Financial Review

Operating Results

Overview

In the fiscal year ended March 31, 2019, SECOM CO., LTD. and its subsidiaries (collectively, "the Company") sought to provide high-quality products and services that respond to the diverse needs of customers in its core security services segment, as well as in its fire protection services, medical services, insurance services, geospatial information services, BPO and ICT services, and real estate and other services segments.

Thanks to the inclusion of a full year of results for TMJ, acquired in October 2017, and an increase in the medical services segment, bolstered by a rise in the number of patients at associated hospitals, among others, consolidated net sales and operating revenue in the period under review rose 2.7%, or ¥28.8 billion, to ¥1,111.6 billion. Nonetheless, operating income declined 11.7%, or ¥16.4 billion, to ¥123.7 billion, owing to a variety of factors, including the occurrence of multiple major natural disasters and a greater loss on other-than-temporary impairment of investment securities, as a result of which the insurance services segment reported an operating loss, and the impact of forward-looking investments to reinforce the Company's operating foundation with the aim of ensuring sustainable growth. Net income attributable to SECOM CO., LTD., was down 7.2%, or ¥6.9 billion, to ¥89.7 billion.

Net Sales and Operating Revenue

Owing to the inclusion of a full year of results for TMJ, acquired in October 2017, and an increase in the medical services segment, underpinned by a rise in the number of patients at associated hospitals, among others, consolidated net sales and operating revenue in the period under review rose 2.7%, or ¥28.8 billion, to ¥1,111.6 billion. (For further details, please see Segment Information below.)

Cost and Expenses

Total costs and expenses advanced 4.8%, or ¥45.2 billion, to ¥987.9 billion. Cost of sales rose 4.4%, or ¥33.0 billion, to ¥784.9 billion, and was equivalent to 70.6% of net sales and operating revenue, up from 69.4% in the previous fiscal year. Principle factors behind this result included an increase in cost of sales in the insurance services segment, which reflected the occurrence of multiple major natural disasters and a greater loss on other-than-temporary impairment of investment securities, and the inclusion of a full year of results for TMJ, which has a comparatively high cost of sales ratio. Owing to the application of a new accounting standard, "Recognition and Measurement of Financial Assets and Financial Liabilities," whereby equity investments are recognized at fair value at end of year, effective from the period under review gains or losses on equity investments are charged to income for the period.

Selling, general and administrative (SG&A) expenses rose 5.0%, or ¥9.5 billion, to ¥200.9 billion, reflecting an increase in up-front expenses, accounted for 18.1% of net sales and operating revenue, up from 17.7% in the preceding period. Impairment loss on long-lived assets declined to ¥595 million, from ¥841 million. Additionally, the Company reported a loss on sales and disposal of fixed assets, net, of ¥1.4 billion, compared with a net gain of ¥1.5 billion in the previous fiscal year attributable to income from real estate sales and other factors.

Operating Income

Operating income decreased 11.7%, or ¥16.4 billion to ¥123.7 billion, despite higher net sales and operating revenue, as both the cost of sales and SG&A expense ratios rose. The operating margin slipped to 11.1%, from 12.9%.

Other Income and Expenses

Other income declined ¥2.2 billion, to ¥11.2 billion. This was attributable largely to a ¥1.2 billion decrease in gain on private equity investments to ¥4.7 billion. Other expenses amounted to ¥6.4 billion, up ¥3.6 billion, reflecting a ¥3.9 billion increase in loss on other-than-temporary impairment of investment securities, to ¥4.0 billion. As a consequence, net other income was ¥4.9 billion, down ¥5.8 billion from the previous fiscal year.

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

The aforementioned results yielded income from continuing operations before income taxes and equity in net income of affiliated companies of ¥128.6 billion, down 14.7%, or ¥22.2 billion, from the preceding period.

