



Bridge Report



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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 wallcoverings, and is the industry's leader in the curtains, 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
¥2,362	71,668,298 shares		¥169.281 billion	3.7%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)	PBR (actual)
¥45.00	1.9%	¥75.27	31.4 x	¥1,625.21	1.5 x

* Stock price as of closing on December 4, 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 (¥)	DPS (¥)
March 2010	108,579	5,646	6,046	3,137	39.10	37.50
March 2011	112,118	7,161	7,530	4,242	52.87	37.50
March 2012	118,518	7,095	7,180	4,151	51.73	37.50
March 2013	123,150	8,020	8,393	4,806	60.26	40.50
March 2014	131,978	8,952	9,475	5,459	71.65	37.50
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

* DPS of March 2013 included commemorative dividend of ¥3.

* Estimates are those of the Company. 2 for 1 stock splits were conducted in April 1, 2015.

From the current fiscal year, the definition for net income has been changed to net income attributable to parent company shareholders (Abbreviated as parent net income).

This Bridge Report provides a review of the first half of fiscal year March 2016 earnings overview for Sangetsu Co., Ltd.

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Key Points

- Sales rose by 0.4% year-on-year to ¥64.2 billion during the first half of fiscal year March 2016. While sales of curtains declined, sales of wallcovering and flooring materials trended favorably due to sales price revisions conducted during the second half of the previous fiscal year. The reviews of costs accompanying the rise in crude oil prices allowed gross income margins to improve by 1.2% points. While distribution costs increased along with the move of the Tokyo showroom to a new location, cost controls were successful in holding down sales, general and administrative expenses (SG&A) to allow operating income to rise by 16.2% year-on-year to ¥4.5 billion. And while sales fell slightly shy of Sangetsu's initial estimates, profits exceeded estimates.
- Sangetsu made no changes to its outstanding earnings estimates for fiscal year March 2016, which call for sales to rise by 2.6% year-on-year to ¥135.5 billion. Sales of the renovation business are expected to rise by a small margin, with sales of non-residential products expected to remain in line with the previous fiscal year. Cost of sales margin is expected to improve by 0.2% points in part by sales price correction. At the same time, SG&A expenses are expected to rise on the back of increases in human resources related and business foundation facilitation related expenses. However, the higher sales are expected to be able to absorb these higher expenses and allow for operating income to rise by 2.7% year-on-year to ¥8.2 billion. Dividend payment of ¥45.00 per share is anticipated, for an expected dividend yield of 59.8%.
- The increase in sales and profits enabled sales to reach a new record high and net profit to exceed the previous record high in the first half of 1991. However, Sangetsu lost market share to competitors in certain products and the Company remained cautious about the current business environment. Consequently, President Shosuke Yasuda recognizes these issues and has identified a goal of "strengthening Sangetsu's non-pricing competitive strengths." And while the effects of strengthening the competitive standing of products, branding and its showroom strategy cannot be expected to appear immediately, changes are apparent as reflected by the growing number of interior coordinators and producers of homes visiting the Shinagawa showroom in Tokyo, and the positive results of these efforts 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 "fabless 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.

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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

