

Bridge Report Sangetsu Co., Ltd. (8130)

 Shosuke Yasuda, President	Company	Sangetsu Co., Ltd.	
	Code No.	8130	
	Exchange	First Section, Tokyo and Nagoya Stock Exchanges	
	Industry	Wholesale (Commerce)	
	President	Shosuke Yasuda	
	HQ Address	1-4-1 Habashita, Nishi-ku, Nagoya-shi	
	Business Description	Sangetsu was founded in 1849 and is Japan's largest trading company specializing in interior products. It conducts development and sales of interior decorating products, including wallcoverings, curtains, flooring materials, and chair upholstery. Sangetsu has top share of wallcovering, and is the industry's leader in the curtain, vinyl and textile flooring materials.	
	Year-end	March end	
	URL	http://www.sangetsu.co.jp/company/ir/english/index.html	

— Stock Information —

Share Price	Shares Outstanding	Market Cap.	ROE (actual)	Trading Unit
¥1,803	73,072,924 shares	¥131.750 billion	3.7%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)
¥45.00	2.5%	¥75.27	24.0x	¥1,625.21
				PBR (actual)
				1.1x

* Stock price as of closing on June 12, 2015. Number of shares issued at the end of the most recent quarter excluding treasury shares.

— Consolidated Earnings Trends —

(Unit: Million Yen)

Fiscal Year	Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	Dividend (¥)
March 2010	108,579	5,646	6,046	3,137	78.20	75.00
March 2011	112,118	7,161	7,530	4,242	105.75	75.00
March 2012	118,518	7,095	7,180	4,151	103.46	75.00
March 2013	123,150	8,020	8,393	4,806	120.52	78.00
March 2014	131,978	8,952	9,475	5,459	143.30	75.00
March 2015	132,050	8,031	8,506	4,402	58.35	41.25
March 2016 Est.	135,500	8,250	8,550	5,500	75.27	45.00

* Estimates are those of the Company. 1 to 2 stock split was done on April 1, 2015. EPS and DPS are calculated retroactively.

This Bridge Report presents Sangetsu's earnings overview for fiscal year March 2015.

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Key Points

• Sangetsu Co., Ltd. is Japan's largest trading firm that specializes in interior decorating products including wallcoverings, floorings, curtains and others. While its main function is a trading company, the Company also performs design, planning and development of products as a "fables company." Sangetsu also boasts of a business model that yields stable earnings and top share of its major product markets. The Company maintains a goal of achieving ROE in excess of its cost of its capital at an early stage as part of its midterm business plan.

• Sales rose by 0.1% year-on-year to ¥132.0 billion during fiscal year March 2015. The performance remained at almost the same level as the previous year due in part to flat growth during the second half that offset a stronger performance during the first half. Sales pricing revisions contributed to a 1.1% point improvement in gross margins, but higher transportation, labor, distribution and facility improvement expenses within sales, general and administrative expenses were left uncovered and contributed to a 10.3% year-on-year decline in operating income to ¥8.0 billion. The booking of impairment and asset retirement losses contributed to a 19.4% year-on-year decline in net income to ¥4.4 billion. Despite these declines, the profit actually exceeded estimates due primarily to improvements in gross margin and successful cost controls.

• Sangetsu's earnings estimates for fiscal year March 2016 call for sales to grow by 2.6% year-on-year to ¥135.5 billion. The renovation business is expected to grow marginally, and nonresidential business is expected to remain in line with the previous year's levels. Revisions in sales pricing are expected to contribute to a 0.2% point improvement in gross margin. Increases in sales, general and administrative expenses due to continued increases in labor and business facilitation expenses are expected to be absorbed, allowing operating income to rise by 2.7% year-on-year to ¥8.2 billion. Dividend payment of ¥22.50 per share is expected to be paid at the end of both the first half and full year for a full year dividend of ¥45.00 per share, and a payout ratio estimate of 59.8%.

• The new management structure under the leadership of President Shosuke Yasuda was able to implement speedy and bold revisions to the corporate governance structure and reviews of the overall organization from a top down approach. With regards to the restructuring of the business strategy, Sangetsu has been able to fortify its insufficiencies, but it is aware of the fact that there is "still room for improvement" and "latent business opportunities" to be cultivated. The Company will pursue an even clearer growth strategy in the coming second year of the new organizational structure.

• The current Midterm Business Plan calls for various fortifications of the organizational structure and speedy and bold reforms of systems. The implementation of this Plan has already been effective in largely changing the mindset of employees. Going forward, the speed and depth of changes in employee mindsets will continue to be an important issue. While assessing data and the overall situation in a tangible manner is difficult, future reports to be issued will also follow the progress in the achievement of targets defined in the Midterm Business Plan. At the same time, Sangetsu's efforts to pursue new market development and expansion of nonresidential business realms should be watched closely.

1. Company Overview

Sangetsu Co., Ltd. is the largest among all Japanese trading companies specializing in wallcoverings, carpets, curtains and other interior decorating products. Being a trading firm, the Company also operates as a "fables company" that plans and develops interior decorating products. Sangetsu boasts of a business model that is able to produce stable earnings and top market share in its main product realms. The Company maintains a goal of raising ROE to above its cost of capital at an early stage as part of its midterm business plan.

The Sangetsu Group includes the following two companies: Sungreen Co., Ltd., a dedicated distributor of exterior products, and Yamada Shomei Lighting Co., Ltd., a planner, designer, manufacturer, and distributor of lighting equipment.



<Corporate History>

Sangetsu was founded in 1849 under the original name of “Sangetsudo” to sell various traditional Japanese interior decorating products including scrolls, wall scrolls, folding screens, sliding doors, partitions, and other products made of cloth and paper. Sangetsu Co., Ltd. was incorporated in 1953 by the founding family. From the latter half of the 1970s onwards, the business was expanded into Tokyo, Fukuoka, Osaka and other parts of Japan. In 1980, Sangetsu was listed on the Second Section of the Nagoya Stock Exchange, and later in 1996 its shares were also listed on the First Section of the Tokyo Stock Exchange. Currently, Sangetsu is expanding its operations into overseas markets and has established itself as the largest total interior decorating product provider within Japan, with a widely recognized brand of interior products.

Shosuke Yasuda was appointed as the first President who is not from the founding family of Sangetsu in April 2014. He will direct the Company during its third stage of growth entitled “Our Third Founding Phase,” following on the heels of the original first phase of founding and the second phase when the company became a publicly listed corporation.

<Corporate Philosophy>

Sangetsu maintains a corporate motto of “integrity,” and endeavors to uphold the “Three Principles of Sangetsu,” which are described below, in all of its business activities. In addition, Sangetsu seeks to contribute to society through the provision of products with high value addition that enriches customers’ home environments and lives.

