



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 specialized in interior products. It conducts development and sales of interior decorating products, including wallcoverings, curtains, flooring materials, and upholstery. Sangetsu has a 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
¥1,930	67,037,303 shares		¥129.381 billion	6.0%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)	PBR (actual)
¥55.00	2.8%	¥82.04	23.5 x	¥1,623.05	1.2 x

* Stock price as of closing on June 13, 2017. 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 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	135,640	7,572	8,368	6,570	97.53	52.50
March 2018 Est.	156,000	7,600	8,100	5,500	82.04	55.00

* 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 fiscal year March 2017 earnings overview for Sangetsu Corporation, a review of "PLG 2019" Medium Term Business Plan, and so on.

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Key Points

• Sales during fiscal year March 2017 rose by 1.2% year-on-year to ¥135.6 billion on the back of increases in sales of all three business segments. The interior business benefitted from strong demand for carpets, carpet tiles, floor tiles and other flooring materials. Gross income rose by 1.5% year-on-year exceeding the growth in sales, but consolidation of distribution facilities, improvements in office facilities, establishment of new showrooms, BPO fees, M&A related expenses and others factors contributed to an increase in sales, general and administrative expenses, which could not be absorbed and caused operating income to decline by 16.9% year-on-year to ¥7.5 billion. The profit contribution from the equity accounting method held affiliate Wavelock Holdings allowed ordinary income to decline by a lesser margin of 11.6% year-on-year to ¥8.3 billion. Profits on the sale of investment securities and from the termination of the retirement benefit system were booked as extraordinary income and allowed net income to rise by 2.8% year-on-year to ¥6.5 billion. Dividend payment is expected to be raised by ¥2.5 to ¥52.5 per share on a full year basis for an anticipated dividend payout ratio of 53.8%.

• Sangetsu's fiscal year March 2018 earnings estimates call for sales to rise by 15.0% or ¥20.3 billion year-on-year to ¥156.0 billion. Despite the outlook for a slight decline in new housing starts within Japan, fortified marketing activities for wallcoverings and flooring materials in the non-residential property realm, and the introduction of new products and new plans in the Company's catalog are expected to contribute to an increase in sales of the interior business segment of 2.7% year-on-year. In addition, the overseas business division is expected to realize sales of ¥16.75 billion during the coming term. The acquisition of Koroseal Co., Ltd. is expected to contribute an additional ¥7.0 billion to gross income for a total increase of ¥8.9 billion and a 1.8% point increase in gross income margin. However, an increase in strategic expenses including marketing, general and administrative expenses and goodwill amortization due to the acquisition of Koroseal Co., Ltd. is expected to limit operating income growth to 0.4% year-on-year to ¥7.6 billion. Interim and yearend dividend payments are expected to be ¥27.5 per share for a full year dividend payment of ¥55 per share, and an anticipated dividend payout ratio of 67.0%.

• With a view to changes in the future business environment, the various successes of the "Next Stage Plan G" strategy will be leveraged, along with the steady implementation of various yet to be realized and new measures for sustained achievement of corporate value as called for in the new "PLG 2019" Medium Term Business Plan (2017 to 2019).

• During the final year of the Medium Term Business Plan "Next Stage Plan G" (2014 to 2016) of fiscal year March 2017, Sangetsu was not able to achieve its sales targets, but its fourth quarter sales and profits exceeded both of its fourth quarter results during the past two previous years. However, return on invested capital fell from 8.6% during fiscal year March 2014 to 7.2% in the term just ended, while increases in leverage allowed return on equity to rise from 4.5% to 6.0% over the same period. However, progress in measures called for in the new Medium Term Business Plan to achieve important issues of improvements in profitability and efficiency going forward need to be closely watched.

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 "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 is comprised of six companies including Sangetsu (Shanghai) Corporation, the company responsible for business in China, “Koroseal Interior Products Holdings, Inc.”, the United States company conducting sales of wallcovering materials for non-residential applications, Fairtone Co., Ltd., that seeks to grow orders on the back of increases in installation capabilities, Sungreen Co., Ltd., a dedicated distributor of exterior products, and Yamada Shomei Lighting Co., Ltd., a planner, designer, manufacturer and distributor of lighting equipment, and “Sangetsu Vosne Corporation”, specialized in curtain fabrics

<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>

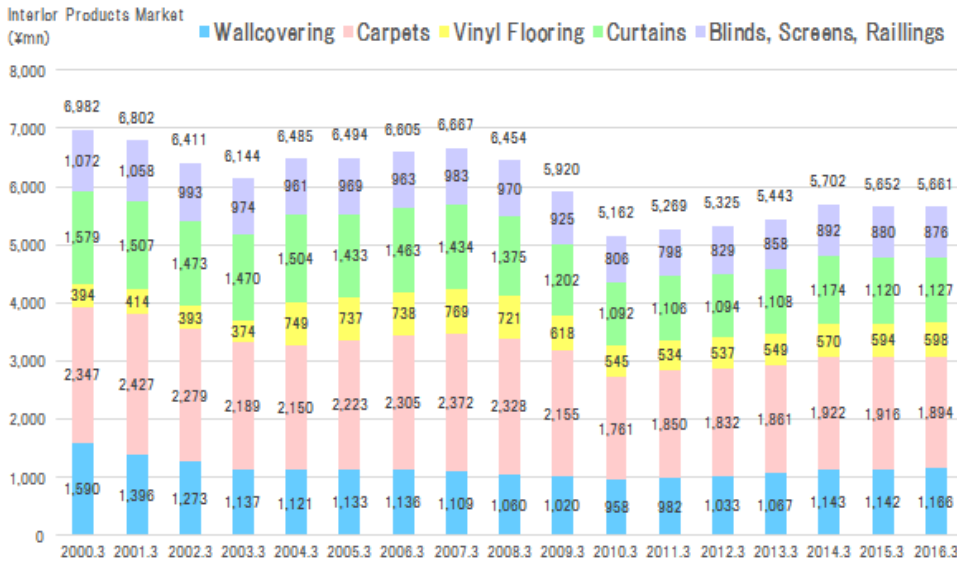
- Brand statement “Joy of Design”
- Brand purpose “We provide the joy of design to those who create new spaces.”

