



Bridge Report

Sangetsu Corporation (8130)

 Shosuke Yasuda, President	Company	Sangetsu Corporation	
	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 —

Stock Information					
Share Price	Shares Outstanding		Market Cap.	ROE (actual)	Trading Unit
¥1,923	68,306,807 shares		¥131,353 billion	5.6%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)	PBR (actual)
¥50.00	2.6%	¥92.23	20.8 x	¥1,587.86	1.2 x

* Stock price as of closing on July 7, 2016. Number of shares issued at the end of the most recent quarter excluding treasury shares.

ROE and BPS are based on the previous year.

— 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	133,972	9,112	9,463	6,393	89.92	47.50
March 2017 Est.	140,000	9,000	9,500	6,300	92.23	50.00

* 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 fiscal year March 2016 earnings overview for Sangetsu Corporation

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Key Points

• Sales rose by 1.5% year-on-year to ¥133.9 billion during fiscal year March 2016. Sales of curtains fell, but strong sales of wall covering and flooring materials were recorded. Gross income margin improved by 0.9% points and gross income rose by 5.3% year-on-year due to the higher sales, revision of sales pricing during the latter half of fiscal year March 2015, and reviews of materials costs due to the lower crude oil prices. Reductions in expenses from reviews of television advertising and other efforts offset increases in expenses arising from relocation of logistic facilities and the opening of a showroom in the Shinagawa area of Tokyo allowed operating income to grow by 13.5% year-on-year to ¥9.1 billion. Sales rose for the sixth consecutive term to a new record high. Net income also rose to a record high exceeding the previous record of ¥6.23 billion recorded in fiscal year March 1991, and is expected to reach the Medium Term Business Plan target of ¥6.3 one year early during the coming fiscal year. And while sales fell shy of initial estimates issued at the start of the fiscal year, profits exceeded estimates.

• Sangetsu's earnings estimates call for sales to rise by 4.5% year-on-year to ¥140.0 billion in fiscal year March 2017. This estimate is based upon the outlook for continued uncertainties in the realm of housing, refurbishments and non-residential applications. In particular, the decline in total floor space of new construction recorded during the past two fiscal years is expected to affect the performance in the coming year. Against this backdrop, the release of the main catalog for wallpaper and flooring materials, reviews of the business structure, strengthening of staffing and functionality of the marketing division and establishment of new smaller showrooms will also be undertaken.

Because pricing reviews and effective reductions in procurement pricing are not anticipated, a key to this coming year's earnings will be the ability to offset higher sales, general and administrative expenses with higher sales. Consequently, Sangetsu expects operating income to decline by 1.2% year-on-year to ¥9.0 billion. Gross income margin is expected to remain in line with the term just ended, whereas sales, general and administrative expenses, including the construction of a new logistics facility, are expected to rise by 6.7% year-on-year. Dividend payment is forecast to be raised by ¥2.50 per share to ¥50.00 per share for an anticipated dividend payout ratio of 54.2%.

• While sales during the year just ended rose to a new record high, President Shosuke Yasuda states that results of measures called for by the Medium Term Business Plan have yet to be realized. And despite uncertainties in the external environment including postponement of the consumption tax hike and potential continued contraction in floor space of new non-housing construction, the positive influence of the release of new product catalogs and establishment of new showrooms should be watched closely.

1. Company Overview

Sangetsu Corporation 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 Corporation 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 established a new corporate philosophy including a new brand philosophy in April 2016 that will enable it to take on the challenge of implementing reforms necessary to take it to its next stage of growth.

A new “brand philosophy” has been added to the “corporate creed”, “corporate mission”, and “Three Principles of Sangetsu” to create an expanded corporate philosophy.

<Corporate Creed>

Integrity

<Corporate Mission>

To contribute to society through interior design and strive to create daily culture of enrichment

<Three Principles of Sangetsu>

Creative Designs, High Reliable Quality, Fair Price

<Brand Philosophy>

“Joy of Design” has been adopted as the brand statement, and “We provide the joy of design to those who create new spaces.” is the brand purpose.

Sangetsu endeavors to create new and entertaining value through cooperation with all of its stakeholders and by connecting interior product makers and users.