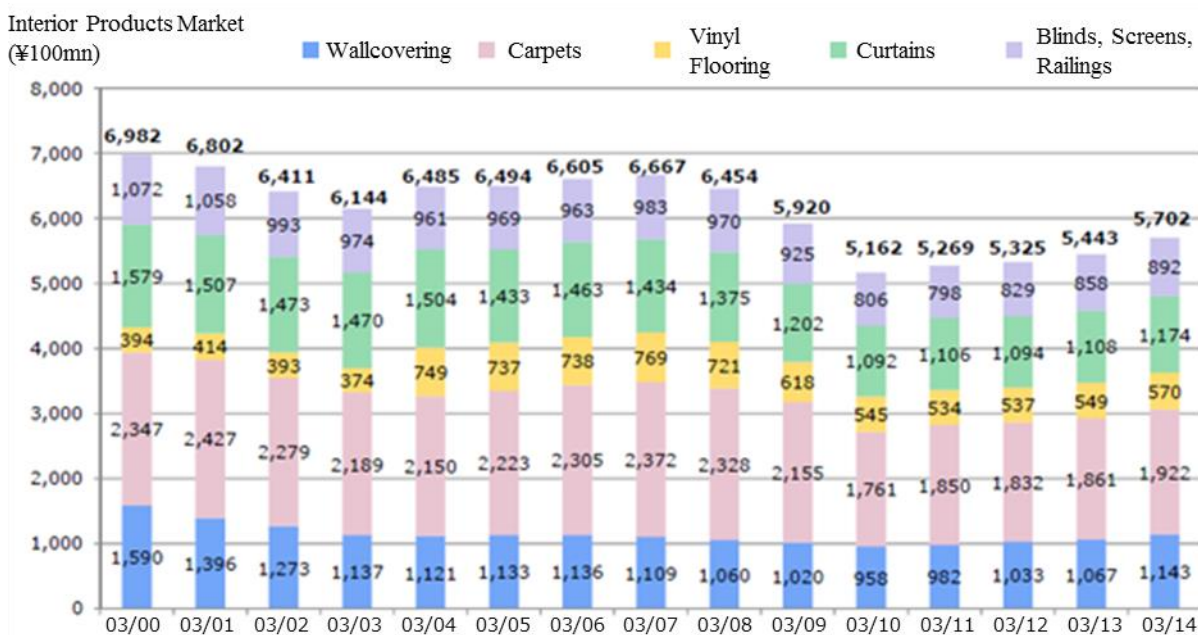
< Three Principles of Sangetsu>

Creative Design
Highly Reliable Quality
Fair Pricing

<Market Environment>

◎ Overview

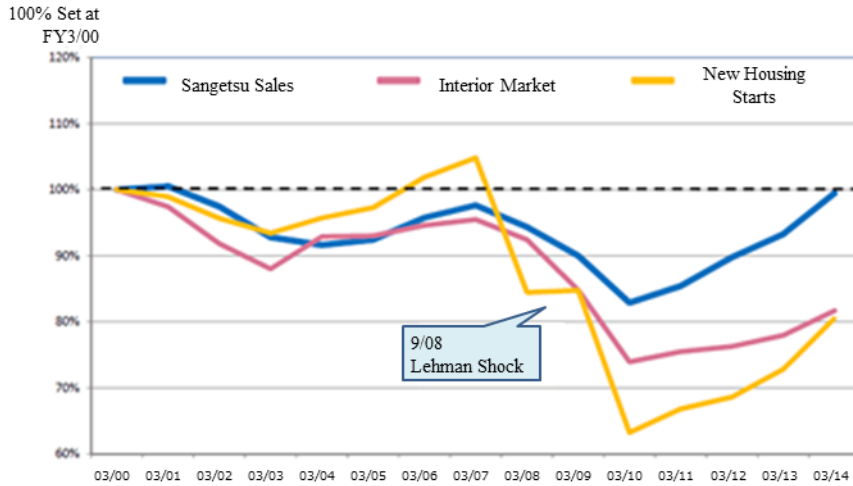
The market environment for the main wallcovering and flooring products is strongly influenced by trends in the Japanese construction market. Declines in new housing start arising from declining population and changing family structures within Japan, and deflationary trends have depressed sales of the interior products market as shown in the graph below.



(Source: Sangetsu)

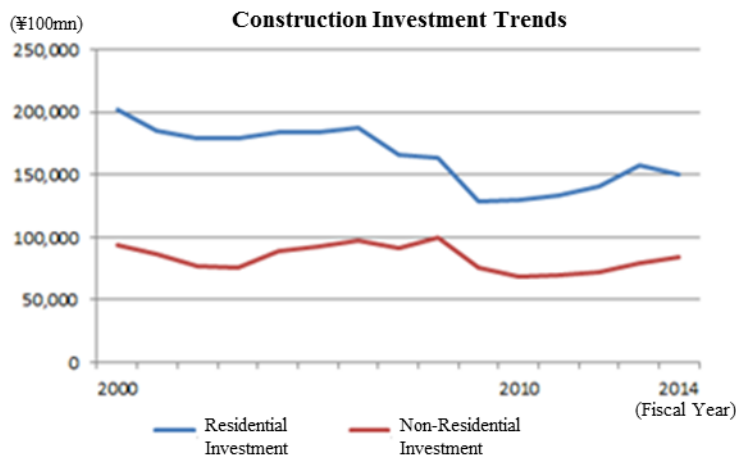
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At the same time, the graph below shows the correlation between sales of Sangetsu relative to sales of the Japanese interior market and new housing starts (Ministry of Land, Infrastructure, Transport and Tourism data). Sales of both Sangetsu and the Japanese interior market show a close relationship to trends in new housing starts. And despite the inability of housing starts and the interior market to recover to the pre-Lehman shock levels, Sangetsu’s sales have been able to recover to its most recent peak level achieved in 2000.

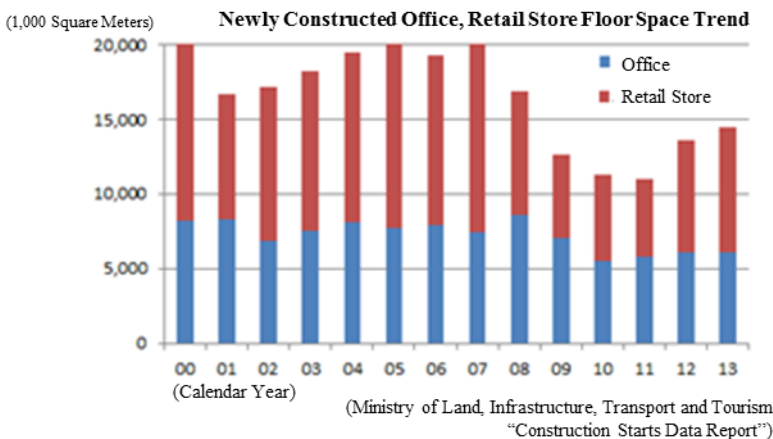


(Source: Sangetsu)

This strong recovery is attributed to Sangetsu’s efforts to cultivate business in the non-residential realm.



(Source: Ministry of Land, Infrastructure, Transport and Tourism)



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The Ministry of Land, Infrastructure, Transport and Tourism reports that while private sector construction investments of non-residential structures were less than that of residential structures, they had recovered to the levels seen in 2000. Furthermore, construction of large floor space office buildings has also recovered to close to 15,000,000 square meters.

Moreover, the Research Institute of Construction and Economy issued a report entitled “Outlook for Construction Investment Based upon a Construction Economy Model” (October 22, 2014) that calls for continued growth of 7.6% and 2.4% year-on-year growth in private sector non-residential investments during fiscal years 2014 and 2015 respectively, following on the heels of 11.1% year-on-year growth recorded during fiscal year 2013.