Sangetsu endeavors to share the joy of creating new value through interior business with all of its stakeholders.

<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.

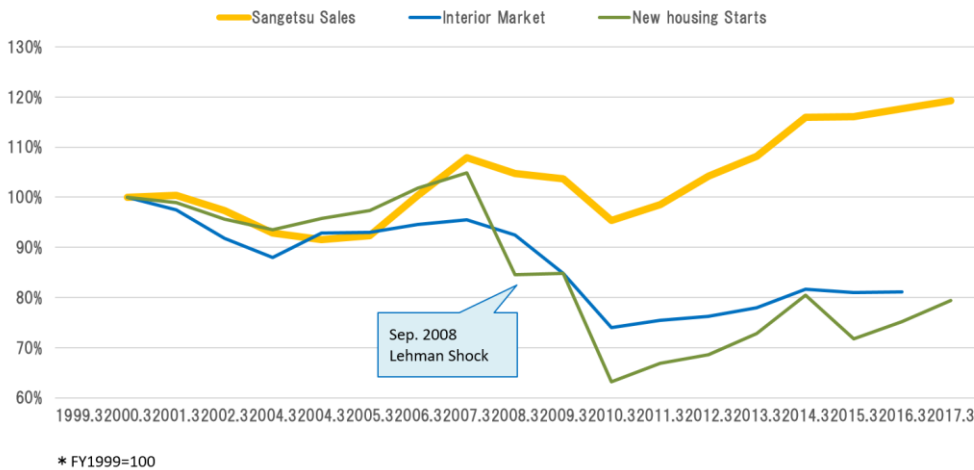


* Nippon Interior Fabrics Association
 "2016 General State of the Interior Fabrics Business and Market Size Determination"

(Source: Sangetsu)

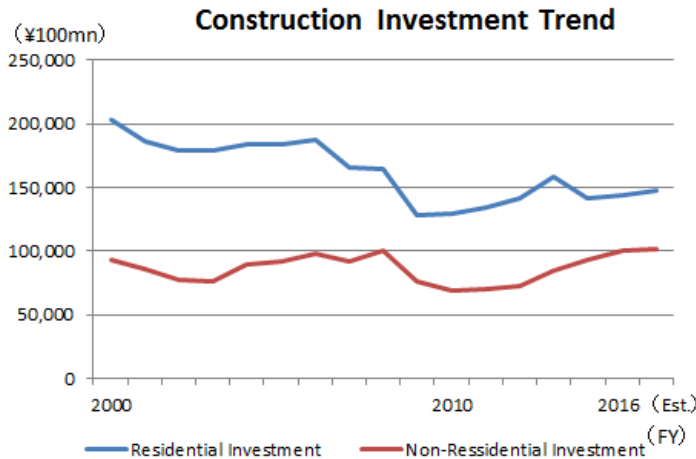
At the same time, the graph below shows the correlation between sales of Sangetsu relative to sales of the Japanese interior market and new housing starts (Ministry of Land, Infrastructure, Transport, and Tourism data).

The trends for both Sangetsu’s sales and the Japanese interior market have been closely linked to new housing starts. After the Lehman Brother’s Shock however, this link has been overcome with Sangetsu’s sales reaching consecutive record highs despite the sluggish trends in new housing starts and the weak overall market.

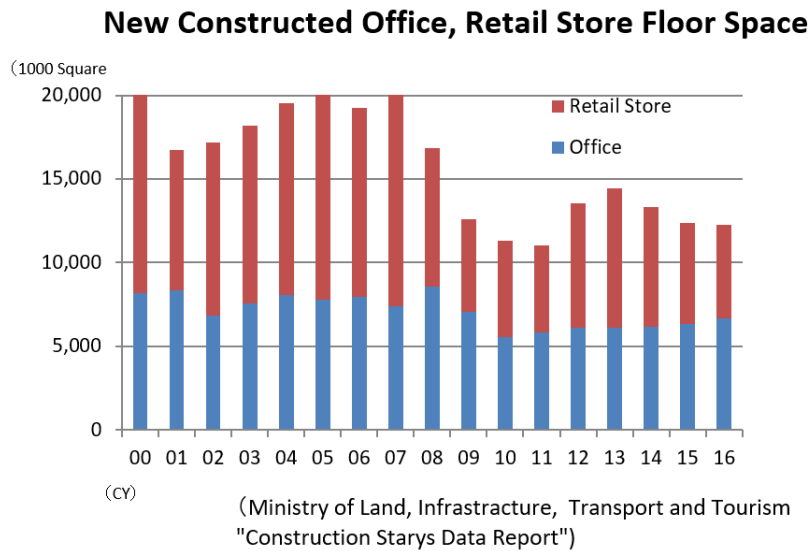


(Source: Sangetsu)

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)



According to the Ministry of Land, Infrastructure and Transport, private sector residential investments declined less than private sector non-residential investments and recovered to above the 2000 year level of ¥10 trillion in recent years.

At the same time, the Research Institute of Construction and Economy report entitled “Construction Economy Forecasting Model for Construction Investments” released on April 26, 2017 estimates that private sector non-residential construction investments steadily rose by 9.4% and 5.6% year-on-year in fiscal years 2014 and 2015 respectively, but then its speed will be down in fiscal years 2016 and 2017 by 0.6% up and 1.2% down respectively.

On a floor space basis, office space is expected to have grown by 12.1% year-on-year while retail store space to have fallen by 8.8% year-on-year in fiscal year 2016, while office space and retail store space both trended sideways at 0.0% in fiscal year 2017.