<Market Environment>

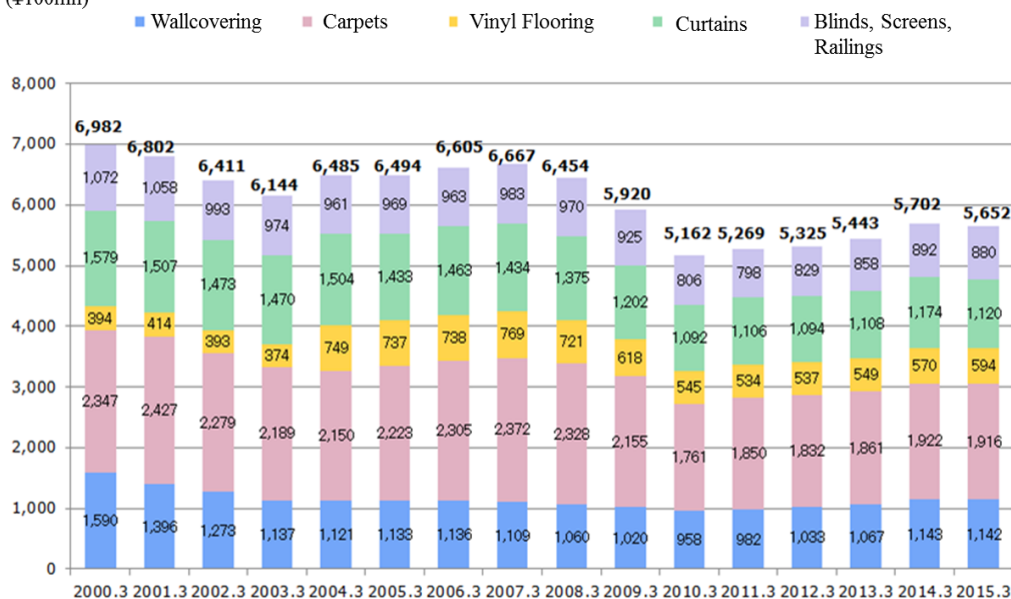
◎ Overview

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.

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Interior Products Market
(¥100mn)



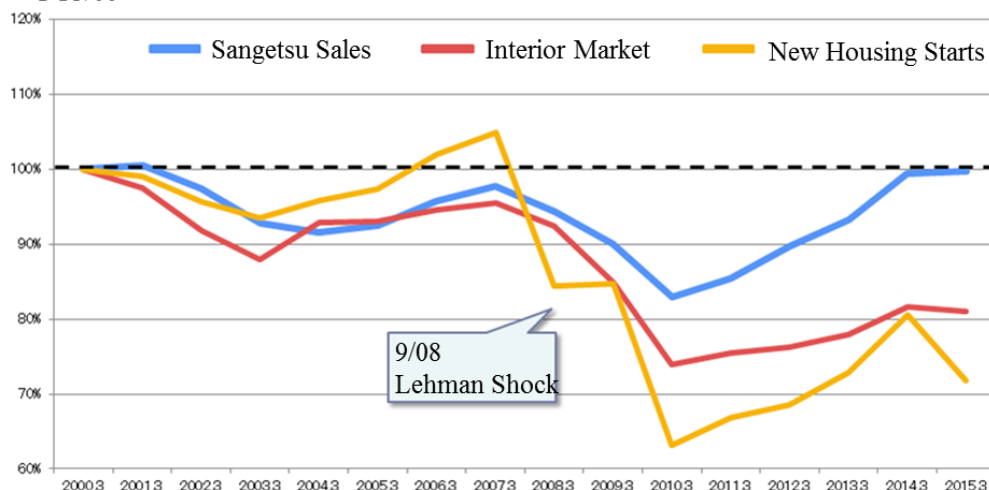
※Nippon Interior Fabrics Association

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

(Source: Sangetsu)