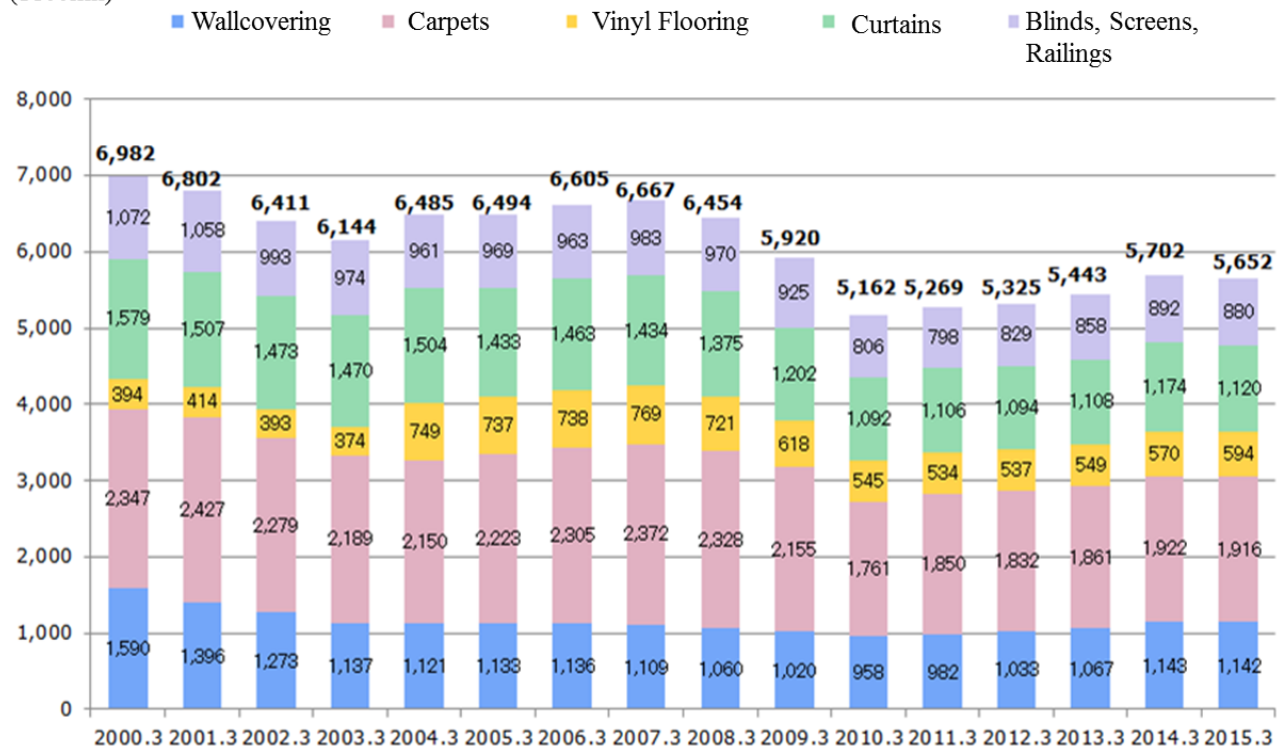
<Market Environment>

◎ 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.

Interior Products Market

(¥100mn)



※Nippon Interior Fabrics Association

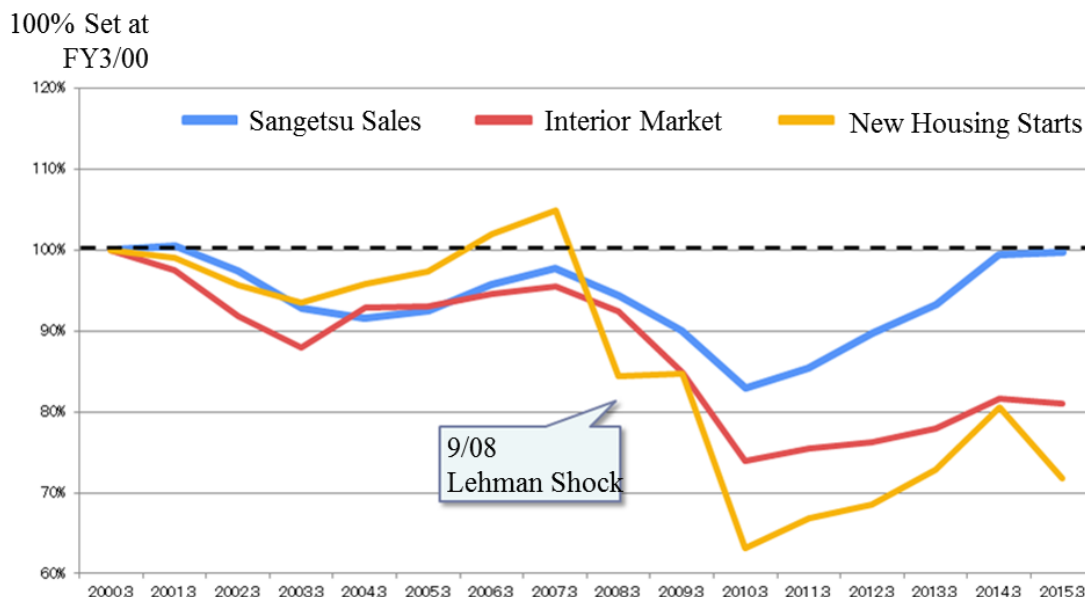
“2015 General State of the Interior Fabrics Business and Market Size Determination”

(Source: Sangetsu)

