Financial Review

Operating Results

Overview

In the fiscal year ended March 31, 2020, SECOM CO., LTD. and its consolidated subsidiaries (collectively, "the Company") sought to provide high-quality services and products 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 increases in all segments, consolidated net sales and operating revenue in the period under review advanced 4.4%, or ¥49.1 billion, to ¥1,160.7 billion. Despite the impact of forward-looking investments to reinforce the Company's operating foundation with the aim of ensuring sustainable growth, operating income rose 5.5%, or ¥6.9 billion, to ¥130.6 billion, bolstered by operating income growth in the fire protection services, BPO and ICT services, geospatial information services, real estate and other services, and medical services segments, as well as by a smaller operating loss in the insurance services segment. Nonetheless, owing to a ¥139 million loss on private equity investments, compared with a ¥4.7 billion gain on such investments in the fiscal year ended March 31, 2019, together with an increase in income taxes that reflected a larger reversal of the valuation allowance in the preceding period, net income attributable to SECOM CO., LTD., decreased 2.8%, or ¥2.6 billion, to ¥87.1 billion.

Net Sales and Operating Revenue

Consolidated net sales and operating revenue in the period under review rose 4.4%, or ¥49.1 billion, to ¥1,160.7 billion, thanks to increases in all segments. (For further information, please see Segment Information below.)

Costs and Expenses

Total costs and expenses advanced 4.3%, or ¥42.3 billion, to ¥1,030.1 billion. Cost of sales rose 4.5%, or ¥34.9 billion, to ¥819.9 billion, and was equivalent to 70.6% of net sales and operating revenue, essentially level with the previous fiscal year. Selling, general and administrative (SG&A) expenses were up 2.4%, or ¥4.9 billion, to ¥205.8 billion, equivalent to 17.7% of net sales and operating revenue, an improvement from 18.1% in the preceding period. Impairment loss on long-lived assets increased ¥357 million, to ¥952 million. The Company also reported an impairment loss on goodwill of ¥758 million. Additionally, the Company reported a loss on sales and disposal of fixed assets, net, of ¥2.8 billion, ¥1.3 billion more than in the previous fiscal year, reflecting the disposal of certain existing buildings as a consequence of reconstruction, a decline in sales of real estate for lease and other factors.

Operating Income

Operating income rose 5.5%, or ¥6.9 billion, to ¥130.6 billion. This was largely attributable to the increase in net sales and operating revenue, which absorbed higher costs and expenses. The operating margin edged up to 11.2%, from 11.1%.

Other Income and Expenses

Other income decreased ¥1.3 billion, to ¥10.0 billion, owing primarily to a loss on private equity investments of ¥139 million, compared with a gain of ¥4.7 billion in the preceding period, although this was partially offset by a ¥2.3 billion gain on sales of securities, net, resulting from the sale of a U.S. subsidiary in the geospatial information services business during the period under review, compared with a ¥115 million loss on sales of securities, net, in the previous fiscal year. Other expenses rose ¥116 million, to ¥6.5 billion. Net other income thus amounted to ¥3.5 billion, down ¥1.4 billion.

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 ¥134.0 billion, up 4.3%, or ¥5.5 billion, from the preceding period.

Income Taxes

Income taxes amounted to ¥40.9 billion, an increase of ¥5.8 billion, owing to a larger reversal of the valuation allowance in the previous fiscal year. This was equivalent to 30.5% of income from continuing operations before income taxes and equity in net income of affiliated companies, up from 27.3%.

Equity in Net Income of Affiliated Companies

Equity in net income of affiliated companies slipped ¥348 million, to ¥6.7 billion.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests rose ¥1.9 billion, to ¥12.6 billion. The principal factor behind this result was increases in operating income in the fire protection services and geospatial information services segments.

Net Income Attributable to SECOM CO., LTD.

Net income attributable to SECOM CO., LTD., decreased 2.8%, or ¥2.6 billion, to ¥87.1 billion, equivalent to 7.5% of net sales and operating revenue, declining from 8.1% in the preceding period. Net income attributable to SECOM CO., LTD., per share was ¥399.23, down from ¥410.91. At the Ordinary General Meeting of Shareholders held on June 25, 2020, a proposal to pay a year-end dividend of ¥85.00 was approved. As a result, cash dividends for the period—which also included an interim dividend of ¥85.00 per share approved at the Board of Directors meeting held on November 8, 2019—amounted to ¥170.00, an increase of ¥5.00. However, the figure of ¥170.00 for cash dividends per share that appears in the consolidated financial statements represents cash dividends paid to shareholders during the period, namely, the ¥85.00 per share year-end dividend for the year ended March 31, 2019, approved at the Ordinary General Meeting of Shareholders held on June 26, 2019, and the ¥85.00 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, 2019.