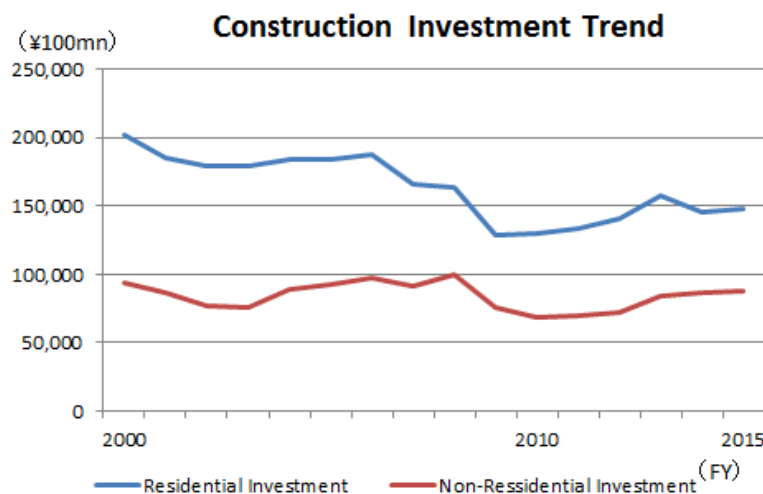
At the same time, the graph below shows the correlation between sales of Sangetsu relative to sales of the Japanese interior market and new housing starts (Ministry of Land, Infrastructure, Transport and Tourism data). Sales of both Sangetsu and the Japanese interior market show a close relationship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

100% Set at
FY3/00

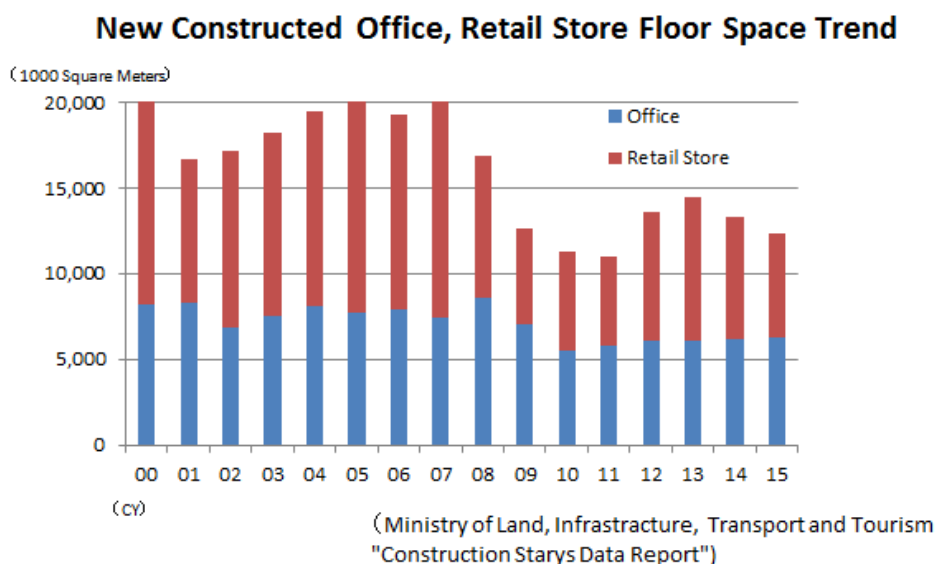


(Source: Sangetsu)

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)



The Ministry of Land, Infrastructure, Transport and Tourism reports that while private-sector non-housing construction investment was less than private-sector housing construction investment, it had recovered to the level seen in 2000. However, whereas floor space of newly constructed office buildings has trended sideways, there is some concern about the fact that floor space of retail buildings has once again begun to decline.

Moreover, the Research Institute of Construction and Economy issued a report entitled "Outlook for Construction Investment Based upon a Construction Economy Model" (October 21, 2015) that calls for a continued trend of gradual recovery at growth rates of 1.3% and 2.2% year-on-year in private sector non-housing construction investment during fiscal years 2015 and 2016 respectively, following on the heels of 2.2% year-on-year growth recorded during fiscal year 2014.