Income Taxes

Income taxes totaled ¥35.1 billion, a decrease of ¥13.0 billion. This was equivalent to 27.3% of income from continuing operations before income taxes and equity in net income of affiliated companies, compared with 31.9% in the previous fiscal year, owing to a reversal of the valuation allowance and other factors.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies edged down ¥177 million, to ¥7.0 billion.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests amounted to ¥10.8 billion, down ¥2.5 billion. Principal factors behind this result included a decline in operating income in the fire protection services segment, an operating loss in the insurance services segment and a decrease in gain on private equity investments.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD., at ¥89.7 billion, declined 7.2%, or ¥6.9 billion. Net income attributable to SECOM CO., LTD., as a percentage of net sales and operating revenue was 8.1%, compared with 8.9% in the previous fiscal year. Net income attributable to SECOM CO., LTD. per share was ¥410.91, down from ¥442.70.

At the Ordinary General Meeting of Shareholders held on June 26, 2019, a proposal to pay a year-end dividend of ¥85.00 was approved. As a consequence, cash dividends for the period—which also included an interim dividend of ¥80.00 approved at the Board of Directors' meeting held on November 8, 2018—amounted to ¥165.00 per share, an increase of ¥10.00. However, because both the ¥80.00 per share year-end dividend for the year ended March 31, 2018, approved at the Ordinary General Meeting of Shareholders held on June 26, 2018, and the ¥80.00 per share interim dividend for the preceding period, determined by the Board of Directors and paid to shareholders of record as of September 30, 2018, 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 ¥160.00 per share.

Segment Information

(For further details, 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 edged up 0.3%, or ¥1.8 billion, to ¥567.2 billion. Excluding inter-segment transactions, net sales and operating revenue in this segment amounted to ¥563.7 billion, representing 50.8% of overall net sales and operating revenue, compared with 51.9% 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 focus on surveillance services for the subscriber' 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 monitoring. Should an irregularity be detected, relevant information is relayed to the control center, where staff dispatch emergency response personnel to take appropriate measures. If necessary, control center staff also notify the police, fire department or other emergency services.

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 declining-balance 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 knowhow in providing electronic security services, together with its R&D team's ability to recognize and address false alarms, to ensure highly efficient operations.

Net sales and operating revenue from electronic security services rose 0.9%, or ¥3.1 billion, to ¥344.3 billion. Despite a decline in large-scale installations, among others, sales of on-line security systems advanced, bolstered by expanded sales of high-value-added commercial security services that respond to diverse security needs and of SECOM Home Security NEO and other home security systems that addresses growing needs for help in caring for vulnerable members of society.

Other security services include static guard services and armored car services. Net sales and operating revenue generated by static guard services, which are provided by highly trained professional security guards for systems requiring human judgment and flexible responsiveness, rose 12.3%, or ¥7.2 billion, to ¥66.3 billion, reflecting contributions from Secom Tosec Co., Ltd., in which we acquired an 80.1% stake in August 2018 and firm demand for these services. Armored car services, which involve the transport of cash, securities and other valuables using specially fitted armored cars and security professionals, generated net sales and operating revenue of ¥62.4 billion, up 2.2%, or ¥1.3 billion. Principal factors behind this result included an increase in sales at Asahi Security, which principally provides cash 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 were down 10.1%, or ¥10.2 billion, to ¥90.8 billion, owing mainly to the absence of large-scale sales-type leases, which pushed up results in the preceding period.

Operating income in the security services segment declined 3.8%, or ¥4.3 billion, to ¥110.1 billion. The operating margin slipped to 19.4%, from 20.2% in the previous fiscal year. These results primarily reflected forward-looking investments to reinforce the Company's operating foundation with the aim of ensuring sustainable growth and to absence of large-scale sales-type leases, a key factor in the previous fiscal year.

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 ¥144.1 billion, up 2.4%, or ¥3.4 billion, underpinned by contributions from major projects, a result of robust sales efforts, and other factors. Operating income decreased 9.8%, or ¥1.5 billion, to ¥14.2 billion, a consequence of factors such as a cluster of projects with a higher cost of sales ratio than in the preceding period and an increase in SG&A expenses, reflecting higher R&D and personnel costs. The operating margin was 9.8%, down from 11.2% in the previous fiscal year.