Aging of the population due to declining birthrates is contributing to a long-term decline in new housing starts and overall difficult conditions. However, the approach of the 2020 Tokyo Olympics is expected to contribute to favorable conditions to continue in the private sector non-residential construction market for the foreseeable future.

◎ Competitors

In addition to Sangetsu, there are three publicly traded competitors that operate in the interior decorating market.

(Units: Million Yen, Times)

Stock Code	Company	Sales	YY Change	Operating Income	Operating Margin	YY Change	Market Cap	PER	PBR	ROE
3501	Suminoe Textile Co., Ltd.	92,000	+4.2%	3,500	9.5%	+3.8%	25,728	10.3	0.8	7.3%
7971	TOLI Corp.	92,000	+1.3%	3,300	4.7%	+3.6%	20,793	9.5	0.7	7.3%
8130	Sangetsu	135,500	+2.6%	8,250	2.7%	+6.1%	131,750	24.0	1.1	3.7%
9827	Lilycolor Co., Ltd.	35,900	+3.0%	290	56.9%	+0.8%	2,251	22.5	0.4	0.9%

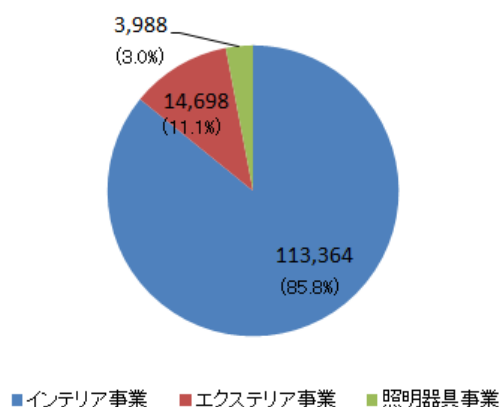
* Estimates of those of the respective companies are as of June 15, 2015. Market capitalization is based upon the closing share price on June 12, 2015.

Although only Sangetsu is traded over 1 time in terms of PBR, its level is still low. The improvement method for ROE in Mid-term Business Plan is expected to be carried out.

<Business Description>

The main businesses include planning, development and sales of wallcovering, curtains, upholstery and other interior products. Sangetsu boasts of a “fabless operation” and does not maintain any manufacturing facilities, but its capabilities exceed that of typical trading firms and all of the products it sells are planned, designed and developed in-house. In addition, Sangetsu provides exterior products and lighting fixtures through its subsidiary.

セグメント別売上高構成比
(2015年3月期、単位:百万円)



① “Interior Business”

(FY3/15: Sales and Operating Income of ¥113.364 and ¥7.550 Billion)

◎ Main Products

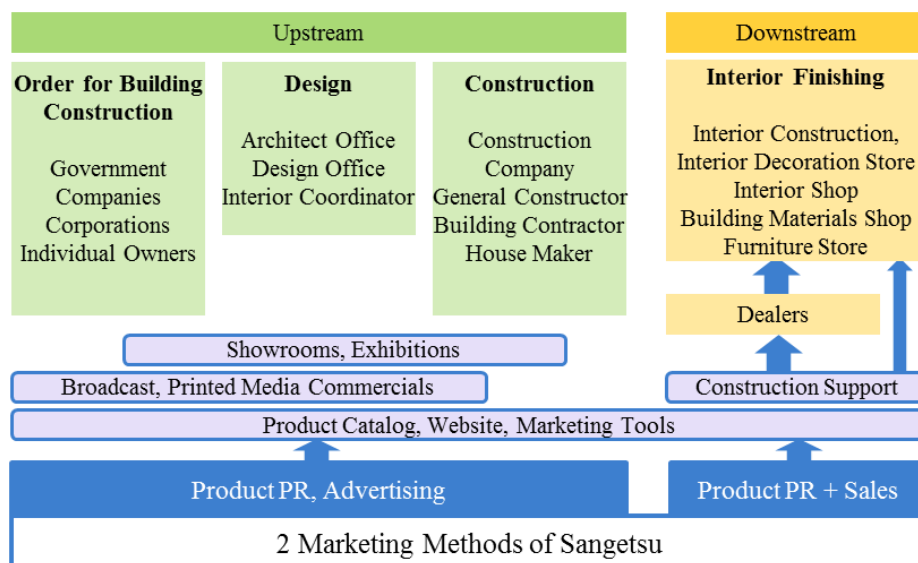
Wallcovering	Sangetsu's main product, used in a wide range of residential and non-residential applications. High functionality products have become popular in recent years that are resistant to staining, odor absorbing, and scratch resistant. Also, wallcoverings with colorful designs are being used to decorate all or part of walls in homes to add an accent to interiors, and collaboration with rental property management companies being promoted for the development of products to raise the value addition of rental properties.
Cushion Vinyl Sheet	Sheeted floor materials that are used in both residential and retail store applications, and commonly used in apartments and condominiums. They boast of wood grain, stone, and a wide range of other motif designs and have cushioning function for use in a wide range of applications.
Heterogeneous Vinyl Sheets	Sheet formed flooring materials used in commercial applications including medical and welfare institutions, and educational institutions. This product boasts of high levels of safety and sanity functionality, and is designed to reduce maintenance costs by being easy to keep clean. It also has been designed with the environment in mind and helps to reduce the environmental burden.
Homogeneous PVC Floorings	Sheet formed flooring materials used in medical and welfare institutions, and educational institutions. Uniquely manufactured with design patterns printed through entire flooring material so patterns will continue to show even after being worn down. They do not require wax for easy maintenance, and thereby reducing maintenance costs and environmental burden.
Luxury Vinyl Tiles	Tile formed vinyl flooring materials in 45 centimeter square sections used in a wide range of applications including apartments, condominiums, educational institutions, and commercial facilities. Manufactured with wood and stone motifs, with highly detailed embossed printing processes used to show highly detailed designs.
Carpets, Carpet Tiles	Textile flooring materials used in a wide range of applications including ryokans (i.e. Japanese inns), hotels, residential and office facilities. Multiple colorful designs with high functionality, formed in 50 centimeter square tile sections for easy installation and superior maintenance.
Curtains	All of the curtains sold by Sangetsu are custom made, and boast of the ability to create unique designs and custom sizes of curtains to match room decorations in which they are used. In addition to highly fashionable designs and heavy materials, mirror-like insulating characteristic lace curtains, which make it difficult to see inside from the outside and reduce the amount of heat transferred into the rooms, have also become popular.

Sangetsu boasts of a diverse product lineup with about 13,000 different products in total. There are about 5,000 different wallcovering products alone. Product catalogs are updated every two years (Curtain product catalogs are updated every three years), with an existing product replacement rate for wallcovering of 50% to 55%, which compares with a 35% to 40% rate for its competitors.

Replacement of existing products is not a simple task. Disposal of products leads to wastes, but the disposal of existing products due to replacement with newly designed products is necessary to maintain the attractiveness of the product catalog and to satisfy customers. Therefore, the ability to maintain a balance between attractiveness and efficiency is highly important and is one of the strengths of Sangetsu.