Segment Information

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 fiscal year ended March 31, 2020, net sales and operating income in this segment rose 2.3%, or ¥13.3 billion, to ¥580.5 billion. Excluding intersegment transactions, segment net sales and operating income amounted to ¥577.3 billion, representing 49.7% of overall net sales and operating revenue, down from 50.8% in the preceding period.

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 subscribers' premises. On-line commercial and home security systems use sensors, controllers and other equipment installed at subscribers' 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, 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 edged up 0.8%, or ¥2.9 billion, to ¥347.2 billion. This was due to increased sales of on-line security systems, underpinned by expanded sales of high-value-added commercial systems that respond to diverse security needs and peripheral services, and of SECOM Home Security NEO and other home security services that address growing needs for help in caring for vulnerable members of society.

Other security services include static guard 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, advanced 5.7%, or ¥3.8 billion, to ¥70.0 billion. This was a consequence of the first full year of contributions from Secom Tosec Co., Ltd., in which we acquired an 80.1% stake in August 2018, as well as solid demand for static guard services. Armored car services, which involve the transport of cash, securities and other valuables using special fitted armored cars and security professionals, generated net sales and operating revenue of ¥63.6 billion, up 1.9%, or ¥1.2 billion. Principal factors behind this result included an increase in the sales of Asahi Security, which principally provides cash collection and delivery services.

The merchandise and other category encompasses 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 rose 6.3%, or ¥5.7 billion, to ¥96.5 billion, underpinned by an increase in sales-type leases of large-scale security systems and higher sales of access control and custom-built systems.

Operating income in the security services segment declined 1.1%, or ¥1.2 billion, to ¥108.9 billion. The operating margin slipped to 18.8%, from 19.4% 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 an impairment loss on goodwill.

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.

Segment net sales and operating revenue increased 8.2%, or ¥11.8 billion, to ¥155.9 billion, bolstered by contributions from large-, medium- and small-scale projects, a result of potent sales efforts. Operating income climbed 25.6%, or ¥3.6 billion, to ¥17.8 billion, owing to the increase in net sales and operating revenue, as well as to a number of comparatively profitable projects and a decline in cost of sales due to improved operating efficiency. The operating margin was 11.4%, up from 9.8% in the preceding period.

Medical Services

The medical services segment provides home nursing services, pharmaceutical dispensing services, support for affiliated medical institutions in Japan, sales of medical equipment, the operation of a general hospital in India, the operation of residences for seniors and other personal care services, health and preventative care services, and ICT-based services, which included electronic medical report systems. Additionally, this segment includes the operations of variable interest entities (VIEs) of which the Company is the primary beneficiary, which manage hospitals and health care-related institutions.

Net sales and operating revenue in this segment were up 3.0%, or ¥5.4 billion, to ¥187.3 billion, a consequence of increases in the net sales and operating revenue of VIEs, underpinned by a rising number of patients at affiliated medical institutions, as well as to higher sales of pharmaceuticals and medical equipment and revenue from pharmaceutical dispensing services. Operating income advanced 7.8%, or ¥450 million, to ¥6.2 billion, reflecting an improvement in the operating income of a hospital operated by the Company in India. The operating margin improved to 3.3%, from 3.2% in the previous fiscal year.

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.

Segment net sales and operating revenue, at ¥46.9 billion, increased 4.9%, or ¥2.2 billion, bolstered by brisk sales of MEDCOM and fire and automobile insurance policies. The segment reported an operating loss of ¥4.3 billion, an improvement from ¥4.9 billion in the preceding period, attributable to higher net sales and operating revenue, as well as to a decrease in losses incurred as a result of multiple major natural disasters.

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 rose 3.5%, or ¥1.8 billion, to ¥53.7 billion, bolstered by an increase in revenue from domestic public-sector customers, owing to the expanded provision of surveying services employing aerial lasers to such customers. Operating income jumped 61.3%, or ¥1.2 billion, to ¥3.0 billion, while the operating margin improved to 5.6%, from 3.6%. This primarily reflected declines in depreciation expenses and impairment losses.