Medical Services

The medical services segment emphasizes Home Medical Services, which comprise home nursing and pharmaceutical dispensing services, support for affiliated medical institutions, sales of medical equipment and pharmaceuticals, the operation of residences for seniors, personal care services, and the provision of electronic medical reporting and other ICT-based systems in Japan, as well as the operation of a hospital in India. The segment also includes the operations of variable interest entities (VIEs) of which the Company is the primary beneficiary, which manage hospitals and health care-related institutions.

Segment net sales and operating revenue advanced 3.6%, or ¥6.4 billion, to ¥181.9 billion, owing to an increase in the net sales and operating revenue of VIEs, bolstered by a rise in the number of patients at associated hospitals, among others. Despite an increase in the cost of sales ratio accompanying the revision of drug prices in Japan, operating income climbed 43.3%, or ¥1.7 billion, to ¥5.8 billion and the operating margin improved to 3.2%, from 2.3% in the previous fiscal year, reflecting an improvement in the profitability of hospitals managed by VIEs.

Insurance Services

The insurance services segment continued to expand sales of an extensive lineup of distinctive non-life insurance policies, 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 extend 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, 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 declined 6.2%, of ¥3.0 billion, to ¥44.8 billion, despite robust sales of MEDCOM and fire insurance policies. This result was attributable mainly to the application of the new "Recognition and Measurement of Financial Assets and Financial Liabilities" accounting standard, which resulted in an increase in loss on other-than-temporary impairment of investment securities. The segment reported an operating loss of ¥4.9 billion, compared with operating income of ¥6.2 billion in the preceding period, owing primarily to increases in losses incurred as a result of the aforementioned major natural disasters and loss on other-than-temporary impairment of investment securities.

Geospatial Information Services

The geospatial information services segment centers on the collection of geographic data using commercial satellites, aircraft and surveying using proprietary vehicles, among others, which is integrated, processed and analyzed to provide geospatial information services to public-sector entities—including national and local governments—and customers in the private sector in Japan. These services are also offered to government agencies overseas.

Net sales and operating revenue in this segment edged up 1.6%, or ¥814 million, to ¥51.9 billion, bolstered by an increase in sales to domestic customers. Operating income rose 12.1%, or ¥202 million, to ¥1.9 billion, thanks to an improved cost of sales ratio in Japan and a decline in SG&A expenses. The operating margin improved to 3.6%, from 3.3% in the previous fiscal year. The name of this segment was changed to geospatial information services, from geographic information services, effective from the period under review. This change did not entail any reclassification of reportable segments.

BPO and ICT Services

BPO and ICT services encompass the provision of data center services, BCP support services, information security services, cloud-based services and BPO services.

Segment net sales and operating revenue climbed 31.8%, or ¥24.4 billion, to ¥101.3 billion, owing to contributions from TMJ, which became a consolidated subsidiary in October 2017, and higher revenue from the data center services, among others. Operating income was up 15.5%, or ¥1.3 billion, to ¥9.4 billion, and the operating margin decreased to 9.3%, from 10.6%. This reflected comparatively profitable systems development projects, the inclusion of a full year of results for TMJ and a decline in impairment loss on long-lived assets, as well as the fact that TMJ has a comparatively lower operating margin.

Real Estate and Other Services

The real estate and other services segment includes the development and sale of, among others, condominiums equipped with distinctive security and disaster preparedness features, as well as real estate leasing, construction and installation, and other services.

Net sales and operating revenue in this segment rose 2.4%, or ¥1.1 billion, to ¥46.6 billion, with contributing factors including an increase in the construction and installation business, as well as to the sale of blocks of renovated pre-owned condominiums. Operating income fell 26.4%, or ¥1.8 billion, to ¥5.1 billion, owing to the absence of income from real estate sales reported in the preceding period. The operating margin declined to 10.9%, from 15.2% in the previous fiscal year.