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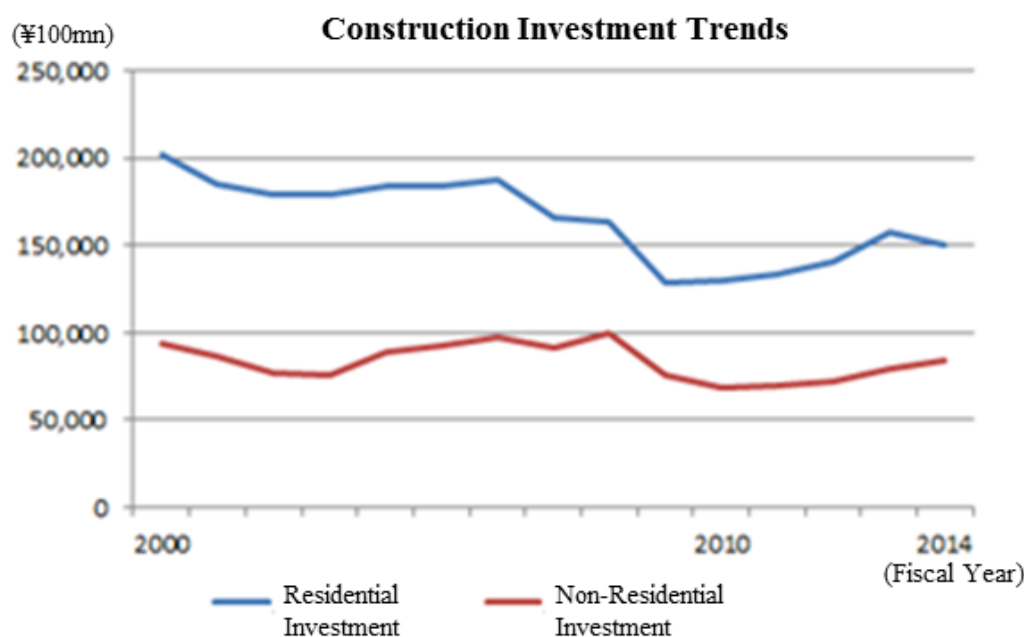


At the same time, the graph below shows the correlation between sales of Sangetsu relative to sales of the Japanese interior market and new housing starts (Ministry of Land, Infrastructure, Transport and Tourism data). Sales of both Sangetsu and the Japanese interior market show a close relationship 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.



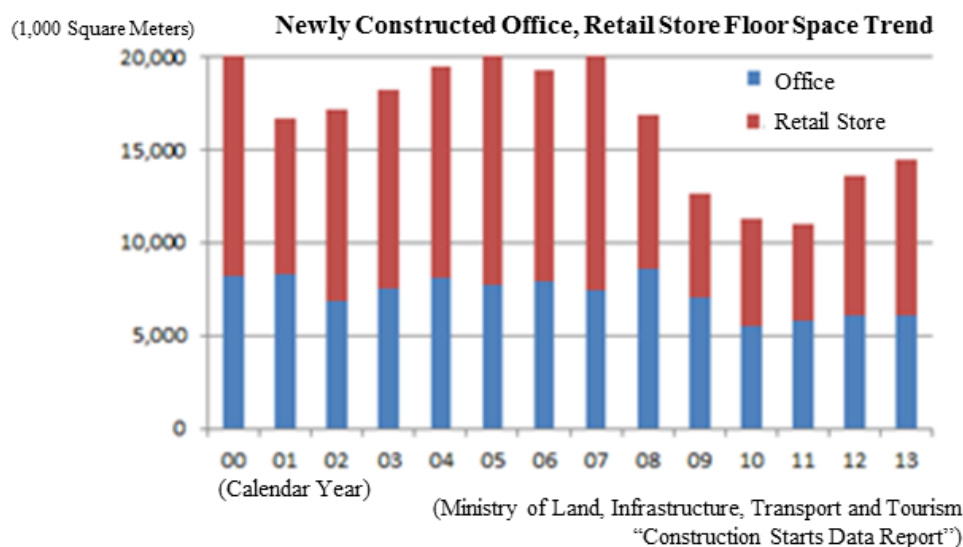
(Source: Sangetsu)

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.	98,000	7.4%	3,800	19.2%	3.9%	27,085	10.5	0.8	7.3%
7971	TOLI Corp.	92,000	1.3%	3,450	9.4%	3.8%	21,409	9.6	0.7	7.3%
8130	Sangetsu	135,500	2.6%	8,250	2.7%	6.1%	169,281	31.4	1.5	3.7%
9827	Lilycolor Co., Ltd.	35,900	3.0%	290	56.9%	0.8%	2,952	29.5	0.5	0.9%

* Estimates are from those of the respective companies. Market capitalization is based upon the closing share price on Dec.4, 2015.

The Company's high profitability and stock price valuation are in sharp contrast to those of its competitors.

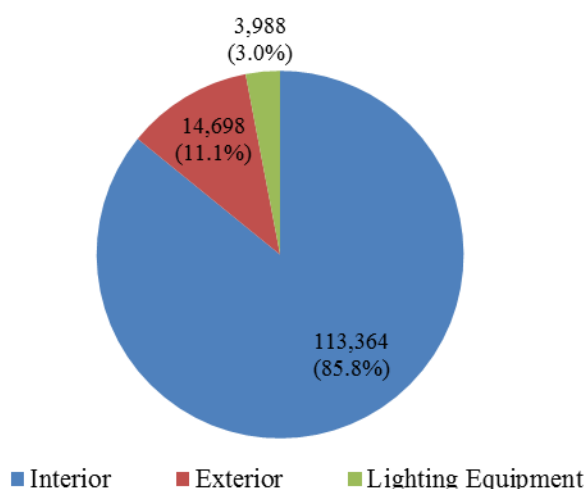
<Business Description>

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.