Ahead of the 2020 Tokyo Olympic and Paralympic Games, private sector non-residential construction investments are expected to continue to trend strongly, despite some uncertainties clouding the near term horizon.

◎ 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.	95,400	-2.2%	1,000	-60.8%	1.0%	18,785	125.1	0.5	7.3%
7971	TOLI Corp.	94,000	2.8%	3,900	-8.2%	4.1%	22,394	8.4	0.7	9.5%
8130	Sangetsu	156,000	15.0%	7,600	0.4%	4.9%	132,533	24.1	1.2	6.0%
9827	Lilycolor Co., Ltd.	34,500	4.6%	320	130.2%	0.9%	1,537	25.6	0.2	2.0%

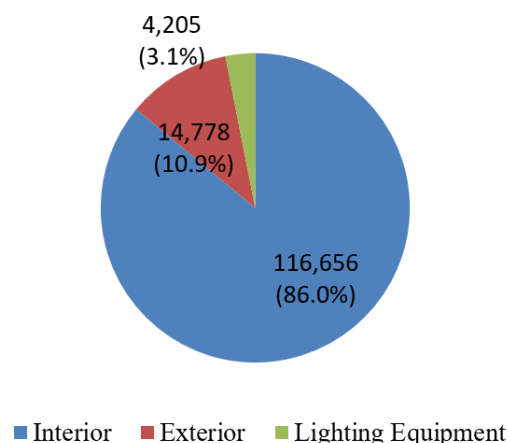
* Estimates are from those of the respective companies. Market capitalization is based upon the closing share price on June 7, 2017.

Sangetsu has the best operating profit on sales among these companies. In addition, only Sangetsu's PBR is over one time.

<Business Description>

The main businesses include planning, development, and sales of wallcovering, floor covering, 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 (FY3/17, Unit: ¥mn)



① “Interior Business”

(FY3/17: Sales and Operating Income of ¥116.656 and ¥7.150 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.

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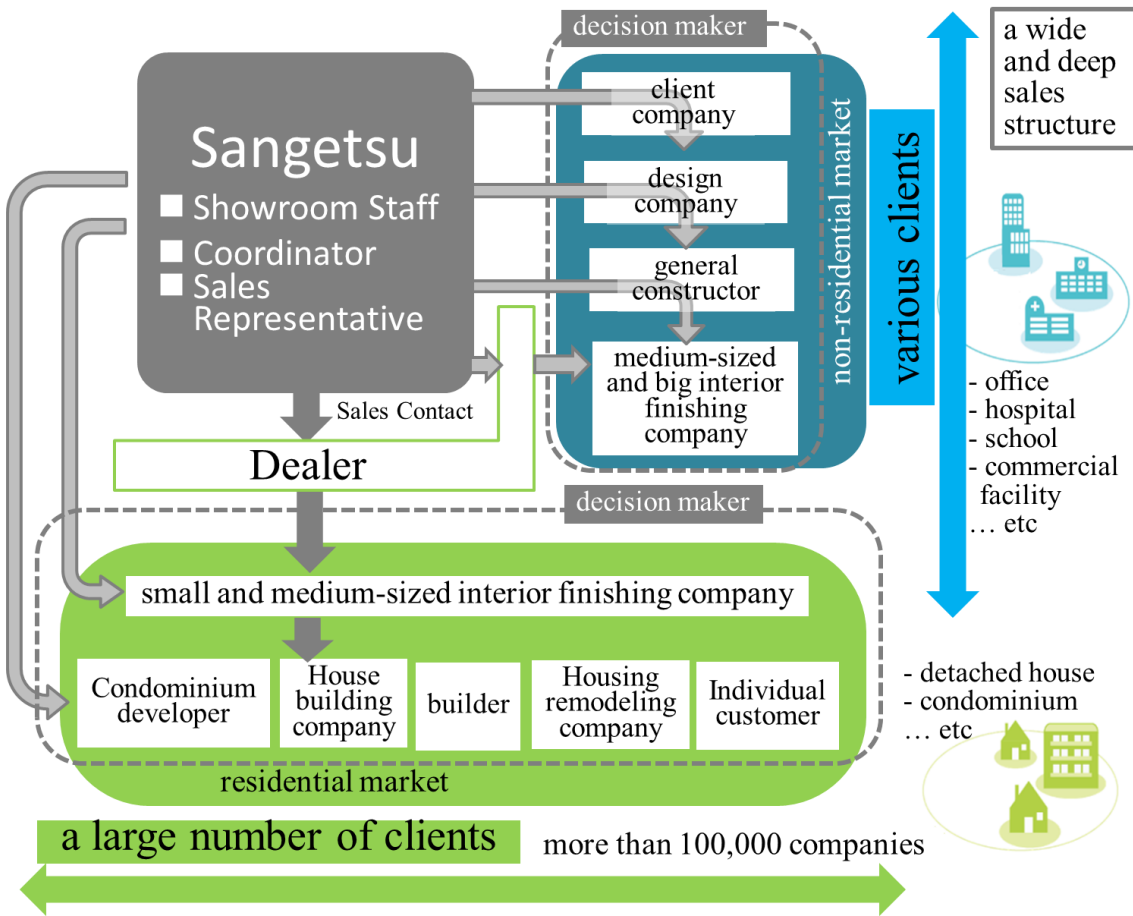
Vinyl Sheets	Sheet formed flooring materials used in commercial applications including medical and welfare institutions, and educational institutions. This product boasts of high levels of safety and sanity functionality, and is designed to reduce maintenance costs by being easy to keep clean. It also has been designed with the environment in mind and helps to reduce the environmental burden.
PVC Floorings	Sheet formed flooring materials used in medical and welfare institutions, and educational institutions. Uniquely manufactured with design patterns printed on 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 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 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 and Carpet product catalogs are updated every three years), with an existing product replacement rate for wallcovering of 30% to 40%, 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.