◎Marketing Structure

In addition to the headquarters located in Nagoya, Sangetsu maintains 8 regional offices and 55 marketing offices throughout Japan, with 6 of these marketing offices also hosting showrooms.



(Source: Sangetsu)

The downstream interior finishing process includes the final delivery of products, booking of sales, and receipt of cash. The main customers are interior construction companies and interior and building material shops that are serviced through dealers. Furthermore, public relations and advertising for products at the start of the process are also very important.

Therefore, Sangetsu conducts public relations and advertising for its products in its product catalog, television commercials and at its showrooms. In addition to these “passive” marketing activities, Sangetsu also conducts “proactive” marketing of its products through its corporate marketing division and its 400 marketing staff to provide and gather information and propose products to clients.

While the main marketing efforts are conducted through dealers, Sangetsu also conducts direct marketing to customers in the Nagoya and surrounding Chubu area, and the number of its directly accessed customers totals 6,000 in these regions alone. While the number of customers dealt with through dealers is not known, the total number of customers is estimated to amount to several tens of thousands nationwide.

◎ Distribution Structure

Sangetsu maintains a network of 13 distribution centers nationwide. Most all products are normally stocked at the Company’s distribution centers in Tokyo, Nagoya, Osaka and Kyushu, with the number of products shipped from these centers surpassing 60,000 per day and the out-of-stock ratio amounting to a low 0.13% (About 70 products) per day. Sangetsu’s nationwide distribution network makes “Just-in-Time” provision of products to match the interior construction schedules of its clients possible. Products are sourced from a wide range of over 100 supplier companies.

② “Exterior Business”

(FY3/15 Sales and Operating Income of ¥14.698 Billion and ¥455 Million)

Sungreen Co., Ltd., which was turned into a subsidiary in 2005, sells doors, fences, terraces and other exterior products within Japan.

③ “Lighting Business”

(FY3/15 Sales and Operating Income of ¥3.988 Billion and ¥30 Million)

Yasuda Shomei Lighting Co., Ltd., which was turned into a subsidiary in 2008, sells down lights, z-lights and other general lighting fixtures within Japan.

<ROE Analysis>

	FY3/12	FY3/13	FY3/14	FY3/15
ROE(%)	3.5	4.1	4.6	3.7
Net Income to Sales Ratio (%)	3.50	3.90	4.14	3.33
Asset Turnover Ratio (x)	0.84	0.88	0.93	0.91
Leverage (x)	1.18	1.19	1.20	1.21

The Company maintains a target of “achieving high levels of ROE that exceeds its cost of capital of 8% to 10% at an early stage” in its mid-term business plan.

Specifically, Sangetsu “seeks to reduce its capital from the end of March 2014 by ¥10.0 to ¥20.0 billion within three to five years” as part of its efforts to achieve a ROE ratio of 8% to 10% by fiscal year 2017 to 2019. Consequently, the Company will implement efforts to raise profitability in addition to this capital strategy.

2. Characteristics and Strengths

① Business Model Capable of Yielding Stable Earnings

Sangetsu is a pioneer in the realm of “fabless companies” that do not maintain their own manufacturing functions and therefore have lower fixed expense burdens because they don’t have to carry facilities for the manufacturing process. In addition, the Company boasts of over 13,000 products, sourced from over 100 suppliers, supplied to several tens of thousands of customers, which diversifies risk in many ways. And while Sangetsu’s may be considered as an economically sensitive company as its business and earnings performances are closely linked to trends in the construction market, the Company has never seen losses since its founding.

② “Creating,” “Proposing,” “Providing” “Creating”

While the actual manufacturing of products is not conducted in-house, Sangetsu performs the planning, design and development functions internally. The previous generation of Sangetsu management made aggressive investments for “unique designs,” one of the three principles of the Company. 20 in-house designers develop new and original versions of products based upon numerous basic designs. The cultivation of designers responsible for various products is done through participation in overseas exhibitions, communication with marketing staff, and discussions with outside design consultants as part of their on-the-job training. Furthermore, Sangetsu maintains a policy of aggressively taking the perceptions and opinions of younger designers and staff into consideration. Sangetsu also boasts of an overwhelming number of products of about 13,000 that far exceeds the number of products of its competitors. In addition, the Company conducts revisions of its products on a regular basis every 2 to 3 years with 28 categories of product catalogs, which far surpass those of its competitors.



(Source: Sangetsu)

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“Provide”

As mentioned earlier in this report, Sangetsu normally maintains inventories of all of its products so that they can be provided on a “Just-in-Time” basis using their nationwide distribution network. However, the Company is required to conduct speedy processing techniques as product orders are placed so that loss rates can be limited to avoid the maintenance of excess inventories and reduced efficiencies. Some wallcoverings are produced in rolls as long as 50 meters, and Sangetsu cuts these rolls into shorter segments when orders are placed for shipment. The remaining segments of wallcovering are then cut to match other orders to eliminate losses. This type of custom-made cutting technology has been cultivated over the long years of experience in the interior decorating business and is an important factor that differentiates Sangetsu from its competitors.



(Source Sangetsu)

“Propose”

Nearly one third of all employees or some 400 work in marketing functions at Sangetsu, the largest marketing function within the industry. These marketing staff are assigned to 63 offices located throughout Japan and conduct proposal-based marketing to clients. Sangetsu also staffs its six showrooms with 64 employees. In addition, 51 interior designers create design boards that combine samples of various products for customers to use when choosing interior products. This high level of proposal-based marketing capability is unmatched within the industry and sets Sangetsu apart from its competitors.



(Source Sangetsu)

2. Fiscal Year March 2015 Earnings Overview

(1) Earnings Overview

(Units: Million Yen)

	FY3/14	Share	FY3/15	Share	YY Change	Divergence from Estimates
Sales	131,978	100.0%	132,050	100.0%	+0.1%	+3.2%
Gross Income	36,055	27.3%	37,510	28.4%	+4.0%	-
SG&A	27,102	20.5%	29,478	22.3%	+8.8%	-
Operating Income	8,952	6.8%	8,031	6.1%	-10.3%	+13.1%
Ordinary Income	9,475	7.2%	8,506	6.4%	-10.2%	+13.4%
Net Income	5,459	4.1%	4,402	3.3%	-19.4%	+0.0%

Fortified Marketing Function Contributes to Higher Sales, but Higher SG&A Expenses Lead to Lower Profits

Sales rose by 0.1% year-on-year to ¥132.0 billion on the back of the issuance of a new product catalog, efforts to fortify design and marketing towards clients, and new product development in refurbishment and non-residential realms. And while business trended favorably during the first half of the term, conditions worsened during the second half and business remained only in line with the second half of the previous term.

Revision of sales pricing to reflect higher raw material costs allowed gross margin to improve by 1.1% point from the previous term. However, higher sales, general and administrative expenses resulting from rises in transportation, labor (salary increase, promotion, etc.), policy costs such as facility improvement expenses for logistical equipment and office buildings associated with business facility improvement were left uncovered and contributed to a 10.3% year-on-year decline in operating income to ¥8.0 billion. The booking of an impairment loss of ¥1.1 billion based on the assumption of the sales of real estate holdings such as employee dormitory facilities and an asset retirement loss of ¥0.1 billion contributed to a 19.4% year-on-year decline in net income to ¥4.4 billion. Despite these declines, these results actually exceeded estimates due primarily to improvements in gross margin and successful cost controls.