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Sales by Business Segment
(FY3/15 ¥mn)



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

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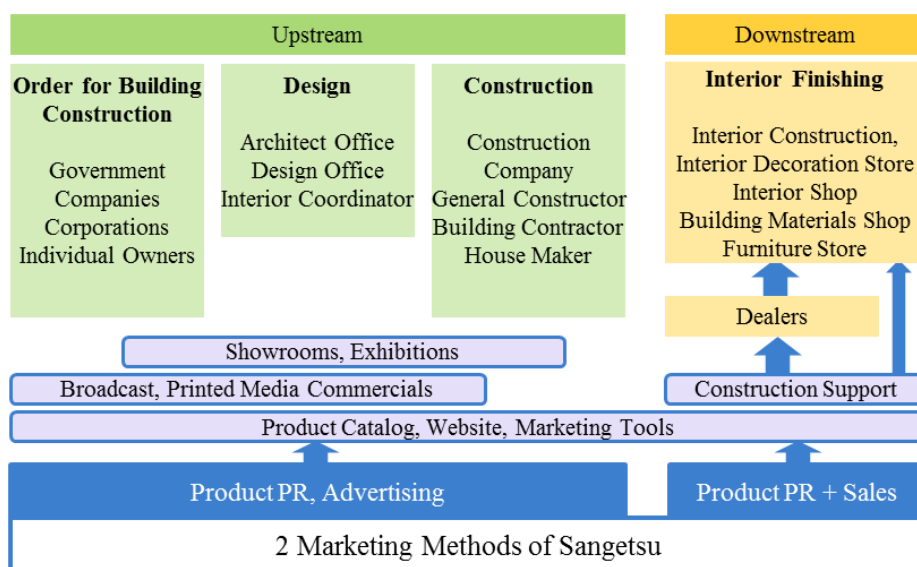


different wallcovering products alone. Product catalogs are updated every two years (Curtain product catalogs are updated every three years), with an existing product replacement rate for wallcovering of 50% to 55%, which compares with a 35% to 40% rate for its competitors.

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 Fukuoka, 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

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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)

Yamada 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.

<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 more than 20 types of catalogs, which far surpass those of its competitors.

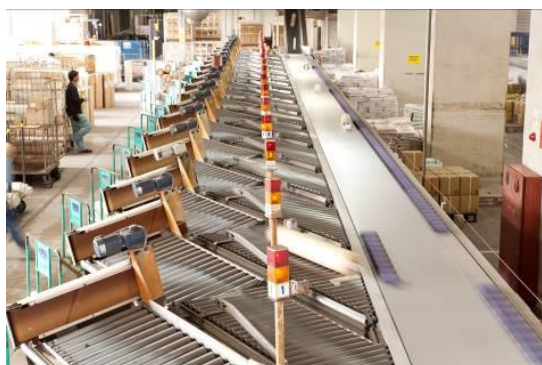
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(Source: Sangetsu)

“Provide”

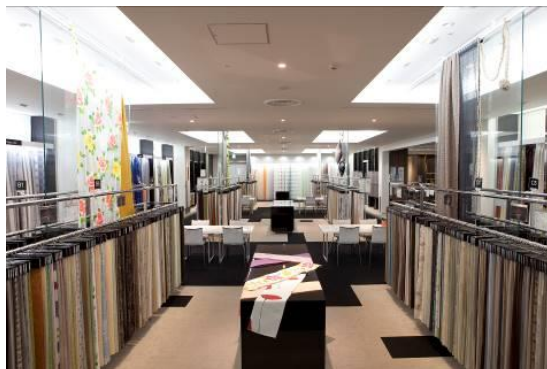
As mentioned earlier in this report, Sangetsu normally maintains inventories of all of its products so that they can be provided on a “Just-in-Time” basis using their nationwide distribution network. However, the Company is required to conduct speedy processing techniques as product orders are placed 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. First Half Fiscal Year March 2016 Earnings Overview

(1) Earnings Overview

(Unit: Million Yen)

	1H FY3/15	Share	1H FY3/16	Share	YY Change	Divergence from Est.
Sales	63,981	100.0%	64,256	100.0%	+0.4%	-0.4%
Gross Income	17,962	28.1%	18,829	29.3%	+4.8%	-
SG&A	14,037	21.9%	14,269	22.2%	+1.7%	-
Operating Income	3,924	6.1%	4,559	7.1%	+16.2%	+20.0%
Ordinary Income	4,218	6.6%	4,762	7.4%	+12.9%	+20.6%
Net Income	2,156	3.4%	3,225	5.0%	+49.6%	+29.0%

Sales, Profits Rise and Record High in First Half.