Financial Position

Total assets as of March 31, 2019, amounted to ¥1,879.7 billion, an increase of ¥40.8 billion from the end of the preceding period. Total current assets rose ¥62.4 billion, to ¥870.3 billion, and accounted for 46.3% of total assets. The current ratio edged up to 2.1 times, from 2.0 times. Cash and cash equivalents totaled ¥349.7 billion, up ¥33.0 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 ¥12.2 billion, to ¥156.9 billion, owing to factors such as an increase attributable to the application of a new accounting standard, "Revenue from Contracts with Customers," as well as to higher net sales and operating revenue. Notes and accounts receivable are affected by the fact that income in the fire protection services and geospatial information segments tend to be concentrated toward the end of the fiscal year. Cash deposits for armored car services advanced ¥6.5 billion, to ¥142.3 billion, with contributing factors including the expansion of cash collection and delivery service contracts. Inventories were down ¥16.1 billion, to ¥65.9 billion, as the application of the new "Revenue from Contracts with Customers" accounting standard resulted in a decrease in costs related to incomplete construction contracts, leading to declines of ¥8.3 billion in inventories of fire protection-related products, to ¥12.2 billion, and ¥7.8 billion in inventories of real estate for sale, to ¥36.6 billion.

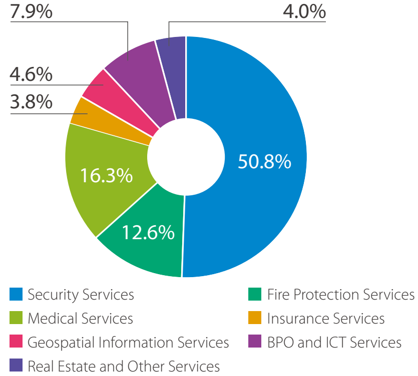
Investments and long-term receivables decreased ¥16.8 billion, to ¥341.4 billion. This represented 18.2% of total assets. Investment securities, at ¥212.6 billion, were down ¥14.6 billion. This was due to the reclassification of corporate bonds and other debt securities due within one year in current assets, as well as to a greater loss on other-than-temporary impairment of investment securities.

Property, plant and equipment, at ¥416.2 billion, was down ¥3.9 billion, equivalent to 22.1% of total assets. Land rose ¥2.6 billion, to ¥116.5 billion, reflecting an increase in real estate for lease.

Other assets declined ¥8.7 billion, to ¥251.8 billion, and accounted for 13.4% of total assets. Goodwill was up ¥1.6 billion, to ¥108.1 billion and other intangible assets rose ¥865 million, to ¥57.9 billion. Deferred charges decreased ¥17.1 billion, to ¥25.2 billion, a consequence of the application of the new "Revenue from Contracts with Customers" accounting standard. Deferred income taxes advanced ¥8.8 billion, to ¥22.1 billion, with

Percentage of Consolidated Net Sales and Operating Revenue*

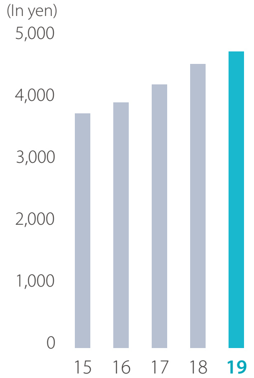
(Year ended March 31, 2019)



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

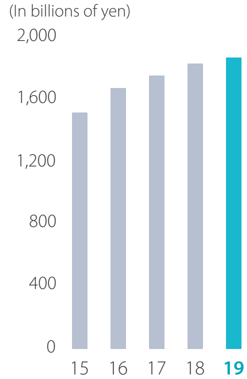
SECOM CO., LTD. Shareholders' Equity per Share

(In yen)



Total Assets

(In billions of yen)



contributing factors including a reversal of the valuation allowance.

Total liabilities as of March 31, 2019, amounted to ¥703.8 billion, a decline of ¥3.8 billion from the end of the previous fiscal year, and accounted for 37.4% of total liabilities and equity. Total current liabilities were ¥405.4 billion, an increase of ¥5.7 billion, and accounted for 21.5% of total liabilities and equity. Deposits received rose ¥8.7 billion, to ¥127.6 billion, as the expansion of service contracts pushed up cash deposits for armored car services.

Total long-term liabilities, at ¥298.4 billion, were down ¥9.5 billion, and represented 15.9% of total liabilities and equity. Long-term debt declined ¥5.0 billion, to ¥45.3 billion, owing to repayments, as well as to the transfer of certain debt to "bank loans" in current liabilities, among others. Deferred income taxes fell ¥10.5 billion, to ¥16.0 billion, reflecting a reversal of the valuation allowance.