(2) External Environment

<Related Market Conditions>

New housing starts during fiscal year 2014 declined by a relatively large margin of 1.8% year-on-year to 880,000. While this decline had little impact upon business performance upon the first half of the term, it did have a large negative impact upon the second half due to the time lag between housing starts and interior facilitation of about four months.

Demand for refurbishment was also negatively impacted by the rush to beat the consumption tax and declined in the aftermath of the hike.

Interior construction in non-residential applications suffered from a shortage of labor and increases in materials costs.

<Materials Markets>

Shipment volumes of wall coverings fell by 2.3%, 9.4% and 6.0% year-on-year during the first half, second half and full year respectively. While shipment volumes contracted, Sangetsu's share of the market expanded.

Within the flooring materials category, carpets saw a 29.6% year-on-year decline in the full year and carpet tiles used primarily in offices fell by 1.2% year-on-year, while long flooring materials rose by 0.6%. Floor tiles used in retail stores also fell by 0.6% year-on-year, but the share of industry-wide sales actually rose.

(3) Business Segment Trends

(Units: Million Yen)

	FY3/14	Share	FY3/15	Share	YY Change
Sales					
Interior	113,181	85.8%	113,364	85.8%	+0.2%
Exterior	15,018	11.4%	14,699	11.1%	-2.1%
Lighting	3,820	2.9%	4,022	3.0%	+5.3%

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Adjustment	-42	-	-35	-	-
Total	131,978	100.0%	132,050	100.0%	+0.1%
Operating Income					
Interior	8,842	7.8%	7,550	6.7%	-14.6%
Exterior	556	3.7%	455	3.1%	-18.1%
Lighting	-435	-	30	0.7%	-
Adjustment	-11	-	-4	-	-
Total	8,952	6.8%	8,031	6.1%	-10.3%

Share of operating income is the same as operating income margin.

① Interior Business

(Units: Million Yen)

	FY3/14	Share	FY3/15	Share	YY Change
Wallcoverings	55,732	49.2%	55,618	49.1%	-0.2%
Floorings	37,922	33.5%	38,641	34.1%	+1.9%
Curtains	8,239	7.3%	8,110	7.2%	-1.6%
Others	11,287	10.0%	10,993	9.7%	-2.6%
Total	113,181	100.0%	113,364	100.0%	+0.2%

The interior business is comprised of the three main product divisions including the wallcovering, flooring and curtain products, for which new product development and marketing strategies are created individually. Branding and promotion strategies are conducted for all three divisions within this business segment jointly.

<Wallcoverings>

While the three new product catalogs “Reserve 1000”, “REATEC”, and “XSELECT” were published, the decline in new housing starts due to the rush to purchase ahead of the consumption tax hike in the previous term contributed to weaker demand in the refurbishment market and a decline in sales.

At the same time, raw material price hikes continued from the previous term led to a rise in purchase pricing. However, Sangetsu has been able to gain the understanding of customers in the market and thus been able to pass along these higher prices through increases in their sales pricing. This in turn has allowed gross income to rise.

<Floorings>

Expansion in the market for non-residential applications including medical, welfare related and commercial facilities, and favorable trends in high functionality products with superior maintainability and shock absorbing function allowed sales to grow. However, increases in costs caused by higher materials prices and the weakening of the yen held gross income to similar levels as the previous term.

<Curtains>

Despite improvements in gross income margin due to pricing revisions released along with the new product catalogs, stagnant demand in the new housing starts market and the negative influence of the rush to purchase ahead of the consumption tax hike in the previous term contributed to lower sales.

② Exterior Business

The exterior products market was also negatively impacted by the decline in new housing starts, and especially from October onwards, the inability of demand to recover in excess of the level of last year’s pre-tax hike demand surge, contributed to declines in both sales and profits.

However, aggressive efforts to strengthen marketing functions including the establishment in February 2014 of Yokohama Branch allowed sales in the Tokyo and surrounding Kanto region to rise by about 30%.

③ Lighting Business

Efforts were made to strengthen sales of value added lighting products to medical, hotel, office and other non-residential realm applications. Furthermore, particular emphasis was placed upon marketing efforts to architectural design and lighting design offices. As a result of these efforts, sales to non-residential applications and overall sales rose. The recovery in orders for products for which evaluation losses were recorded during the previous term realized profits to be realized after losses in the previous term.

(4) Financial Condition, Cash Flow

◎ Balance Sheet

(Units: Million Yen)

	End 3/14	End 3/15		End 3/14	End 3/15
Current Assets	91,313	99,613	Current Liabilities	20,914	18,967
Cash, Equivalents	18,919	28,238	Payables	14,389	13,198
Receivables	45,496	44,927	Noncurrent Liabilities	5,101	5,350
Marketable Securities	15,002	13,300	Retirement Benefits	3,654	3,909
Inventories	10,950	11,851	Total Liabilities	26,016	24,317
Noncurrent Assets	54,590	43,462	Net Assets	119,887	118,758
Tangible Noncurrent Assets	30,304	28,579	Shareholders' Equity	118,667	115,067
Intangible Noncurrent Assets	346	332	Total Liabilities, Net Assets	145,903	143,076
Investments, Others	54,950	14,550	Total Interest Bearing Liabilities	116	93
Total Assets	145,903	143,076	Equity Ratio	82.2%	83.0%

* Interest bearing liabilities include lease liabilities.

Redemption of government bonds and other factors contributed to a ¥8.3 billion increase in current assets compared with the end of the previous term. On the other hand, booking of impairment losses on assets held and declines in investment securities contributed to a ¥11.1 billion decline in noncurrent assets. Consequently, total assets fell by ¥2.8 billion to ¥143.0 billion.

Declines in accounts payables contributed to a ¥1.9 and ¥1.6 billion declines in current and total liabilities to ¥18.9 and ¥24.3 billion respectively.

Net assets declined by ¥1.1 to ¥118.758 billion on the back of declines in retained earnings.

Equity ratio rose by 0.8% points year-on-year to 83.0%.

◎Cash Flow

(Units: Million Yen)

	FY3/14	FY3/15	YY Change
Operating Cash Flow	7,878	4,765	-3,113
Investing Cash Flow	-5,477	6,134	+11,611
Free Cash Flow	2,401	10,899	+8,498
Financing Cash Flow	-3,025	-7,692	-4,667
Cash and Equivalents	12,333	15,540	+3,207

A decline in accounts payable and an increase in inventories contributed to a reduction in increase of net cash inflow of operating cash flow. Reductions in the value of investment securities acquired allowed investing cash flow to turn to a net cash inflow from the net outflow recorded during the previous term. Consequently, the net inflow of free cash flow increased.

Increases in acquisition of treasury stock led to a large increase in the net cash outflow in financing cash flow. As a result of these changes, cash position increased.

One issue is the increase in working capital despite the flat growth in sales.

Sangetsu's recognition of this issue has led it to establish "the Return on Invested Capital Improvement Committee" to promote reforms.