Sales rose by 0.4% year-on-year to ¥64.2 billion to a new record high for the first half. While sales of curtains declined, sales of wallcoverings and flooring materials trended favorably due in part to the sales pricing revisions conducted from the second half of the previous fiscal year. Reviews of costs were conducted from June along with the decline in crude oil prices and allowed gross margin to improve by 1.2% points and gross income to increase by 4.8% from the previous term. While distribution expenses rose due to increases in the number dispatch routes and the move of Tokyo showroom, successful control of selling, general, and administrative expenses allowed operating income to rise by 16.2% year-on-year to ¥4.5 billion. While profits exceeded initial estimates, sales fell slightly shy of estimates.

(2) Business Segment Trends

(Unit: Million Yen)

	1H FY3/15	Share	1H FY3/16	Share	YY Change
Sales					
Interior	54,633	85.4%	55,119	85.8%	+0.9%
Wallcoverings	27,105	49.6%	27,450	49.8%	+1.3%
Floorings	18,311	33.5%	19,137	34.7%	+4.5%
Curtains	4,002	7.3%	3,642	6.6%	-9.0%
Others	5,215	9.5%	4,889	8.9%	-6.3%
Exterior	7,512	11.7%	7,185	11.2%	-4.4%
Lighting	1,867	2.9%	1,973	3.0%	+5.7%
Adjustments	-32	-0.1%	-22	0.0%	-31.3%
Total	63,981	100.0%	64,256	100.0%	+0.4%
Operating Income					
Interior	3,641	6.7%	4,496	8.2%	+23.5%
Exterior	260	3.5%	152	2.1%	-41.5%
Lighting	30	1.6%	-85	-	-
Adjustments	-8	-	-3	-	-
Total	3,924	6.1%	4,559	7.1%	+16.2%

* Share of various components of the interior business is that within the interior business. * Share of operating income is the same as operating income margin.

① Interior Business

Sangetsu adopted a pricing focused marketing strategy in light of the difficulties faced in the volume, share and sales of wallcoverings and curtains. Gross income rose on the back of the successful diffusion of price hikes and reductions in cost of sales. At the same time, Sangetsu recognizes the need to strengthen its non-pricing competitive strengths (Products, branding, and marketing strengths).

<Wallcoverings>

While demand for interior related products from newly constructed homes stagnated, Sangetsu endeavored to cultivate demand from non-residential realms including offices, retail stores, and accommodation facilities. Furthermore,

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Sangetsu's efforts to expand sales of high value added and high functionality products including rigid chloride self-adhesive sheets "Reatec" have been successful in cultivation strong latent demand from offices.

<Floorings>

Cushion vinyl sheet "H Floor", heterogeneous vinyl sheets "S Floor" and other fortified products used by medical and welfare institutions trended favorably. The range of applications for multiple layered vinyl floor tile "Floor Tile" was expanded from its existing market of commercial facilities to rental housing.

<Curtains>

Conditions within the custom made curtain market segment remained severe due the continued progression of deflationary trends in interior products.

Sangetsu fortified products showcased in its product catalog "Sanwinc", including shades and vertical blinds as part of its efforts to propose curtain and other improvements in window applications.

② Exterior Business

As a part of marketing function fortification plan, Sungreen focused upon sales promotions including campaigns and fortification of sales in the Kanto region, allowing it to achieve higher sales in the current term over the previous year in the Kanto region where a branch was newly established in Yokohama last year. At the same time, training programs have been provided to construction engineers to fortify Sangetsu's construction capabilities. However, disappearance of special demand created by snow related disasters in previous term contributed to difficult operating conditions.

③ Lighting Business

Yamada Shomei Lighting leveraged its technological and product development capabilities that embody its customer needs to publish its "Z-Light Catalog" and "General Catalog", which propose various high value added products to its audience of interior and lighting designers. Investments in infrastructure for the upcoming Tokyo Olympics are expected to act as a tailwind and allow for favorable deliveries of order for products in non-residential applications. Whiles sales grew, booking of evaluation losses on product inventories and increases in costs to strengthen the business foundation contributed operating loss.