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

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◎ 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%	16,296	6.3	0.5	7.3%
7971	TOLI Corp.	92,800	1.0%	4,050	5.9%	4.4%	16,904	6.3	0.6	8.2%
8130	Sangetsu	140,000	4.5%	9,000	-1.2%	6.4%	125,889	20.0	1.2	5.6%
9827	Lilycolor Co., Ltd.	35,100	-3.9%	470	-37.9%	1.3%	1,340	7.4	0.2	0.9%

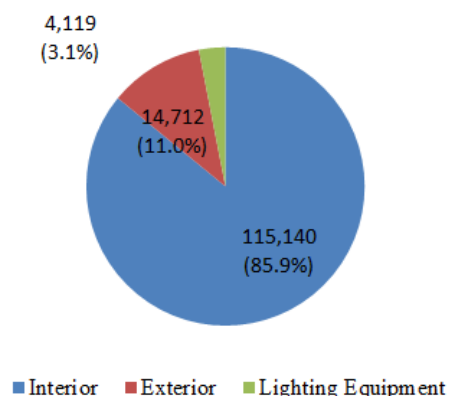
* Estimates are from those of the respective companies. Market capitalization is based upon the closing share price on June.16, 2015.

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.

Sales by Business Segment
(FY3/16, Unit: ¥mn)



① "Interior Business"

(FY3/16: Sales and Operating Income of ¥115.140 and ¥8.873Billion)

◎ 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.

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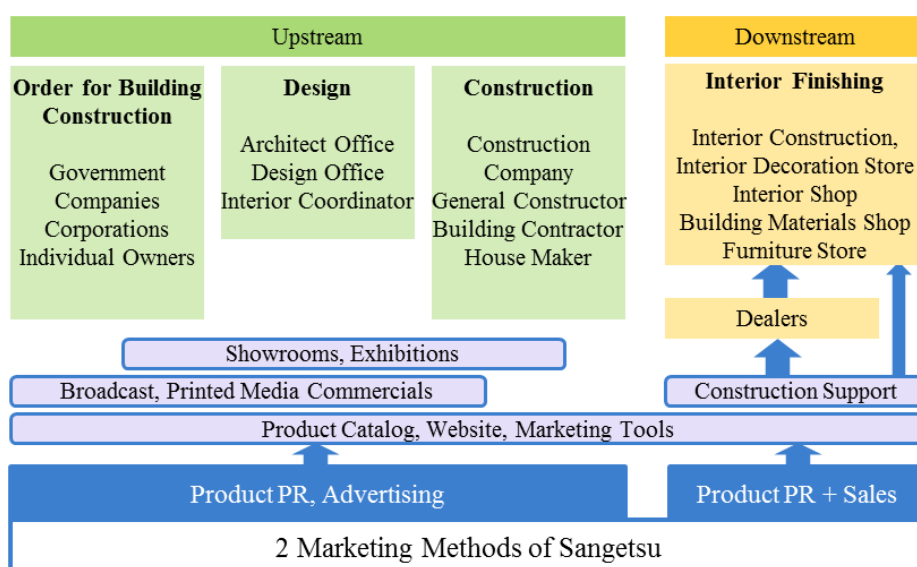
Homogeneous PVC Floorings	Sheet formed flooring materials used in medical and welfare institutions, and educational institutions. Uniquely manufactured with design patterns printed through entire flooring material so patterns will continue to show even after being worn down. They do not require wax for 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.

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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 schedules of its clients possible. Products are sourced from a wide range of over 100 supplier companies.

② “Exterior Business”

(FY3/16 Sales and Operating Income of ¥14.712Billion and ¥367 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”

(FY3/16 Sales and Operating Income of ¥4.119 Billion and ¥ -128Million)

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	FY3/16
ROE(%)	3.5	4.1	4.6	3.7	5.6
Net Income to Sales Ratio (%)	3.50	3.90	4.14	3.33	4.77
Asset Turnover Ratio (x)	0.84	0.88	0.93	0.91	0.95
Leverage (x)	1.18	1.19	1.20	1.21	1.24

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

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market, the Company has never seen losses since its founding.