◎Sales Structure

In addition to the headquarters located in Nagoya, Sangetsu maintains 8 regional offices and 53 marketing offices throughout Japan, with 9 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, at its showrooms, and so on. In addition to these “passive” marketing activities, Sangetsu also conducts “proactive” marketing of its products through its corporate marketing division and its 450 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 customer 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 0.14% (About 70 products) per day. Sangetsu seldom asks their clients for backordering because the out-of-stocks are covered by surrounding distribution centers immediately.

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”**(FY3/17 Sales and Operating Income of ¥14.778 Billion and ¥402 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”**(FY3/17 Sales and Operating Income of ¥4.205 Billion and ¥ 23 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	FY3/16	FY3/17
ROE(%)	3.5	4.1	4.6	3.7	5.6	6.0
Net Income to Sales Ratio (%)	3.50	3.90	4.14	3.33	4.77	4.84
Asset Turnover Ratio (x)	0.84	0.88	0.93	0.91	0.95	0.90
Leverage (x)	1.18	1.19	1.20	1.21	1.24	1.39

The new Medium Term Business Plan calls for the quantitative target for return on equity of between 8% and 10% to be achieved by fiscal year March 2020. Furthermore, measures to reduce capital and raise profitability will also be implemented.

<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 do not have to carry facilities for the manufacturing process. Besides, 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. Moreover, while Sangetsu 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”**

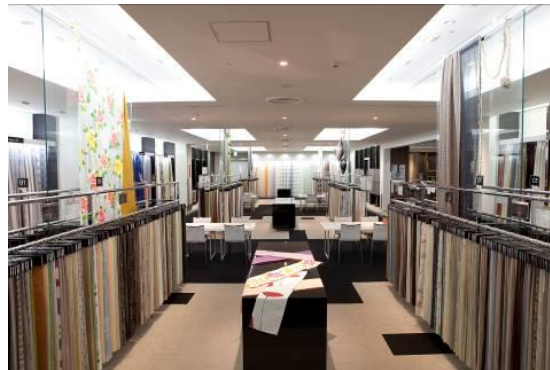
While the actual manufacturing of products is not conducted in-house, Sangetsu performs the planning, design and development functions internally. The previous generation of Sangetsu management made active investments for “unique designs,” one of the three principles of the Company. 25 in-house designers 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 foreign 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 actively 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)

“Proposal based sales marketing”

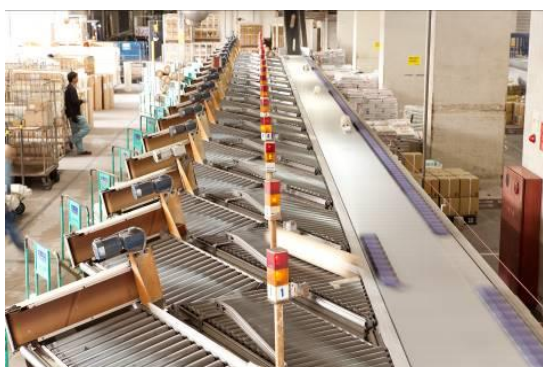
Nearly one third of all employees or some 450 work in marketing functions at Sangetsu, the largest marketing function within the industry. These marketing staffs are assigned to 63 offices located throughout Japan and conduct proposal-based marketing to clients. Sangetsu also staffs its 9 showrooms with 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)

“Distribution system”

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. Generally, 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 2017 Earnings Overview

(1) Earnings Overview

(Units: ¥mn)

	FY3/16	Share	FY3/17	Share	YY Change	Divergence from Est.	Comparison to Revised Estimates
Sales	133,972	100.0%	135,640	100.0%	+1.2%	-3.1%	-1.0%
Gross Income	39,527	29.5%	40,104	29.6%	+1.5%	-3.2%	-1.0%
SG&A	30,415	22.7%	32,532	24.0%	+7.0%	+0.3%	+0.1%
Operating Income	9,112	6.8%	7,572	5.6%	-16.9%	-15.9%	-5.4%
Ordinary Income	9,463	7.1%	8,368	6.2%	-11.6%	-11.9%	-2.7%
Net Income	6,393	4.8%	6,570	4.8%	+2.8%	+4.3%	+11.4%

Marginal Sales Increase, Profit Decline

Sales rose by 1.2% year-on-year to ¥135.6 billion on the back of increases in all three business segments, with particular strength noted in the interior business due to strong demand for carpets, floor tiles and other flooring materials. The growth in gross income exceeded that of sales at 1.5% year-on-year, but costs arising from consolidation of logistics facilities, improvements in office facilities, newly established showrooms, shift to a business process outsourcing (BPO) model, M&A related activities and other sales, general and administrative expenses were left unabsorbed and caused operating income to decline by 16.9% year-on-year to ¥7.5 billion. The booking of investment profits on equity accounting method from Wavelock Holdings Co., Ltd. of ¥0.32 billion allowed ordinary income to decline by a lesser margin of 11.6% year-on-year to ¥8.3 billion. Profits on sale of investment securities and from retirement benefit system termination of ¥0.8 and ¥0.1 billion respectively were booked at the extraordinary income level and allowed net income to rise by 2.8% year-on-year to ¥6.5 billion. Dividends are expected to be increased from initial estimates by ¥2.5 to ¥52.5 per share on a full year basis, for an anticipated dividend payout ratio of 53.8%.

(2) Business Segment Trends

(Units: ¥mn)

	FY3/16	Share	FY3/17	Share	YY Change
Sales					
Interior	115,140	85.9%	116,656	86.0%	+1.3%
Wallcoverings	56,350	48.9%	56,349	41.5%	-0.0%
Floorings	40,453	35.1%	41,377	30.5%	+2.3%
Fabrics	7,781	6.8%	7,701	5.7%	-1.0%
Others	10,555	9.2%	11,183	8.2%	+5.9%
Exterior	14,712	11.0%	14,778	10.9%	+0.4%
Lighting	4,145	3.1%	4,239	3.1%	+2.3%
Adjustments	-26	-	-33	-	-
Total	133,972	100.0%	135,640	100.0%	+1.2%
Operating Income					
Interior	8,873	7.7%	7,150	6.1%	-19.4%
Exterior	367	2.5%	402	2.7%	+9.5%
Lighting	-128	-	23	0.5%	-
Adjustments	0	-	-3	-	-
Total	9,112	6.8%	7,572	5.6%	-16.9%

* Share of operating income is the same as the operating income margin. The fabric category of sales includes both curtains and upholstery.