3. Fiscal Year March 2016 Earnings Estimates

(1) Earnings Estimates

(Units: Million Yen)

	FY3/15	Share	FY3/16	Share	YY Change
Sales	132,050	100.0%	135,500	100.0%	+2.6%
Gross Income	37,510	28.4%	38,700	28.6%	+3.2%
SG&A	29,478	22.3%	30,450	22.5%	+3.3%
Operating Income	8,031	6.1%	8,250	6.1%	+2.7%
Ordinary Income	8,506	6.4%	8,550	6.3%	+0.5%
Net Income	4,402	3.3%	5,500	4.1%	+24.9%

* Estimates are those of the Company.

Small Increases in Sales, Profits Expected

Sangetsu's estimates call for sales to rise by 2.6% year-on-year to ¥135.5 billion. During the full year, new housing starts are expected to grow marginally, but the interior business is expected to suffer from stagnant demand during the second half of the previous year. Refurbishments are expected to rise by a small margin and non-residential realm business is expected to remain in line with the previous fiscal year. Corrections in sales pricing are expected to offset increases in costs during the first half, and a reduction in products which saw evaluation losses is expected to allow gross income margin to improve by 0.2% points. Higher labor costs arising from increases in pay and promotions as part of reforms in the human resources system, efforts to strengthen design capabilities and business foundation fortification efforts are expected to continue leading to increases in SG&A expenses. However, the increase in sales is expected to absorb these costs and allow operating income to rise by 2.7% year-on-year to ¥8.2 billion. Due to the disappearance of impairment and asset retirement losses that occurred in the term just ended, net income is expected to rise at a double-digit rate, 24.9% year-on-year. Dividend of ¥22.50 per share are expected to be paid at the end of both the first half and full year for a full year dividend of ¥45.00 per share. The anticipated dividend payout ratio is 59.8%.

(2) Segment Business Trends

(Units: Million Yen)

	FY3/15	Share	FY3/16 Est.	Share	YY Change
Sales					
Interior	113,364	85.8%	116,500	86.0%	+2.8%
Exterior	14,699	11.1%	15,000	11.1%	+2.0%
Lighting	4,022	3.0%	4,000	3.0%	-0.5%
Adjustment	-35	-	-	-	-
Total	132,050	100.0%	135,500	100.0%	+2.6%
Operating Income					
Interior	7,550	6.7%	7,800	6.7%	+3.3%
Exterior	455	3.1%	500	3.3%	+9.9%
Lighting	30	0.7%	-50	-	-
Adjustment	-4	-	-	-	-
Total	8,031	6.1%	8,250	6.1%	+2.7%

* Share of operating income is the same as operating income margin.

4. Achievements of the Mid-term Business Plan, 2014-2016: Next Stage Plan G

Sangetsu identifies 2014 as its "Third Founding Phase" and has created the "Midterm Business Plan, 2014-2016: Next Stage Plan G" to define the vision to be pursued and direction to be taken in the coming years. Achievements of the plan are outlined below.

<Specific Measures>

Target Stakeholders	Target Realms	Specific Measures
Employees	Internal Structure	1) Facilitate a corporate structure that allows employees to actively participate in business management A) Organizational review B) Personnel structure reforms C) Review organization operational rules D) IT system restructuring
Clients, Suppliers	Products, Marketing	2) Business strategy restructuring A) Expand existing businesses B) Promote growth strategies
Shareholders, Society	Capital Markets, CSR	3) Improve the reputation amongst stakeholders A) Capital and IR strategies B) Societal contribution activities C) Environmental management

1) Business Foundation Facilitation

Fortification of Corporate Governance Structure

Along with the implementation of a “corporate auditor committee company structure” as of the general shareholders meeting held on June 18, the founder and chairman and senior executive director, and six new directors including President Yasuda and five corporate auditors (outside directors) were appointed. At the same time, a new director compensation system that is linked to the earnings and share price performance of the Company was introduced. Also introduced was a mandatory retirement system. All in all, the changes represent aggressive and large changes in the structure of Sangetsu.

Employee Awareness Reforms Promoted

A net income target of ¥6.3 billion has been established for the paid for stock option (350 employees and directors of the Sangetsu Group are eligible to receive these options) along with a 6% cost of capital trigger that links earnings to compensation. These changes are part of the Company’s switch to a meritocratic system that provides for early promotions and performance-based compensation.

Aside from these changes, efforts have been implemented to strengthen the “brand image”, IT systems, and risk management systems of Sangetsu.

2) Business Strategy Restructuring

Organizational Reviews

The headquarter function has been fortified through the acquisition of superior human resources for the legal affairs, quality control, accounting and other divisions along with the introduction of a business division system.

In addition, aiming at strengthening downstream and consumer strategies, the New Market Development Office and the Refurbishment Business Promotion Office have been established. The section in charge of film and Upholstery Business Department have been established to fortify specialized sales activities. Increases in staffing of the housing divisions and corporate marketing divisions have also being undertaken.

Facilitation of Distribution Facilities

As the first step in creating a foundation for a new supply chain management structure, new logistic bases will be established with two in the Kanto region and one in the Chubu region.

These facilities are expected to require about two years to complete and upon their completion the functions of the three existing facilities will be transferred and consolidated into two facilities. Marketing function will be fortified along with cost reduction efforts concerning labor and transportation. Especially in the Kanto region, a new facility is being

constructed in Kuki, Saitama Prefecture, where numerous supplier companies exist. In addition to pick-up and delivery functions, the cargo procurement function will also be fortified.

Showroom Strategy

In July 2015, the flagship showroom was moved from Akasaka area to Shinagawa area of Tokyo.

In addition to displaying products, the new showroom also proposes various coordinated usages of interior products and materials. Therefore, the number of model rooms and the overall floor space were expanded significantly, and three-dimensional and other cutting-edge digital systems were introduced. In addition, a new interior laboratory function (A service where interior materials for non-residential applications can be considered) with designers who can propose various usages of interior materials and products was established, too. And the new showroom provides “an enjoyable experience for users to create interiors” through its ability to allow customers to “see,” “select,” and “combine” various interior products and materials.

Moreover, spaces where architects and design offices can provide seminars to customers will be expanded.

In addition to the existing showrooms in Tokyo, Nagoya, Osaka, Okayama, Hiroshima and Kyushu, smaller showrooms targeting reform demands will be opened in the countryside.

3) Improve Corporate Reputation with Stakeholders

Capital Policy

Sangetsu maintains a goal of achieving average consolidated payout ratio of over 100% for three years. As a partial attempt to achieve this goal, the Company acquired ¥4.78 billion worth of treasury stock and made a total dividend payment of ¥3.07 billion, for a total comprehensive payout of ¥7.85 billion and a comprehensive payout ratio of 178.6% during fiscal year March 2015.

In addition, Sangetsu has established a plan of reducing its capital by ¥10.0 to ¥20.0 billion within three to five years, and has successfully reduced both its common equity and capital by ¥3.6 and ¥1.1 billion respectively during the previous term as a means of raising its capital efficiency.

Societal Contribution Strategy

In addition to the traditional societal contribution strategy, Sangetsu calls for each of its employees to take proactive steps to participate in societal contribution activities which leverage its business. As a specific example, employees participate in renovations and improvements at a children’s foster home in Nagoya using materials and products sold by Sangetsu. Furthermore, the Company is considering the expansion of this effort to other regions.