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

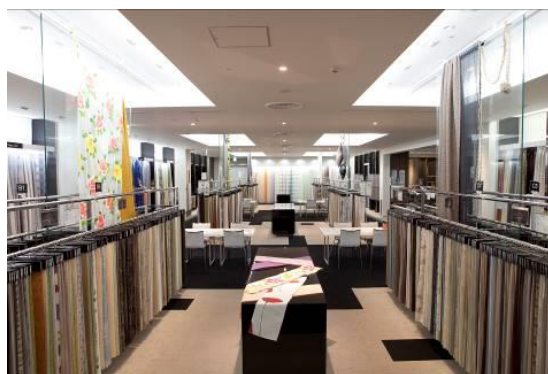
While the actual manufacturing of products is not conducted in-house, Sangetsu performs the planning, design and development functions internally. The previous generation of Sangetsu management made aggressive investments for “unique designs,” one of the three principles of the Company. 20 in-house designers 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 30 types of catalogs, which far surpass those of its competitors.



(Source: Sangetsu)

“Proposing”

Nearly one third of all employees or some 450 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 eight showrooms with 45 employees. In addition, about 40 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)

“Providing”

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)

2. Fiscal Year March 2016 Earnings Overview

(1) Earnings Overview

(Units: ¥mn)

	FY3/15	Share	FY3/16	Share	YY Change	Divergence from Est.
Sales	132,050	100.0%	133,972	100.0%	+1.5%	-1.1%
Gross Income	37,510	28.4%	39,527	29.5%	+5.3%	+2.1%
SG&A	29,478	22.3%	30,415	22.7%	+3.2%	-0.1%
Operating Income	8,031	6.1%	9,112	6.8%	+13.5%	+10.4%
Ordinary Income	8,506	6.4%	9,463	7.1%	+11.2%	+10.7%
Net Income	4,402	3.3%	6,393	4.8%	+45.2%	+16.2%

Sales and Profits Rise, Sales Reach Record High

Sales rose by 1.5% year-on-year to ¥133.9 billion. Sales of curtains and other products declined, but sales of wall coverings and flooring materials trended favorably. With regards to curtains, although their sales declined during the first half by double digits, sales rose during the second half due to the introduction of new products and exceeded the level for the same period last year.

The higher sales, sales pricing revisions conducted during the second half of fiscal year March 2015, and lower materials costs accompanying the decline in crude oil prices allowed gross income margin to rise by 0.9% point year-on-year to 5.3%.

Efforts to reduce television advertising and other expenses offset increased expenses arising from the move of the logistics facilities and consulting for reviews of the logistics function, and from opening of a new showroom in Shinagawa, Tokyo allowing operating income to rise by 13.5% year-on-year to ¥9.1 billion.

Large declines in impairment losses booked in the previous fiscal year allowed net income to rise by 45.2% year-on-year to ¥6.3 billion.

Sales rose for sixth consecutive year and achieved a new record high. Net income also rose to a new record high, surpassing the previous record set in fiscal year March 1991 of ¥6.23 billion, and rose to the target defined in the current Medium Term Business Plan of ¥6.3 billion one year earlier than expected.

While sales fell slightly below initial estimates, profits exceeded estimates.

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(2) Business Segment Trends

(Units: ¥mn)

	FY3/15	Share	FY3/16	Share	YY Change	Divergence from Est.
Sales						
Interior	113,364	85.8%	115,140	85.9%	+1.6%	-1.2%
Wallcoverings	55,618	49.1%	56,350	48.9%	+1.3%	-
Floorings	38,641	34.1%	40,453	35.1%	+4.7%	-
Curtains	8,110	7.2%	7,781	6.8%	-4.1%	-
Others	10,993	9.7%	10,555	9.2%	-4.0%	-
Exterior	14,699	11.1%	14,712	11.0%	+0.1%	-1.9%
Lighting	4,022	3.0%	4,145	3.1%	+3.1%	+3.6%
Adjustments	-35	-	-26	-	-	-
Total	132,050	100.0%	133,972	100.0%	+1.5%	-1.1%
Operating Income						
Interior	7,550	6.7%	8,873	7.7%	+17.5%	+13.8%
Exterior	455	3.1%	367	2.5%	-19.3%	-26.6%
Lighting	30	0.7%	-128	-	-	-
Adjustments	-4	-	0	-	-	-
Total	8,031	6.1%	9,112	6.8%	+13.5%	+10.4%

* 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

Strengthening of the product planning and development related organization allowed for establishment of a new product development structure that can more accurately respond to needs of the market. In addition, a new brand called “process#100” that appeals to the customers’ emotions was launched with a goal of selling high value added products that have better design and functionality. Furthermore, strengthening of marketing capabilities for non-housing market applications, including strengthened corporate client marketing, allowed work for particularly large projects to be captured.