① Interior Business

Higher Sales, Lower Profits

<Wallcovering Materials>

Sales of wallcovering materials trended in line with the previous term.

Strong new housing starts contributed to strong trends in rental residential properties, but lackluster growth in new single dwelling residential units and the high exposure of wallcovering to single dwelling units contributed to weak earnings of the wall covering materials division. At the same time, efforts were made to capture refurbishment demand from commercial facilities and hotels through strengthened marketing efforts leveraging the newly published “FAITH” catalog, which includes non-flammable wallcoverings.

<Flooring Materials>

Flooring materials trended strongly.

In the flooring materials division, sales of specially designed carpets and carpet tiles rose strongly on the back of strong refurbishment demand from hotels providing accommodations to inbound travelers from overseas. In addition, sales of PVC floor tiles expanded on the back of strong demand from rental residential properties.

<Fabric Materials>

Sales of fabric materials declined.

In the fabric materials division, Sangetsu published a curtain catalog containing products for use by medical facilities, hotels and other users in the contract market and strengthened its sales activities for non-residential construction applications. Furthermore, they also published a new chair fabric catalog, and strengthened their marketing activities to acquire new customers in the furniture manufacturing and contract markets. Despite these efforts, weaker demand for custom made curtains in the residential property applications contributed to lower sales.

② Exterior Business

Sales trended in line with the previous year’s levels, but profits rose by double digits.

In the exterior business conducted by Sungreen Co., Ltd., restructuring was undertaken to strengthen the sales management structure and synergies with the marketing activities with Sangetsu were pursued amidst intensifying competition.

③ Lighting Business

Sales rose, and turned profitable.

In the lighting business conducted by Yamada Shomei Lighting Co., Ltd., pricing competition is intensifying along with the rapid expansion of low energy consumption LED lighting usage. Also, marketing activities are being focused upon design offices and developers with a goal of cultivating business opportunities in the strategic market of non-residential properties in the Tokyo metropolitan area. Consequently, success has been achieved in capturing demand for contract projects from large office buildings, hotels and commercial facilities, which in turn allowed profitability to be achieved.

(4) Financial Conditions, Cash Flow

◎ Summarized Balance Sheet

(Units: ¥mn)

	End 3/16	End 3/17		End 3/16	End 3/17
Current Assets	88,825	96,200	Current Liabilities	22,716	32,578
Cash, Equivalents	29,802	25,945	Payables	15,969	22,910
Receivables	45,574	48,491	Noncurrent Liabilities	7,986	22,247
Marketable Securities	300	1,800	Retirement Benefits	2	12,934
Inventories	11,714	17,446	Total Liabilities	30,702	54,825
Noncurrent Assets	50,395	67,517	Net Assets	108,517	108,892
Tangible Assets	31,003	35,103	Shareholders' Equity	108,058	108,775
Intangible Assets	1,295	13,484	Treasury Stock	-1,748	-2,023
Investments, Others	18,095	18,928	Total Liabilities, Net Assets	139,220	163,717
Total Assets	139,220	163,717	Capital Adequacy Ratio	77.9%	66.5%

Both assets and liabilities grew due mainly to the conversion of Koroseal of the United States into a subsidiary in November 2016.

Current assets rose by ¥7.3 billion from the end of the previous term. Noncurrent assets rose by ¥17.1 billion, along with a ¥24.4 billion rise in total assets to ¥163.7 billion over the same period.

Current liabilities also rose by ¥9.8 billion. Long term debt from syndicated loans for use in M&A activities grew by ¥12.9 billion, causing noncurrent liabilities to rise by ¥14.2 billion and total liabilities to grow by ¥24.1 to ¥54.8 billion.

Net assets remained nearly unchanged at ¥108.8 billion and capital adequacy ratio declined by 11.4% points to 66.5%.

◎Cash Flow

(Units: ¥mn)

	FY3/16	FY3/17	YY Change
Operating Cash Flow	10,834	10,072	-762
Investing Cash Flow	15,154	-22,392	-37,546
Free Cash Flow	25,988	-12,320	-38,308
Financing Cash Flow	-13,528	7,533	+21,061
Cash, Equivalents	27,998	23,119	-4,879

Improvement in CCC allowed working capital to improve, but higher corporate tax payments caused the net margin of net cash inflow from operating activities to contract.

Along with the payment for acquisition of shares accompanying the conversion of Koroseal of the United States into a subsidiary, decline in income arising from disappearance of the redemption of investment securities in the previous term caused both investing and free cash flows to turn from net inflows in the previous term to net outflows in the current term. The assumption of long term debt caused financing cash flow to turn from a net outflow in the last term to a net inflow in the current term.

Cash position declined.

3. Fiscal Year March 2018 Earnings Estimates

(1) Earnings Estimates

(Units: ¥mn)

	FY3/17	Share	FY3/18 Est.	Share	YY Change
Sales	1,356.4	100.0%	1,560.0	100.0%	+15.0%
Gross Income	401.0	29.6%	490.0	31.4%	+22.2%
SG&A	325.3	24.0%	414.0	26.5%	+27.3%
Operating Income	75.7	5.6%	76.0	4.9%	+0.4%
Ordinary Income	83.6	6.2%	81.0	5.2%	-3.2%
Net Income	65.7	4.8%	55.0	3.5%	-16.3%

*Estimates are those of the Company

Sales to Rise by Double Digits, Operating Income to Trends Sideways

Sales are expected to rise by 15.0% or ¥20.3 billion year-on-year to ¥156.0 billion despite the outlook for a small decline in new housing starts. Sangetsu will strengthen its marketing activities for wall coverings and floor coverings to non-residential property applications, and introduce new products and publish new catalogs with a goal of growing sales. The anticipated increase in sales of the interior business also includes sales amounting to over ¥3.0 billion derived from the consolidation of Fairtone Co., Ltd., in addition to ¥16.7 billion in overseas sales expected to be derived from the consolidation of Koroseal which was acquired in November 2016.

