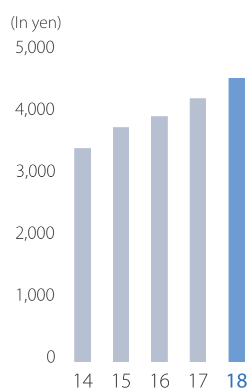
Other assets totaled ¥260.5 billion, up ¥34.7 billion, and accounted for 14.2% of total assets. The consolidation of TMJ, among others, boosted goodwill ¥17.6 billion, to ¥106.5 billion, and other intangible assets ¥6.3 billion, to ¥57.0 billion. Prepaid pension

Percentage of Consolidated Net Sales and Operating Revenue*

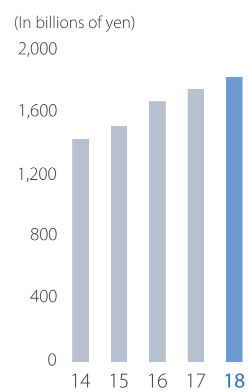


* Pie chart shows percentage of consolidated net sales and operating revenue (excluding intersegment transactions)

SECOM CO., LTD. Shareholders' Equity per Share



Total Assets



and severance costs rose ¥6.1 billion, to ¥41.4 billion, bolstered by increases in the fair value of plan assets. Owing to the revision of an accounting standard governing balance sheet classification whereby deferred tax assets and liabilities must be classified as noncurrent assets and liabilities on the balance sheets, deferred income taxes climbed ¥5.0 billion, to ¥13.2 billion.

Total liabilities as of March 31, 2018, amounted to ¥707.6 billion, down ¥4.2 billion from the end of the previous fiscal year, and accounted for 38.5% of total liabilities and equity. Total current liabilities were ¥399.7 billion, an increase of ¥5.7 billion, and accounted for 21.7% of total liabilities and equity. Deposits received rose ¥6.8 billion, to ¥118.9 billion, as an increase in service contracts pushed up cash deposits for armored car services.

Total long-term liabilities, at ¥308.0 billion, were down ¥9.9 billion, and represented 16.8% of total liabilities and equity. Long-term debt, at ¥50.3 billion, was down ¥3.9 billion, owing to repayments, as well as to the shift of certain debt to the bank loans category, among others. The revision of an accounting standard was one of several factors contributing to a ¥7.3 billion decrease in deferred income taxes, to ¥26.5 billion.

Total SECOM CO., LTD. shareholders' equity advanced ¥71.0 billion, to ¥1,000.3 billion. Retained earnings rose ¥63.8 billion, to ¥896.6 billion, with contributing factors including an increase in net income attributable to SECOM CO., LTD. and the payment of dividends. A positive pension liability adjustment of ¥1.6 billion, compared with a negative adjustment of ¥3.5 billion in the preceding fiscal year, boosted accumulated other comprehensive income ¥7.1 billion, to ¥27.2 billion. As a result, the equity ratio was 54.4%, compared with 52.7% as of March 31, 2017.

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 ¥133.3 billion. The principal components of this were net income of ¥109.9 billion; depreciation and amortization, including amortization of deferred charges, a non-cash item, of ¥79.0 billion; an increase in inventories of ¥18.6 billion; and an increase in deferred charges of ¥15.9 billion, attributable primarily to the deferral of costs related to the installation of equipment used to provide on-line security systems. (For further details, please see note 12 of the Notes to the Consolidated Financial Statements.)

Net cash provided by operating activities was ¥45.4 billion lower than in fiscal year ended March 31, 2017. Factors behind this decline included an ¥18.6 billion increase in inventories, compared with an decrease of ¥187 million in the previous period; a ¥2.4 billion decrease in accrued income taxes, compared with a ¥4.3 billion increase in the preceding fiscal year; and other, net, of ¥2.8 billion, down from ¥9.3 billion provided by this item in the previous period. The decline in cash provided in the other, net, category, primarily reflected the impact on the preceding period's result of payments received 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 was ¥61.5 billion. This result reflected payments for purchases of property, plant and equipment of ¥53.8 billion, reflecting outlays for security equipment and control stations necessitated by an increase in the number of security services subscribers; payments for purchases of investment securities of ¥51.1 billion, primarily in the insurance services segment and through private equity investments in the United States; and acquisitions, net of cash acquired, of ¥23.3 billion, owing to the acquisition of TMJ, among others. These outlays were partially offset by proceeds from sales and redemptions of investment securities of ¥69.4 billion.

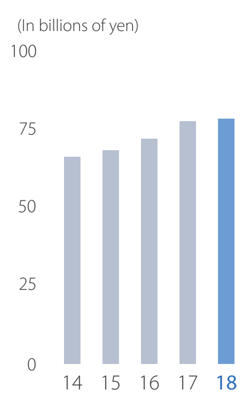
Net cash used in investing activities was ¥14.3 billion higher than in the fiscal year ended March 31, 2017. Contributing factors included a ¥23.1 billion increase in acquisitions, net of cash acquired.

Net cash used in financing activities amounted to ¥55.0 billion. This was attributable primarily to dividends paid to SECOM CO., LTD. shareholders of ¥32.7 billion and repayments of long-term debt of ¥20.6 billion.

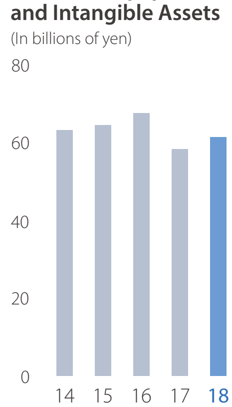
Net cash used in financing activities was ¥4.8 billion lower than in the preceding fiscal year. Factors behind this change included increases of ¥2.2 billion in dividends paid to SECOM CO., LTD. and ¥1.9 billion in dividends paid to noncontrolling interests and a decrease in bank loans, net, of ¥3.4 billion, compared with a decrease of ¥13.5 billion in the previous period.

The Company's operating, investing and financing activities in the period under review yielded net cash and cash equivalents at end of year of ¥316.7 billion, up ¥17.1 billion from net cash and cash equivalents at beginning of year, which were ¥299.6 billion.

Depreciation and Amortization



Purchases of Property, Plant and Equipment and Intangible Assets



Cash Flows