<Wallcoverings>

A new wallpaper product catalog entitled “Fine 1000”, that includes medium price range wallpapers that boast of high levels of customer satisfaction and superior functionality and design compared with general use type wallpapers, was launched. This new catalog also responds to the contraction in the residential market resulting from the low birth rates and aging population by offering premium type products that match needs of the market.

In addition, efforts to strengthen sales of high value added modern Japanese paper and lacquer products contributed to an expansion in sales to hotels and other commercial facility applications.

<Flooring Materials>

Along with the expansion in the rental home market, sales of PVC tiles with realistic wood graining, manufactured using advanced printing technologies, expanded. Furthermore, fortification of product lineup and Group coordination function contributed to an expansion in the use of custom designed carpets in refurbishment of hotel banquet rooms.

<Curtains>

The product catalog “Sun Wink” that presents roll screens and vertical blinds was launched in September 2015. Moreover, in “AC Curtain Fabrics,” the catalog launched in November to renew Sangetsu's brand image, the pricing policy was revised and product development and marketing activities were strengthened to match the needs and trends of the market. As a result of these efforts, the performance in the latter half of the year recovered to the level of the same period of the previous year, but full-year earnings declined due to a rather large contraction in the first half of the year.

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② Exterior Business

Efforts were made to conduct aggressive marketing and strengthen logistics, enabling sales of the Yokohama Office to grow strongly in its second year of operations. Furthermore, efforts to strengthen sales capability in not only the Chubu region but also the Kanto region were conducted. While a recovery in the number of new housing starts during the second half of the fiscal year allowed sales to remain in line with the previous year, profits declined.

③ Lighting Business

Marketing activities to architectural design offices and lighting design offices were strengthened with a focus upon non-housing applications such as offices and hotels. In addition, energy saving lighting products were proposed including high value added products that have been developed by leveraging the lighting characteristics and controllability of LEDs. Furthermore, the Tokyo Showroom was refurbished with the objective of being able to conduct more aggressive and effective marketing of products and to derive synergies with the interior business. Consequently, sales of LED and other non-housing application products grew, but anticipatory expenses in preparation to secure future growth led to an increase in overall expenses, and valuation losses on material inventories caused a loss to be incurred.

(3) Financial Condition

◎Balance Sheet

(Units: ¥mn)

	End 3/15	End 3/16		End 3/15	End 3/16
Current Assets	99,613	88,825	Current Liabilities	18,967	22,716
Cash, Equivalents	28,238	29,802	Payables	13,198	15,969
Receivables	44,927	45,574	Noncurrent Liabilities	5,350	7,986
Marketable Securities	13,300	300	Retirement Benefits	3,909	6,816
Inventories	11,851	11,714	Total Liabilities	24,317	30,702
Noncurrent Assets	43,462	50,395	Net Assets	118,758	108,517
Tangible Assets	28,579	31,003	Shareholders' Equity	115,067	108,058
Intangible Assets	332	1,295	Total Liabilities, Net Assets	143,076	139,220
Investments, Others	14,550	18,095	Total Interest Bearing Liabilities	93	3
Total Assets	143,076	139,220	Capital Adequacy Ratio	83.0%	77.9%

A fall in marketable securities contributed to a decline in current assets of ¥10.7 billion from the end of the previous fiscal year. Acquisition of tangible assets (Property) and investment securities led to a ¥6.9 billion rise in noncurrent assets. As a result of these developments, total assets declined by ¥3.8 billion from the end of the previous term to ¥139.2 billion at the end of the current term.