(3) Financial Condition, Cash Flow

◎Balance Sheet

(Unit: Million Yen)

	3/15 End	9/15 End		3/15 End	9/15 End
Current Assets	99,613	95,768	Current Liabilities	18,967	17,775
Cash, Equivalents	28,238	41,401	Payables	13,198	12,690
Receivables	44,927	40,788	Noncurrent Liabilities	5,350	5,139
Marketable Securities	13,300	300	Retirement Benefits	3,909	3,954
Inventories	11,851	12,445	Total Liabilities	24,317	22,914
Noncurrent Assets	43,462	44,496	Net Assets	118,758	117,349
Tangible Assets	28,579	29,905	Shareholders' Equity	115,067	113,935
Intangible Assets	332	782	Total Liabilities, Net Assets	143,076	140,264
Investments, Others	14,550	13,807	Total Interest Bearing Liabilities	92	-
Total Assets	143,076	140,264	Equity Ratio	83.0%	83.6%

Declines in receivables and marketable securities contributed to a ¥3.8 billion decline in current assets compared with the end of previous term. Acquisition of tangible noncurrent assets (land) and other factors allowed noncurrent assets to rise by ¥1.0 billion, which in turn contributed to a decline in total assets of ¥2.8 billion to ¥140.2 billion. Declines in accounts payables led to ¥1.1 and ¥1.4 billion declines in current liabilities and total liabilities to ¥17.7 and ¥22.9 billion over the same period respectively. Net assets declined by ¥1.1 to ¥113.9 billion on the back of declines in retained earnings. Capital adequacy ratio rose by 0.6% points year-on-year to 83.6%.

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◎Cash Flow

(Unit: Million Yen)

	1H FY3/15	1H FY3/16	YY Change
Operating Cash Flow	3,591	6,236	+2,645
Investing Cash Flow	1,433	8,849	+7,416
Free Cash Flow	5,024	15,085	+10,061
Financing Cash Flow	-1,441	-4,464	-3,023
Cash, Equivalents	15,917	26,162	+10,245

An increase in profits and reductions in the value of inventories and payables contributed to growth in the net inflow of operating cash flow. The net inflow of investing cash flow increased due in part to a decline in marketable securities acquisitions and a boost in income from redemption of investment securities. Consequently, the net inflow of free cash flow grew by a large margin. Increases in acquisition of treasury stock and dividend payments led to a large increase in the net outflow in financing cash flow. As a result of these changes, cash position increased.

3. Fiscal Year March 2016 Earnings Estimates

(1) Earnings Estimates

(Unit: Million Yen)

	FY3/15	Share	FY3/16 Est.	Share	YY Change	Divergence from Est.
Sales	132,050	100.0%	135,500	100.0%	+2.6%	47.4%
Gross Income	37,510	28.4%	38,700	28.6%	+3.2%	48.7%
SG&A	29,478	22.3%	30,450	22.5%	+3.3%	46.9%
Operating Income	8,031	6.1%	8,250	6.1%	+2.7%	55.3%
Ordinary Income	8,506	6.4%	8,550	6.3%	+0.5%	55.7%
Net Income	4,402	3.3%	5,500	4.1%	+24.9%	58.6%

- Estimates are those of the Company

Sangetsu Maintains Outstanding Earnings Estimates, Small Increases in Sales, Profits Expected

Sangetsu made no revisions to its outstanding earnings estimates, which call for sales to rise by 2.6% year-on-year to ¥135.5 billion. During the full year, refurbishments are expected to rise by a small margin on the back of marginal growth in new housing starts, and the non-residential realm business is expected to remain in line with the previous fiscal year. Corrections in sales pricing and reductions in inventories of products which saw evaluation losses are expected to allow gross income margin to improve by 0.2% points. Higher labor costs arising from increases in pay due to promotions as part of reforms in the human resources system, efforts to strengthen design capabilities and business foundation fortification efforts are expected to contribute 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 previous term, net income is expected to rise by double digits year-on-year. A dividend of ¥45.00 per share is expected to be paid for an anticipated dividend payout ratio is 59.8%.

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(2) Business Segment Trends

(Unit: Million Yen)

	FY3/15	Share	FY3/16 Est.	Share	YY Change	Est. Attainment Rates
Sales						
Interior	113,364	85.8%	116,500	86.0%	+2.8%	47.3%
Exterior	14,699	11.1%	15,000	11.1%	+2.0%	47.9%
Lighting	4,022	3.0%	4,000	3.0%	-0.5%	49.3%
Adjustment	-35	-	-	-	-	-
Sales, Total	132,050	100.0%	135,500	100.0%	+2.6%	47.4%
Operating Income						
Interior	7,550	6.7%	7,800	6.7%	+3.3%	57.6%
Exterior	455	3.1%	500	3.3%	+9.9%	30.4%
Lighting	30	0.7%	-50	-	-	-
Adjustment	-4	-	-	-	-	-
Operating Income, Total	8,031	6.1%	8,250	6.1%	+2.7%	55.3%

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

4. Progress in the Medium Term Business Plan

① Business Reforms, Information and Distribution System Restructuring

Sangetsu seeks to achieve strong and effective marketing through its marketing support services offered to its sales force from February 2015. Sangetsu has selected a next generation backbone system sold by Accenture to begin operation from 2016, and will also receive associated consulting services from Accenture. In addition, external consultants will be employed to conduct reviews of Sangetsu's distribution system including both external and internal systems.