Total SECOM CO., LTD. shareholders' equity increased ¥43.9 billion, to ¥1,044.2 billion. Retained earnings climbed ¥71.1 billion, to ¥967.7 billion, with contributing factors including net income attributable to SECOM CO., LTD. and the payment of dividends, as well as cumulative-effect adjustment from unrealized gains on securities to retained earnings at the beginning of the fiscal year of ¥20.8 billion. Accumulated other comprehensive loss was ¥78 million, compared with accumulated other comprehensive income of ¥27.2 billion in the preceding period, owing to a decrease in unrealized gains on securities, which was a significant factor in the previous fiscal year. As a result, the equity ratio was 55.6%, compared with 54.4% 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 ¥158.3 billion. The principal components of this were net income of ¥100.4 billion, and depreciation and amortization, including amortization of deferred charges, a non-cash item, of ¥75.3 billion, which were partially offset by an increase in receivables and due from subscribers, net of allowances, of ¥17.4 billion and an increase in deferred charges of ¥10.7 billion. Deferred charges consisted primarily of costs related to the installation of equipment for on-line security systems. (For further details, please see note 2 (12) of the Notes to the Consolidated Financial Statements.)

Net cash provided by operating activities was ¥25.1 billion higher than in the fiscal year ended March 31, 2018. Factors behind this increase included a ¥4.3 billion decrease in inventories, compared with an ¥18.6 billion increase in the previous fiscal year, owing to declines in inventories of real estate for sale and of fire protection-related products, the latter reflecting a decrease in costs related to incomplete construction contracts.

Net cash used in investing activities was ¥64.4 billion. This result was despite proceeds from sales and redemptions of investment securities of ¥43.6 billion and was a consequence of payments for purchases of property, plant and equipment of ¥56.4 billion, owing to outlays for security equipment and forward-looking investments to reinforce the Company's operating foundation; payments for purchases of intangible assets of ¥11.5 billion, attributable to forward-looking investments to reinforce the Company's operating foundation; and payments for purchases of investment securities of ¥36.7 billion, primarily in the insurance services segment and through private equity investments in the United States.

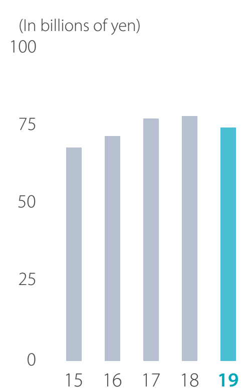
Net cash used in investing activities was ¥3.0 billion higher than in the fiscal year ended March 31, 2018, despite a decline in outlays for acquisitions, net of cash acquired, which rose in the previous period as a result of the acquisition of TMJ, among others. Factors behind this result included cash generated by an increase in short-term investments and net proceeds from sales and redemption of investment securities of ¥2.7 billion, compared with ¥17.1 billion in the preceding period, and an increase in outlays for purchases of property, plant and equipment and of intangible assets.

Net cash used in financing activities was ¥60.3 billion. This was due primarily to dividends paid to SECOM CO., LTD. shareholders of ¥34.9 billion, and repayments of long-term debt of ¥20.2 billion.

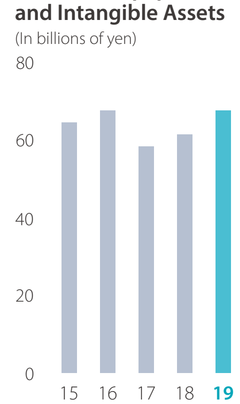
Net cash used in financing activities was ¥5.3 billon higher than in in the fiscal year ended March 31, 2018. This primarily reflected dividends paid to noncontrolling interests arising from the purchase of treasury stock by subsidiary Secom Joshinetsu Co., Ltd., a decline in proceeds from long-term debt and the increase in dividends paid to SECOM CO., LTD. shareholders.

The Company's operating, investing and financing activities in the period under review yielded net cash and cash equivalents of ¥349.7 billion, up ¥33.0 billion from net cash and cash equivalents at the beginning of the period, which were of ¥316.7 billion.

Depreciation and Amortization



Purchases of Property, Plant and Equipment and Intangible Assets



Cash Flows