Increases in payables caused current liabilities to rise by ¥3.7 billion from the end of the previous term. An increase in retirement benefits led to a ¥2.6 billion rise in noncurrent liabilities and a ¥6.3 billion rise in total liabilities to ¥30.7 billion.

Net assets fell by ¥10.2 to ¥108.0 billion on the back of a decline in retained earnings.

Capital adequacy ratio fell by 5.1% points from the end of the previous term to 77.9% at the end of the current term.

◎Cash Flow

(Units: ¥mn)

	FY3/15	FY3/16	YY Change
Operating Cash Flow	4,765	10,834	+6,069
Investing Cash Flow	6,134	15,154	+9,020
Free Cash Flow	10,899	25,988	+15,089
Financing Cash Flow	-7,692	-13,528	-5,836
Cash, Equivalents	15,540	27,998	+12,458

Increases in profits and accounts payable caused the net inflow of operating cash flow to expand.

Increases in refund of deposits also allowed the margins of net inflows of investing cash flow and free cash flow to grow.

Increases in acquisition of treasury stock and dividend payments caused the net outflow of financing cash flow to expand. Cash position rose.

3. Fiscal Year March 2017 Earnings Estimates

(1) Earnings Estimates

(Units: ¥mn)

	FY3/16	Share	FY3/17	Share	YY Change
Sales	133,972	100.0%	140,000	100.0%	+4.5%
Gross Income	39,527	29.5%	41,450	29.6 %	+4.9%
SG&A	30,415	22.7%	32,450	23.2%	+6.7%
Operating Income	9,112	6.8%	9,000	6.4%	-1.2%
Ordinary Income	9,463	7.1%	9,500	6.8%	+0.4%
Net Income	6,393	4.8%	6,300	4.5%	-1.5%

- Estimates are those of the Company

Estimates Call for Slight Sales Growth, Flat Profits Growth

Sangetsu's earnings estimates call for sales to rise by 4.5% year-on-year to ¥140.0 billion during fiscal year March 2017 despite uncertainties in the operating environment for housing, refurbishment and non-housing segments of the market. In particular, non-housing applications have been impacted by the continued contraction in floor space of new construction starts in the fiscal year two years before and the fiscal year one year before. Against this backdrop, reviews of the business structure and release of new a wallcovering and flooring materials catalog have been conducted, along with strengthening of the marketing division entailing increases in staff numbers and opening of new smaller showrooms. Profit estimates do not include any effect from the sales pricing revisions or procurement price reductions that were responsible for the increase in profits during the past two years. Therefore, the ability to achieve higher sales will be important in offsetting increases in sales, general and administrative expenses, and estimates call for operating income to fall by 1.2% year-on-year to ¥9.0 billion.

Gross income margin is expected to remain in line with the previous fiscal year, but the establishment of new logistic facilities is expected to raise sales, general and administrative expenses by 6.7% year-on-year.

Dividend payment is expected to be raised by ¥2.50 per share year-on-year to ¥50.00 for an anticipated dividend payout ratio of 54.2%.

(2) Business Segment Trends

(Units: ¥mn)

	FY3/16	Share	FY3/17 (Est.)	Share	YY Change
Sales					
Interior	115,140	85.9%	120,600	86.1%	+4.7%
Exterior	14,712	11.0%	15,200	10.9%	+3.3%
Lighting	4,145	3.1%	4,200	3.0%	+1.3%
Adjustment	-26	-	-20	-	-
Sales, Total	133,972	100.0%	140,000	100.0%	+4.5%
Operating Income					
Interior	8,873	7.7%	8,520	7.1%	-4.0%
Exterior	367	2.5%	480	3.2%	30.8%
Lighting	-128	-	0	0.0%	-
Adjustment	0	-	0	-	-
Operating Income, Total	9,112	6.8%	9,000	6.4%	-1.2%

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

4. Interview with President Shosuke Yasuda

We asked President Shosuke Yasuda about Sangetsu's business results during fiscal year March 2016 and progress in achieving goals identified in the Medium Term Business Plan "Next Stage Plan G".

"I am dissatisfied with our top-line growth, and will implement measures to strengthen our product lineup and marketing structure."