② Strengthening Alliances with Procurement Partners

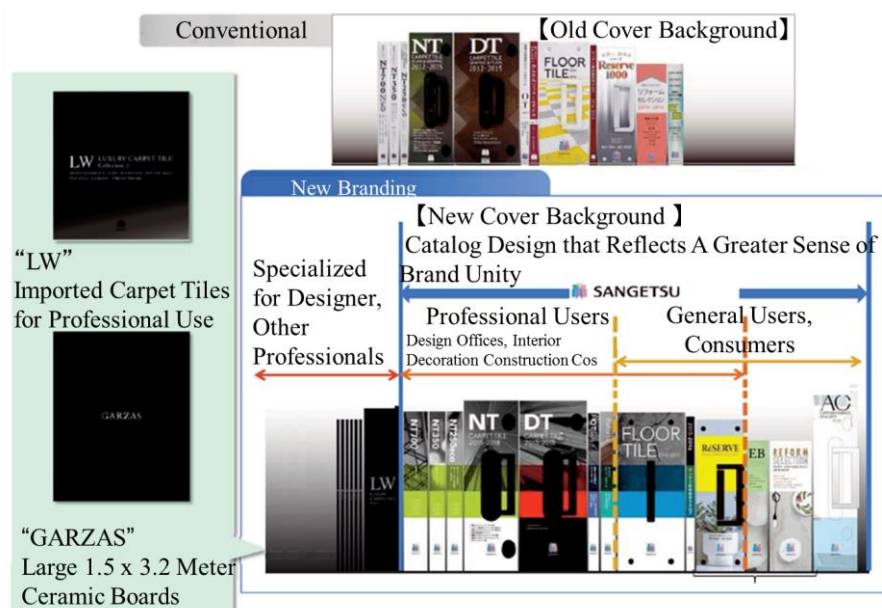
Sangetsu seeks to maintain its negotiating power based upon its position as the largest interior products trading company by avoiding increases in reliance upon single companies from which products are procured. However, the environment for procurement partners is changing with some competitors concentrating their product purchases and increases in publishing costs for product catalogs arising from higher product elimination rates. Furthermore, customers are also calling for fundamental revisions in product procurement strategies due to their difficulty to use.

Amidst these trends, Sangetsu acquired 22.2% of Wavelock Holdings Co., Ltd. shares turning it into an equity accounting method held affiliate. Wavelock Interior Co., Ltd., a subsidiary of Wavelock Holdings Co., Ltd., is the leading manufacturing company within the vinyl wallcovering industry within Japan and is one of main product procurement companies. In addition to efforts to fortify and long-term stabilize the procurement structure, efforts will also be made to increase the value addition of Wavelock Holdings.

③ Strengthening of Product Capability, Branding Restructuring

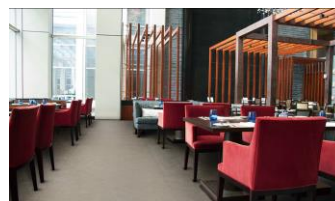
In addition to strengthening its position in the residential market, Sangetsu will also promote efforts to strengthen its product capability and restructure its branding as part of its strategy to fortify its position within the non-residential market. Along with these goals, the Company will change the front page of its product catalog to bring about a sense of unity that embodies the full range of the "Sangetsu" brand. Various aspects of concern to general users and consumers will be considered including the ease of use, sense of enjoyment, design, and function of the catalog and products listed within it. Other aspects such as budget, inventories and distribution will be considered in addition to design and function for interior design offices, construction companies and producers. Furthermore, a new catalog containing products including imported carpet tiles which do not have the Sangetsu logo will be launched with professional designers in mind. The products listed in this catalog entitled "LW" are also designed with the goal of raising the value addition the buildings in which they are used.

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As part of the product capability strengthening strategy, sales of large sized ceramic slab “GARZAS” products for use by professionals were launched from October 2015. Large sized ceramic slab “GARZAS” products are designed for use in wall, floor, furniture and kitchen surface material applications. “GARZAS” products boast of a maximum size of 1.5 by 3.2 meters, and thickness of between 3.0 to 6.4 millimeters, and come in 63 different varieties of products in 40 different colors, enabling them to respond to a wide range of highly demanding interior needs. These products enable the creation of new concepts of interior spaces which could not be created using conventional products.

(Examples of Interiors Using “GARZAS”)



(Source: Sangetsu)

In addition, Sangetsu’s “brand statement”, which reflects the Company’s branding philosophy, and new logo mark are expected to be released in April 2016. Moreover, the wallcovering series “SHITSURAH” and flooring carpet tile “process#100” of the “SUMI product series” were selected as recipients of the “2015 Good Design Award” in October 2015. Sangetsu will continue to strengthen its product capabilities to raise its brand value even further.