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 increased 9.5%, or ¥9.7 billion, to ¥110.9 billion, bolstered by higher revenue from data center services and contributions from subsidiary TMJ, a provider of contact center, back office support and other BPO services. Operating income, at ¥10.6 billion, was up 13.1%, or ¥1.2 billion, and the operating margin rose to 9.6%, from 9.3%, reflecting an improvement in the cost of sales ratio attributable to higher sales in the data center business.

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 advanced 9.9%, or ¥4.6 billion, to ¥51.2 billion, with contributing factors including an increase in condominium development and sales. Operating income rose 17.9%, or ¥912 million, to ¥6.0 billion, and the operating margin increased to11.7%, from 10.9%.

Financial Position

Total assets as of March 31, 2020, amounted to ¥2,081.1 billion, an increase of ¥201.4 billion from the end of the previous fiscal year. Total current assets rose ¥65.6 billion, to ¥935.9 billion, and accounted for 45.0% of total assets. The current ratio was 2.2 times, up from 2.1 times. Cash and cash equivalents totaled ¥414.7 billion, an increase of ¥64.9 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, rose ¥9.7 billion, to ¥166.6 billion, owing 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 services businesses tend to be concentrated toward the end of the fiscal year. Cash deposits for armored car services declined ¥1.4 billion, to ¥140.9 billion. These cash deposits are funded primarily through bank overdrafts and deposits and their use by the company is restricted. The sales of real estate for sale and other factors led to a decline in inventories of ¥9.6 billion, to ¥56.3 billion.

Investments and long-term receivables decreased ¥16.1 billion, to ¥325.3 billion, which represented 15.6% of total assets. Investment securities, at ¥194.8 billion, were down ¥17.8 billion. Contributing factors included the reclassification of corporate bonds and other debt securities due within one year as current assets.

Property, plant and equipment, less accumulated depreciation, amounted to ¥425.5 billion, up ¥9.3 billion and equivalent to 20.4% of total assets. This primarily reflected increases in buildings and improvements, attributable to data center business–related investments, and in security equipment and control stations, a result of purchases of security equipment necessitated by a rising number of security services subscribers.

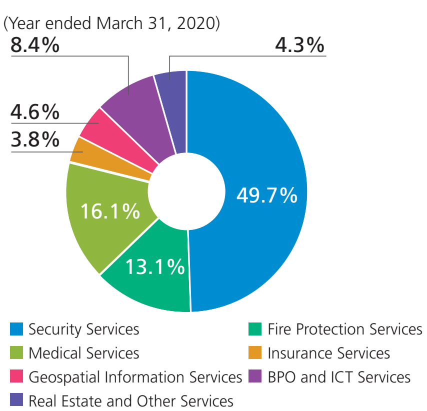
Other assets, at ¥394.4 billion, were up ¥142.6 billion and accounted for 19.0% of total assets. Owing to the application of Accounting Standards Update (ASU) No. 2016-02, "Leases," from the beginning of the period under review, the Company was required to recognize almost all lease assets and lease liabilities arising from lease contracts, which are classified as operating leases, on its balance sheets. As a consequence, operating lease right-of-use assets of ¥143.5 billion were included in other assets. In addition, prepaid pension and severance costs declined ¥6.7 billion, to ¥31.8 billion, reflecting deteriorating investment conditions, while deferred income taxes rose ¥3.7 billion, to ¥25.8 billion.

Total liabilities as of March 31, 2020, amounted to ¥853.7 billion, up ¥149.9 billion from the end of the preceding period, and accounted for 41.0% of total liabilities and equity. Total current liabilities, at ¥431.2 billion were up ¥25.8 billion and represented 20.7% of total liabilities and equity, owing largely to the application of ASU No. 2016-02, which resulted in the inclusion of current operating lease liabilities of ¥19.2 billion, and to a ¥4.9 billion increase in other current liabilities, to ¥37.9 billion, as a consumption tax rate hike led to an increase in accrued consumption tax.

Total long-term liabilities rose ¥124.1 billion, to ¥422.5 billion, and represented 20.3% of total liabilities and equity. This increase primarily reflected the inclusion of long-term operating lease liabilities of ¥124.3 billion as a result of the application of ASU No. 2016-02.