Gross income is expected to grow by ¥8.9 billion, including some ¥7.0 billion from the acquisition of Koroseal, and gross income margin is expected to rise by 1.8% points. The consolidation of Koroseal is expected to lead to ¥5.4 billion in addition sales, general and administrative expenses, a ¥0.6 billion increase in goodwill amortization, and an ¥8.8 billion increase in strategic expenses. These additional expenses are expected to limit growth in operating income to a marginal 0.4% year-on-year to ¥7.6 billion.

Interim and yearend dividends of ¥27.5 per share are expected to be paid, for a full year dividend of ¥55 per share and an anticipated dividend payout ratio of 67.0%.

(2) Business Segment Trends

(Units: ¥mn)

	FY3/17	Share	FY3/18 Est.	Share	YY Change
Sales					
Interior	1,166.3	86.0%	1,198.0	76.8%	+2.7%
Exterior	147.7	10.9%	150.0	9.6%	+1.5%
Lighting	42.3	3.1%	44.5	2.9%	+5.0%
Overseas	0.1	0.0%	167.5	10.7%	-
Adjustment	-0.3	0.0%	-	0.0%	-
Sales, Total	1,356.4	100.0%	1,560.0	100.0%	+15.0%
Operating Income					
Interior	71.7	6.1%	63.0	5.3%	-12.1%
Exterior	4.0	2.7%	4.4	2.9%	+9.8%
Lighting	0.2	0.5%	0.3	0.7%	+18.1%
Overseas	-0.2	-	8.3	5.0%	-
Adjustment	0.0	-	-	-	-
Operating Income, Total	75.7	5.6%	76.0	4.9%	+0.4%

* Overseas: Sangetsu (Shanghai), Koroceal. Share of operating income is the same as operating income margin.

4. “PLG 2019” Medium Term Business Plan (2017 – 2019)

Sangetsu has announced a new Three Year Medium Term Business Plan (2017 to 2019) called “PLG 2019”, which ends in fiscal year March 2020.

1. Reflecting Upon the “NEXT Stage Plan G” Previous Medium Term Business Plan

The three year period from 2014 was identified as the “Third Founding Phase” in which Sangetsu sought to establish a new management structure which had previously been comprised primarily of the founding family members. At the same time, the “Next Stage Plan G” (2014 to 2016) Medium Term Business Plan was created with a goal of promoting development of Sangetsu as a publicly traded company where its employees take responsibility for management and measures are implemented to create a new business structure strategy that can capture future business opportunities for growth.

◎Results and Issues of Fundamental Measures

Fundamental Measures	Results	Issues
(1) Facilitation of Business Foundations	<ul style="list-style-type: none"> Implementation of reviews and improvements in logistics, offices, showroom and other facilities, organizational structure, regulations 	<ul style="list-style-type: none"> Introduce new core system Establish logistics structure in Western Japan Reform awareness, strengthen capabilities of employees
(2) Restructuring of Business Strategy	<ul style="list-style-type: none"> Alliances for product development, procurement, measures to strengthen organizational structure, construction capability, and branding Established local companies in China Acquired Koroceal of the United States 	<ul style="list-style-type: none"> Facilitate a consolidated management structure Expand earnings of the overseas business
(3) Improving Stakeholders Evaluation	<ul style="list-style-type: none"> Fortify returns to shareholders Employee societal contribution 	<ul style="list-style-type: none"> Create, implement clearly defined environmental policy

(4) Quantitative • Growth • Profitability	Achieved record high profits in FY2015	<ul style="list-style-type: none"> • Initial sales target of ¥140.0 billion, actual sales of ¥135.6 billion • Increase in SG&A (Compared with FY2013, temporary and structural factors: ¥0.6, ¥3.8 billion)
• Efficiency	CCC improvements	<ul style="list-style-type: none"> • Accounts payable, inventory turnover period improvement

While Sangetsu's actual sales fell shy of its target for fiscal year March 2017 of ¥140.0 billion, it was able to achieve its net income target of ¥6.3 billion one year early in fiscal year March 2016.

In addition, Sangetsu was able to steadfastly implement “measures to achieve future growth”, despite not being able to achieve its goals of expanding and improving earnings of its affiliated companies, strengthening its front line sales, optimizing transportation, strict control of sales, general and administrative expenses, and its most important goal of “heightening the awareness of employees to take on responsibility for management”.

2. Medium Term Business Plan “PLG 2019” (2017-2019)

With a view to potential changes in the future business environment, Sangetsu will leverage the various successes achieved in the “Next Stage Plan G” Medium Term Business Plan and will implement measures to realize those goals yet to be realized and to achieve sustained creation of corporate value of Sangetsu Group in the new Medium Term Business Plan “PLG 2019” (2017 to 2019).

① Business Recognition

(Interior Business Characteristics)

Because Sangetsu conducts a difficult business model that serves a wide variety of customers with a wide variety of product needs in small lots, the risk of competition from new market entrants is relatively low. At the same time, the Company needs to attain economies of scale to secure profits.

(Worldwide Market)

Looking at the global wall covering materials markets, Japan, China, Russia, other Asian markets, Europe and the United States are estimated to consume 670, 1,570, 950, 530, 520 and 110 million square meters of wallcovering. And while Japan is a significant consumer of wallcovering, it can be said that the overseas markets are huge relative to Japan.