5. Interview with President Shosuke Yasuda

We interviewed President Shosuke Yasuda to get his opinions of the past year since he was appointed in April 2014 as the Company’s first president from outside the founding family. We asked his thoughts and opinions about the past year, about progress in achieving the Midterm Business Plan. We also asked him if he has any message to his shareholders.

<The Past Year in Retrospect>

- Since assuming the role of President in April of last year, we have addressed various issues. Of course we have not yet achieved results in dealing with all of the issues, but our management is steadily promoting measures based upon accurate assessment of the various issues. In particular, we have promoted reforms and reviews of our corporate governance and organizational structures as part of our efforts to fortify our business foundations, and we have acted with a speedy and drastic top-down approach to these issues.
- With regards to the restructuring of our business strategy, Sangetsu has been able to clearly identify its deficiencies which need to be strengthened. But we remain aware of the fact that there is “still room for improvement” and that there are “latent business opportunities” to be cultivated. Therefore it has been a year full of various discoveries.
- It has also been a significant year for us as we have received numerous business offers from potential customers who have recognized that “Sangetsu has changed” through the implementation of its Midterm Business Plan since I

became President.

- This coming year marks the second year of my tenure, and we will promote a clearly defined growth strategy under the guidance of our new management structure.

<Midterm Business Plan Promotion>

①Facilitate a Structure that Allows Employees to Participate in Business Management

- The real nature of the third founding period is to become “a publicly traded company that is truly managed by employees” and in order to do so, changing the mindset of our employees is a major issue. Because of the heavy burden of day-to-day tasks of our marketing staff, who comprise the bulk of our employees, they may find it difficult to realize that the changes in our Company are real and that they impact each employee as well.
- Consequently, we established an operational reform committee in November 2014 to oversee all our subsidiaries and offices and to promote marketing operational reforms. First, order taking and marketing support operations have been assigned to dispatched temporary workers, and employees responsible until now have been assigned to marketing positions.
- In addition, the marketing structure had been self-contained with a single marketing staff being responsible for a single sales territory. However, from April of this year, a new structure was implemented where teams were formed to cover a wider sales territory. These changes to the frontline of our operations have not been performed in the past and they are contributing to the realization by our employees of the potential for changes in our Company.
- The resignation of the founding family members from the Company’s management represents the adoption of a new strategy, and the introduction of paid for stock options has also had a large impact. In particular, the stock options have had a particularly large impact upon the Sungreen Co., Ltd. and Yamada Shomei Lighting Co., Ltd. in raising the awareness of the Group’s earnings and share price.
- In addition, the awareness of employees has changed dramatically in response to measures representing meritocracy including the early and expanded promotion of staff as part of the human resources compensation system implemented from July.
- Since I am the one who introduced a mandatory retirement system for directors, I also bear the heavy responsibility of cultivating the next generation of management. The Company is increasing the opportunities for employees’ growth through the introduction of an in-house training system and the encouragement of employees’ participation in external training courses. During the training session I talk to our employees in person. I ask them questions such as, “What do you think our Company expects of you?” and “Are you aware of what actions you should take, while your position and role in the company is in a process of great change?” Along with the changes in the awareness of our employees, I believe that their motivation for participating in our training has improved significantly.
- I would like to highlight the importance of “rebranding” in the process of improving value addition as part of our business foundation facilitation efforts. Sangetsu needs to restructure its brand to be able to provide attractive solutions in realms demanded by professional designers and architects in nonresidential realms as part of our strategy of operating our business with a keener awareness of consumers’ needs. We will begin using a new corporate logo in April 2017 and will perform reviews of our “product catalogs” which may be considered to be our main marketing tool.

②Restructuring of Our Business Strategy

- We have newly established the “New Market Development Office” to take on new challenges within Japan and as part of our value chain efforts. This move is undertaken to create new business by taking our consumers’ needs and tastes directly into consideration. Until now, Sangetsu has dealt in products for general home usage solely as an indirect result of the business flow process. However in recent years, wallcoverings have become a familiar product to consumers based upon major department stores displays of wallcovering products, and there are increasing cases where consumers actively choose wallcoverings as part of the refurbishment process. Consequently, product development catering to consumer tastes is vital in increasing the value addition, including pricing, of these products. The newly appointed Chief of the New Market Development Office is a former chief

development staff for wallcovering products. While the Chief and the staff seemed perplexed at first, they are now aggressively taking on challenges in developing new business realms.

- At the same time, we have newly established the Upholstery Office as part of our product development strategy. Since upholstery marketing channels are different from those for other products, this realm had been hardly explored. Therefore, a specialized organization with dedicated staff has been established to cultivate new markets.
- In addition to these two developments, Sangetsu recognizes that there are still various “things that we can do” to expand our business. We expect to expand our business realms through alliances formed in line with our value chain, geographical region and product strategies.

③Improving Our Reputation Amongst Our Stakeholders

- Our announcement of a capital strategy last year provoked a great interest. However, the inability to gain the proper understanding of our strategies by some stakeholders is unfortunate.
- These three years are a period of preparation, with an acceleration in various investments for growth expected to be made at the expense of short-term profit growth. Amidst these conditions, Sangetsu believes that it needs to offer shareholders a sustainable level of shareholder returns with a view to our Company’s medium- to long-term growth, and we announced a goal of achieving average total return ratio of over 100% as part of our capital strategy. The reduction in capital that allowed ROE to increase was not merely undertaken as a means of influencing our share price. Therefore we ask our shareholders for their understanding of the motivation behind our strategy.
- We will flexibly consider increases in dividends and treasury stock acquisition as means of increasing our medium- to long-term shareholder returns.

④Diffusion of Our Corporate Philosophy and Principles

- While Sangetsu has become a truly public company along with the resignation of the founding family members, our Company still needs to maintain the consciousness, passion and energy from our establishment and growth phase.
- While the original product catalog that enabled Sangetsu to enter the Kanto region and to become the industry leader, this product catalog, preserved in our Company, is still considered to be amazing and serves to show the passion of our founding family towards our business.
- Along with the arrival of our “third founding,” we need to inherit our predecessors' visions and ideals, not only words, while leveraging our precious mementos such as the above, and continue to take on new challenges.

<Message to Investors>

- While I believe we need a bit more time before we can provide returns to our investors in the form of an expansion in sales and profits, we have promoted the fortification of our business foundation and the initial stages of our next phase of growth have already been put in place.
- As mentioned earlier in reference to our capital strategy, we will endeavor to provide shareholders with an appropriate level of returns. Therefore, we ask for the understanding and support of our shareholders in our various efforts to maintain growth over the medium to long term.

6. Conclusions

The current Midterm Business Plan calls for various fortifications of the organizational structure and speedy and bold reforms of systems. The implementation of this Plan has already been effective in bringing about large changes in the mindset of employees. Going forward, the speed and depth of further changes in employee mindsets will remain to be an important issue. While assessing data and the overall situation in a tangible manner is difficult, future reports to be issued will also follow the progress in the achievement of targets defined in the Midterm Business Plan. At the same time, Sangetsu’s efforts to pursue new market development and expansion of nonresidential business realms should be watched closely.