④ Showroom Strategy

The Shinagawa Showroom opened on July 31, 2015 has been favorably received. The success of this showroom is reflected by the facts that the number of visitors to this showroom during the months of August, September and October have risen from the previous year and that the ratio of professional users amongst all visitors has also risen above expectations. In addition, various events such as seminars held by design offices and studios for their customers at the expanded seminar facilities of the new Shinagawa showroom have been held and the range of activities held at the showroom is growing.

⑤ Others

- Preparations for the restructuring of distribution facilities are progressing smoothly. The Kuki Center (Covering the Kanto region), the Chubu Logistics Center II (Covering the Chubu region), and the Heiwajima Center (Covering the Tokyo metropolitan region) are expected to begin operating from August 2016, January 2017 and January 2018 respectively.

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- A resolution was passed during the board of directors' meeting held on November 5, 2015 to allow Sangetsu to perform a share buyback, with a maximum number and value of shares of 2.5 million and ¥6.0 billion respectively, between the period of November 10, 2015 to April 28, 2016. And during the period from November 10 to 30, the Company acquired 422,300 shares worth ¥961 million.

5. Conclusions

Sangetsu was able to record increases in both sales and profits. Consequently, sales rose to a record high for the first half, and net income to the first record high since 1991. Despite these strong earnings, Sangetsu maintains a conservative outlook for the future as it has lost market share to its competitors in some product areas. Consequently, President Shosuke Yasuda recognizes these issues and has identified a goal of "strengthening Sangetsu's non-pricing competitive strengths." And while the effects of strengthening the competitive standing of products, branding and its showroom strategy cannot be expected to appear immediately, changes are apparent as reflected by the growing number of interior decorators and producers of homes visiting the Shinagawa Showroom in central Tokyo. Therefore, the positive results of these efforts should be watched closely.

<Reference: Medium Term Business Plan “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. 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	✧ Expand operations, improve earnings of consolidated companies
Full Scale Overseas Business Deployment	✧ Develop products specifically for the overseas markets

<Specific Measures>

Target Stakeholders	Target Realms	Specific Measures
Employees	Internal Structures	1) Facilitate a corporate structure that allows employees to actively participate in business management A) Organizational review B) Human resources 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

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

1) Strengthen Business FoundationFortification of Governance Structure

Along with the implementation of a “corporate auditor committee structure company” 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 resigned from their posts. At the same time, a new director compensation system that is linked to the earnings and share price performance of Sangetsu has been introduced. In addition, the introduction of a mandatory retirement system and the above mentioned changes reflect 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 non-gratis 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

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compensation. These changes are part of the Company's switch to a compensation system that provides for early promotions and compensation based upon performance. Aside from these changes, efforts will be implemented to strengthen the "brand image", IT systems, and risk management systems of Sangetsu.

2) Business Strategy Restructuring

Organizational Reviews

The headquarter function will be 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, new market development and refurbishment business promotion offices with the goal of strengthening downstream and consumer strategies have been established. A seat covering material office responsible for films and with strengthened and specialized marketing functions has also been established. Increases in staffing of the housing divisions and corporate marketing divisions are also being undertaken.

Facilitation of Distribution Facilities

As the first step in creating a foundation for a new supply chain management structure, new distribution centers 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 three existing facilities will be transferred and consolidated into two facilities. Marketing function will be fortified along with efforts to reduce labor and transportation costs. In particular, a new facility is being constructed in Kuki, Saitama Prefecture where numerous companies from which products are purchased exist. In addition to collection and distribution functions, the consolidating point function will also be fortified.

Showroom Strategy

In July 2015, the flagship showroom is moved from Akasaka area to Shinagawa area of Tokyo. In addition to display of products at the new showroom, it will also propose various coordinated usages of interior products and materials. Therefore, the number of model rooms and the overall floor space will be expanded by a large amount, and three dimensional and other cutting edge digital systems will be 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 will also be established. And the new showroom will provide "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 seminars provided to architect and design offices and other customers will be expanded. Additional smaller showrooms will also be opened in addition to the existing showrooms in Tomeihan, Okayama, Hiroshima and Kyushu regions.

3) Improve Corporate Reputation with Stakeholders

Capital Policy

Sangetsu maintains a goal of achieving consolidated comprehensive payout ratio of over 100% for three years. As part of 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 level of capital efficiency. Also, a return to shareholders strategy which can be sustained over the medium to long term will be implemented.

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 the Nagoya region using materials and products sold by Sangetsu. Furthermore, the Company is considering the expansion of this effort to other regions.

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<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.

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 in the absence of sales because of the startup of 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 Achieve 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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