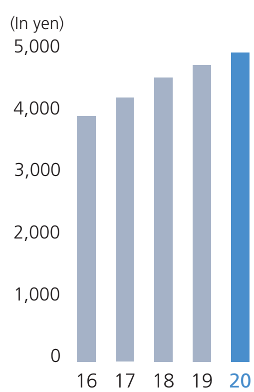
Total SECOM CO., LTD., shareholders' equity increased ¥44.6 billion, to ¥1,088.7 billion. Retained earnings rose ¥50.0 billion, to ¥1,017.7 billion, owing principally to net income attributable to SECOM CO., LTD., and the payment of dividends. Accumulated other comprehensive loss rose ¥7.0 billion, to ¥7.1 billion. As a consequence, the equity ratio was 52.3%, compared with 55.6% at the end of the previous fiscal year.

Percentage of Consolidated Net Sales and Operating Revenue*

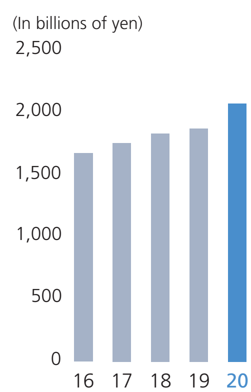


* Pie chart shows percentage of consolidated net sales and operating revenue (excluding intersegment transactions)

SECOM CO., LTD. Shareholders' Equity per Share



Total Assets



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.

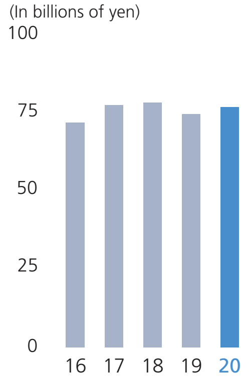
In the period under review, net cash provided by operating activities amounted to ¥184.4 billion. The principal components of this were net income of ¥99.8 billion and an adjustment for depreciation and amortization, including amortization of deferred charges, a non-cash item, of ¥77.6 billion. Net cash provided by operating activities was ¥26.1 billion higher than in the fiscal year ended March 31, 2019. Factors behind this result included a ¥5.1 billion increase in accrued income taxes, compared with a ¥4.9 billion decrease in the previous fiscal year; a decrease in deferred income taxes of ¥7.4 billion; an increase in receivables and due from subscribers, net of allowances, of ¥10.6 billion, compared with an increase of ¥17.4 billion in the preceding period; and an increase in accrued consumption tax of ¥4.5 billion, compared with a decrease of ¥831 million in the previous fiscal year.

Net cash used in investing activities amounted to ¥66.6 billion. Principal components of this were payments for purchases of property, plant and equipment of ¥63.1 billion, owing to purchases of security equipment necessitated by a rising number of security services subscribers and forward-looking investments to reinforce the Company's operating foundation; payments for purchases of intangible assets of ¥11.7 billion, attributable to forward-looking investments to reinforce the Company's operating foundation; and payments for purchases of investment securities of ¥45.3 billion, primarily in the insurance services segment and through private-equity investments in the United States, exceeding proceeds from sales and redemptions of investment securities of ¥50.3 billion. Net cash used in investing activities rose ¥2.2 billion from the previous fiscal year, with contributing factors including a ¥1.6 billion decrease in time deposits, compared with a ¥1.3 billion increase in the preceding period, and payments for purchases of property, plant and equipment, which were up ¥6.7 billion from the previous fiscal year. Owing to investments in the insurance services segment and private equity investments in the United States, net cash generated by an increase in short-term investments and net proceeds from sales and redemptions of investment securities rose to ¥3.6 billion, from ¥2.7 billion in the previous fiscal year.

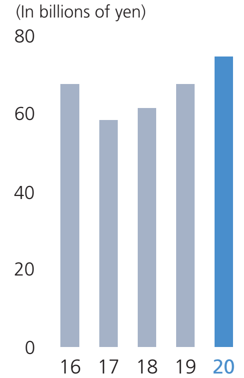
Net cash used in financing activities was ¥52.9 billion. This primarily reflected dividends paid to SECOM CO., LTD. shareholders of ¥37.1 billion and repayments of long-term debt of ¥18.8 billion. Net cash used in financing activities was ¥7.4 billion less than in the preceding period. This was due largely to declines in dividends paid to noncontrolling interests and payments for acquisition of shares of consolidated subsidiaries from noncontrolling interest holders, the latter a result of the absence of the purchase of treasury stock by subsidiary Secom Joshinetsu, which pushed up outlays in the previous fiscal year.

Owing to the Company's operating, investing and financing activities in the period under review, cash and cash equivalents at end of year amounted to ¥414.7 billion, up ¥64.9 billion from cash equivalents at beginning of year, which were ¥349.7 billion.

Depreciation and Amortization



Purchases of Property, Plant and Equipment and Intangible Assets



Cash Flows