- While we were able to achieve record high sales during fiscal year March 2016, I remain dissatisfied by the small margin of growth.
- Ever since measures to "strengthen our product development structure" have been implemented as part of our business restructuring strategy, we have received high regard for our product catalogs that have been newly released after the installation of this new structure. However, this strong regard of our customers has yet to be reflected in terms of tangible increases in sales, and we will continue to implement efforts to strengthen our marketing structure and increase top-line growth.

"A new brand concept was announced, and efforts to raise awareness of the new Sangetsu are being conducted in and outside the Company."

- A new brand concept was published in April 2016.
- Our brand statement is: "Joy of Design: We provide joy of designing for those of you who aspire to create new space. In addition, new corporate logos and symbols have also been adopted. Along with the announcement of the new brand concept, nationwide showrooms have been renamed; the Shinagawa Showroom is now called "Sangetsu Design Site" and other smaller regional showrooms "Sangetsu Design Studios".
- The new brand concept, of course, aims at increasing the awareness of the "New Sangetsu" outside the Company. But not only that, it is also meant to be a message within the Company: an expression of company-wide determination to "create a New Sangetsu by ourselves".

"Clear Change in Employee Awareness"

- Nearly all of the measures designed to reform the human resources system and revise the business structure in accordance with our Medium Term Business Plan have been completed.
- In addition to increases in promotions and reforms of the salary system, the awareness of employees is clearly changing through the implementation of a "strategy of creating a New Sangetsu" and the subsequent efforts to "achieve goals" and "proactively take steps to achieve goals". As evidence of these efforts, two of the Sangetsu Design Studios recently opened were proposed by our employees.

"Prepare a Necessary and Sufficient Quality Management Structure"

- In order to establish a necessary and sufficient quality management structure as a fabless manufacturer, staffing of the quality management technology office was strengthened. In addition to the office manager responsible for quality management, testing research, exterior technology and flooring material technology managers were also hired externally.
- In addition to strengthening of the technology support structure for new product development, quality management was strengthened to eliminate faulty products, a fieldwork system for suppliers was introduced, and improvements to the in-house product quality assessment function were conducted.
- Because reductions in customer complaints can contribute to significant improvements in profitability, efforts to further strengthen quality management will be implemented.

"Similar functions to those in Japan will be facilitated in China to establish the brand and cultivate the China market."

- "Sangetsudo China" was established in Shanghai, China in April 2016.
- The wallpaper market in China is already double the size of that in Japan.
- Currently, 85% of walls in Chinese construction are finished using paints, with wallpaper accounting for only 8% of

the total wall space. However, demand for wallpaper is expected to steadily expand along with increasing desire to decorate homes and offices with more unique designs.

- “Sangetsudo China” is a Japanese-style local company with warehousing, distribution, showroom and installation functions.
- Sangetsu could have pursued a short term strategy which may have been more effective in producing sales and profits by not establishing a local company with these functions and relying upon local agents and outsourcing installation of wallpaper to local companies. However, our Company maintains a goal of establishing Sangetsu as a company known for its superior “Japanese wallpapers” and has therefore decided to create a local company with these various functions.
- And while it may take some time to yield tangible results, Sangetsu will endeavor to realize profits over the long term by firmly establishing the “Sangetsu brand” to cultivate the huge local market potential.

5. Conclusions

While sales during the year just ended rose to a new record high, President Shosuke Yasuda states that results of measures called for in the Medium Term Business Plan have yet to be realized. And despite uncertainties in the external environment including postponement of the consumption tax hike and potential continued contraction in floor space of new non-housing construction starts, positive influence of the release of a new product catalog and establishment of new showrooms should be watched closely.

<Reference 1: 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 <ul style="list-style-type: none"> 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 <ul style="list-style-type: none"> A) Expand existing businesses B) Promote growth strategies

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Shareholders, Society	Capital Markets, CSR	3) Improve the reputation amongst stakeholders A) Capital and IR strategies B) Societal contribution activities C) Environmental management
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In addition, Sangetsu will promote the four specific measures mentioned below as part of “**4) Diffusion of Our Corporate Philosophy and Principles**” strategy.

<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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