<Reference: Mid-term Business Plan, 2014-2016: Next Stage Plan G>

Sangetsu identifies 2014 as its “Third Founding Phase” and has created the “Mid-term Business Plan (2014-2016) Next Stage Plan G” to define the vision to be pursued and direction to be taken in the coming years. The targets included in this plan entail “corporate restructuring and fortification, investments and preparations for future growth, and preparations to cultivate development of business over the next three years.”

<Basic Policy>

Business Restructuring	<ul style="list-style-type: none"> ◇ Replace, newly create distribution, office facilities ◇ Restructure IT systems ◇ Expand investments in human resources
Interior Business Fortification	<ul style="list-style-type: none"> ◇ Expand sales of refurbishment (Residential, non-residential) ◇ Fortify non-residential use products ◇ Fortify flooring products ◇ Restructure the curtain related business
New Business Development	<ul style="list-style-type: none"> ◇ Expand operations, improve earnings of consolidated companies
Full-Scale Overseas Business Deployment	<ul style="list-style-type: none"> ◇ Develop products specifically for the overseas markets

<Specific Measures>

Target Stakeholders	Target Realms	Specific Measures
Employees	Internal Structure	2) Facilitate a corporate structure that allows employees to actively participate in business management E) Organizational review F) Personnel structure reforms G) Review organization operational rules H) IT system restructuring
Clients, Suppliers	Products, Marketing	2) Business strategy restructuring C) Expand existing businesses D) Promote growth strategies
Shareholders, Society	Capital Markets, CSR	3) Improve the reputation amongst stakeholders D) Capital and IR strategies E) Societal contribution activities F) Environmental management

In addition, Sangetsu will promote the four specific measures mentioned below as part of “4) Diffusion of Our Corporate Philosophy and Principles” strategy.

◎ Progress in Achieving Various Measures

1) Facilitate a Corporate Structure that Allows Employees to Participate in Business Management

A. Organizational Reviews	<ul style="list-style-type: none"> ✓ Transitioned to a new organizational structure on July 1 ✓ Introduced business structure that clearly defines responsibility for earnings ✓ Fortified headquarter functions ✓ Established new, overseas business divisions
B. Personnel System Reforms	<ul style="list-style-type: none"> ✓ Under consideration of introducing a new personnel system that increases employee motivation; Scheduled to be introduced in April 2015 ✓ Will increase number of female marketing staff
C. Organizational Operation Reviews	<ul style="list-style-type: none"> ✓ Fortified earnings, management efficiency by function, including headquarters, branch offices, divisions, product catalogs, and products ✓ Fortified risk management function ✓ Conducted transfer of authority through company rule reviews



D. IT System Restructuring	<ul style="list-style-type: none"> ✓ Introduced new operating systems ✓ Salesforce to be introduced as a new marketing management system from January 2015; Will fortify marketing by mobilizing marketing staff, efficiency improvements ✓ Under consideration of introducing new backbone system
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2) Business Strategy Restructuring

A. Expand Existing Interior Business	<ul style="list-style-type: none"> ✓ Currently reviewing product development (Planning, design) and implementing efforts to restructure branding strategy ✓ Creation of an optimized distribution structure underway
B. Promote Growth Strategy	<ul style="list-style-type: none"> ✓ Consideration of new channels for new products, business realms underway ✓ Pursuing synergies within the Sangetsu Group ✓ Selection of key overseas markets underway

3) Improve Corporate Reputation with Stakeholders

Based upon the identification of ongoing improvements of corporate value as the basic means of returning profits to shareholders, Sangetsu has sought to implement a stable level of dividends. (The combined total dividend payout over the past five years amounts to over 70%) In addition, the Company has implemented a management strategy that places a priority upon safety of its balance sheet in addition to sales growth and profitability. However, Sangetsu recognizes the necessity of making a shift in its management strategy that favors efficiency of the balance sheet and considers cost of capital in addition to safety and expansion of earnings in light of the recent Japanese capital market conditions. Consequently, the Company announced a capital strategy as detailed below on November 7, 2014.

Basic Principle	<ul style="list-style-type: none"> ➤ Realize higher ROE in excess of cost of capital at an early stage, with a medium- to long-term ROE target of 8% to 10% ➤ Secure capital needed for stability and growth, implement efficient usage of operating capital, improve capital efficiency ➤ Fortify shareholder return strategy to ensure a sustained level of returns over the medium- to long-term
Capital Strategy based upon Next Stage Plan G	<ul style="list-style-type: none"> ➤ Raise consolidated comprehensive shareholder return to average over 100% over the 3 years from 2014 to 2016 ➤ Reduce capital by ¥10.0 to ¥20.0 billion in 3 to 5 years from end of FY3/14, with an eye to market conditions ➤ Improve medium- to long-term shareholder returns, flexibly acquire treasury stock, consider and implement increases in dividends, with ¥3.0 billion purchase of treasury stock as the first step in this plan

While investments are necessary to secure midterm growth and maintenance of reserves needed to respond to fluctuations in the economy, Sangetsu is not expected to make any large investments or conduct any large scale M&A activities during the next several years. While a shift from a fables company to one that maintains a “manufacturing division” may be possible in order to expand the scale of its business and raise earnings generation capability over the long term, Sangetsu is expected to focus its attention upon strengthening its partnerships with the companies in which it has minority stakes over the near term. Therefore, Sangetsu may adopt an aggressive shareholder return strategy due to the lack of need for large amounts of cash reserves. However increasing the volatility of the Company’s share is not in the best interests of either the Company or its shareholders, and efforts will be made to implement not one-off but “sustained shareholder returns,” which is deemed important, over a period of between 3 to 5 years.

Bridge Report



<Targets>

◎ Targets to Be Achieved Between 2014-2016

Sales	¥140.0 Billion
Net Income	¥6.3 Billion

Sangetsu endeavors to achieve record high levels of profits while at the same time conducting anticipatory investments to facilitate a structure that can achieve sustained growth.

(Units: Billion Yen)

	Consolidated	Interior	Exterior	Lighting
Sales	140.0	120.0	16.0	4.0
Gross Income	38.8	35.5	2.1	1.2
SG&A	29.3	26.5	1.6	1.2
Operating Income	9.5	9.0	0.5	0.0
Ordinary Income	9.7	9.2	0/5	0.0
Net Income	6.3	6.0	0/3	0.0

In addition to refurbishment of existing businesses and promotion of large scale renovation of hospitals and nursing care facilities in the interior business, a shift to high value added products and efforts to achieve higher sales are expected to be promoted. Sales, general and administrative expenses are expected to increase due to efforts for new business development and overseas business deployment. Based upon the assumption of limited expansion in the exterior business, Sangetsu is expected to prioritize the establishment of a stable business foundation for the lighting business. Consequently earnings are not expected to grow.

◎ Targets to Be Achieved Between 2017-2019

Based upon this midterm business plan, the next midterm business plan is expected to end in fiscal year March 2020 and maintains the themes of “realizing profitability of new, overseas businesses, and consolidated subsidiaries,” “steadily expand earnings of the interior business,” and “introduction of new capital strategy.” In addition, the next plan maintains a “target of achieving ROE of 8% to 10%.”

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