According to the same survey, the growth rates in the value of construction investments (From 2017 to 2019) are expected to decline in Japan for residential properties, but grow by 3% to 5% in non-residential properties. In the United States, growth in non-residential property construction investments is anticipated to grow between 5% and 7%, and by 8%, 7% and between 6% and 7% in India, Indonesia, and Vietnam respectively. At the same time, China, Singapore and Thailand are expected to see a growth rate of between 3% and 5%.

(New Direction of Growth)

Sangetsu went through a period of growth from 1953 to the first half of the 1990s from its origins in the Tokai region of Japan, and achieved domination of the nationwide market. With regard to sales, Sangetsu relies primarily upon dealers who sell BtoB in limited positions.

In addition to wallcovering and flooring materials, the Company has expanded its scale by deploying a business model that covers a wide range of interior products including a diversified lineup of fabrics as well.

However, Sangetsu entered a period of stability during the latter half of the 1990s after it conquered the nationwide market. The Company also encountered the issues of how to come up with adequate responses to deal with diversification of the market and expansion in the consumer market, and how to provide support of sales by dealers and construction companies. In addition, Sangetsu was confronted with the issue of how to deal with large changes in the procurement environment with the rapid increase in size of overseas product manufacturers and the consolidation of the Japanese market with product

suppliers suffering from a game of survival of the fittest.

In order to overcome these difficult conditions, Sangetsu started to promote a “global market approach” for its regional business strategy from 2014, with a goal of accurately responding to the needs of a diversifying market by providing a deeper and wider range of products.

Moreover, Sangetsu has pursued higher levels of specialization and more comprehensive capabilities as a means of providing customers with higher levels of value addition.

Furthermore, the procurement function has been strengthened by active pursuit of alliances with product manufacturers both within and outside of Japan.

② Medium Term Business Plan “PLG 2019” (2017-2019) Overview

◎ Vision

Based upon the “Corporate Creed: Integrity” and “Brand Philosophy: Joy of Design”, Sangetsu has created its Medium Term Business Plan “PLG 2019” with the goal of establishing strong roots within both the Japanese and overseas markets by leveraging the Group’s “diversified product lineup and highly specialized knowledge”.

“P” stands for personal and reflects the highly professional employees that helps it to link to people outside of the Company.

“L” stands for local and refers to the strong positioning in local markets.

“G” stands for global and represents Sangetsu’s global lineup of products and designs.

◎ Targets for the Final Year of “PLG 2019”

Target	ROE: 8~10%
Associated Targets	<ul style="list-style-type: none"> • Sales: ¥165.0~¥175.0 billion • Net Income: ¥8.0~¥10.0 billion • Capital: ¥105.0~¥100.0 billion • CCC: 75~60 days

In line with the previous Medium Term Business Plan, Sangetsu will focus upon raising its capital efficiency as a common goal shared with all of its stakeholders. The details of its sales targets are outlined below.

Interior Business	¥122.0~¥126.0 billion
Exterior Business	¥15.5~¥16.0 billion
Lighting Business	¥5.0 billion
Overseas Business (NA, China, SE Asia)	¥22.5~¥28.0 billion
Total Sales	¥165.0~¥175.0 billion

◎ Themes

As a basic policy, Sangetsu has identified the following measures as part of its strategy of “strengthening the function and expanding geographic sales of the interior materials business (planning, procurement, logistics, sales)”.

(1) Business Strategy for Growth

① Realizing Stable Growth in Earnings through Expansion and Strengthening of the Value Chain Activities Realm in Japan as a Fundamental and Stable Source of Revenues

Sangetsu will promote “development and procurement of materials and raw materials through alliances with superior suppliers within and outside of Japan”, “strengthen interior coordinator proposal and installation capability”, “fortify alliances and cooperation with dealers” and “conduct reviews of internal sales structure”.

② Strengthen Activities in Overseas Markets with High Growth Potential, Fortify Product Lineup and Functionality to Promote Geographic Expansion

Local logistic and sales structures will be strengthened in important markets including North America, Asia and others.

③ Create a Global Product Planning, Procurement Structure to Promote Global Designs, Cultivate Global Product
Sangetsu will strengthen cooperation with local facilities in Japan, United States and China for the implementation of “cooperation between Sangetsu globally and superior overseas product manufacturers” and “efforts to promote joint marketing of products and deployment of European and Japanese designs”.

④ Strengthen Consolidated Management Structure to Pursue Comprehensive Synergies, Integrated Management of Affiliates Responsible for Special Markets, Functions and Geographic Regions

A management structure system will be introduced to maximize business synergies and conduct clearly controlled earnings management, and to act as a surveillance support structure for the overall Group.

A consolidated management division will be newly established with authority to oversee the entire Group.

In addition, regularly scheduled monitoring and communications will be introduced to increase the overall effectiveness of the Group.

⑤ Business Format Conversion Trials to be Conducted with a View to the New Medium Term Business Plan

In order to pursue synergies and leverage business resources and the characteristics of each Group company, Sangetsu will conduct trials and promote business format conversion.

(2) Strengthen Human Resources

In order to cultivate real professionals, all of the Sangetsu Group companies will implement measures to 1) cultivate professional human resources, 2) conduct strict adherence to performance, 3) promote diversity, 4) reform work styles and 5) maintain a healthy management structure.

(3) Strengthen the Earnings Management Structure

① Strict Control, Reduction of Sales, General and Administrative Expenses

A chief cost controller will be appointed, and sales, general and administrative expense control methodologies will be facilitated. Also, the total number of staff of the parent company Sangetsu will be reduced.

② CCC Management Will be Introduced for All Group Companies

Targets for return on equity and CCC management through Dupont analysis on a consolidated basis will be promoted.

③ Sangetsu to Clearly Define and Promote Management Benchmarks for Each Business, Company

Targets for sales and gross income by employee will be established for each of the Group companies.

(4) ESG/CSR Policies

① E: Environment

☆The Sangetsu Group will assess the environmental burden of its overall businesses to create a structure that seeks to achieve sustainability and prevent global warming.

- A plan to achieve CO2 zero emissions will be created.

② S: Society

☆Provide support to workers including those who are socially vulnerable to foster diversity of each Group company.

- Retain women in 15% of all management positions (Actual 10.6% as of FY3/17).
- Retain workers with disabilities as 3% of the total workforce (Currently 2.3%).

☆Promote Corporate Social Responsibility in Supply Chain Function

☆Expand Societal Contribution Activities of Employees

- Provide support for interiors of childcare welfare facilities (Target: Over 20 facilities per year)

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③ G: Governance

☆Strict implementation of compliance, maintain and improve transparency of corporate governance activities

- Improve communications with shareholders, investors, employees, business partners and all other stakeholders

(5) Capital Policy

① Financial Policy for Improvement of Capital Efficiency

Sangetsu will continue to conduct share buybacks and stable increases in dividend payments with a goal of reducing its net worth to between ¥100.0 and ¥105.0 billion (¥108.8 billion as of FY3/17) with a view to conditions within the capital markets.

② Shareholder Return Policy of the Medium Term Business Plan

- Achieve over 100% total consolidated shareholder return ratio over a three year period
- Conduct stable increases in dividends over the long term
- Conduct share buybacks flexibly and in response to stock market conditions

We provide details of our capital procurement and capital allocation below.

Capital Creation, Sourcing	
Cash, Equivalents as of End FY3/17	¥30.0 billion
Operating CF (Medium Term Plan)	¥31.0~¥38.0 billion
Debt (Medium Term Plan)	¥0~¥22.0 billion
Total	¥61.0~¥90.0 billion

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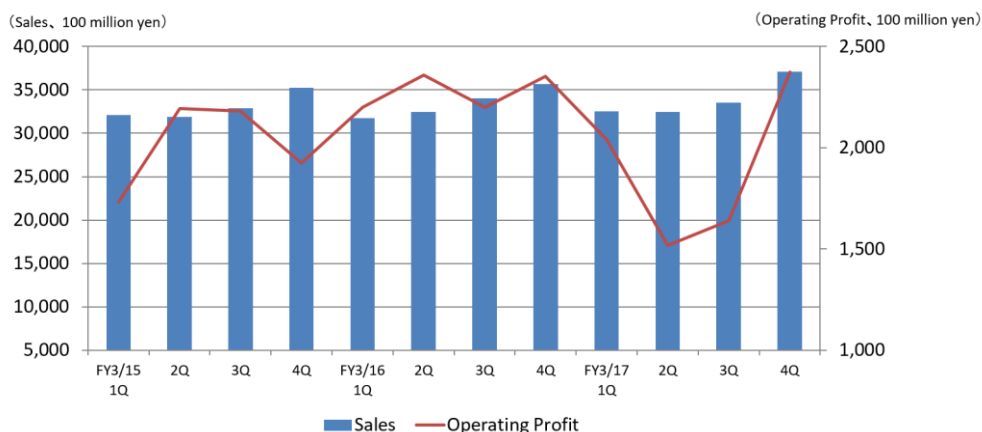
Capital Allocation	
LT Investments	¥10.0~¥25.0 billion
Shareholder Returns	¥25.0~¥33.0 billion
Term End Cash, Equivalents	¥25.0~¥30.0 billion
Total	¥60.0~¥88.0 billion

5. Conclusions

While Sangetsu sales during fiscal year March 2017 fell shy of its targets for the last year of its Medium Term Business Plan “Next Stage Plan G” (FY2014 to FY2016), it was able to achieve record high profits during the past two years. Furthermore, the outlook is optimistic for the Company to achieve sales target of ¥165.0 to ¥175.0 billion of its New Medium Term Business Plan.

Also, return on invested capital declined from 8.6% in fiscal year March 2014 to 7.2% in fiscal year March 2017 and return on equity rose from 4.5% to 6.0% over the same period due in part to the increase in leverage. Consequently, measures implemented to raise profitability and efficiency are important factors.

Also, progress in measures defined in the new Medium Term Business Plan will need to be watched closely.



<Reference: Regarding Corporate Governance>**◎ Organization type and the composition of directors**

Organization type	Company with audit and supervisory committee
Directors	10 directors, including 4 external ones

◎ Corporate Governance Report

Last modified: March 28, 2017.

<Reasons for Non-compliance with the Principles of the Corporate Governance Code (Excerpts)>

The company implements each principle of the Corporate Governance Code.

<Disclosure Based on the Principles of the Corporate Governance Code (Excerpts)>

Principles	Disclosure contents
【Principle 1-4 So-called strategically held shares】	<p>1. Our company believes that cooperative relationships with a multitude of companies are essential in the processes of manufacturing, development, sale, construction, and distribution of our products in order to constantly expand our Interior Business and Housing-related Business. We make decisions on shares to strategically hold for the medium- to long-term by comprehensively judging from various perspectives, considering companies with which we should newly forge relationships and companies with which we should continue to strengthen relationships as our clients for business strategies. In our company, strategically held shares are discussed and reviewed every year at a meeting of the board of directors.</p> <p>2. Attitude toward exercise of voting rights Our company respects the management policy of every company which we invest in and exercises our voting rights as needed after having interaction and communication through a wide range of channels and making comprehensive judgment as to various aspects including medium- to long-term improvement of such companies, their attitude to shareholder return, and their efforts at corporate governance and CSR.</p>
【Principle 5-1 Policy on constructive communication with shareholders】	<p>Aiming to establish good relationships with shareholders by encouraging constructive communication with them and striving for information disclosure and interaction with high transparency, our company proactively performs IR activities as follows:</p> <ul style="list-style-type: none"> • In our company, the Chief Executive Officer manages the implementation of IR activities. • Our company has established the Public Relations and IR Department for rational communication with our shareholders and swift IR activities. • The Chief Executive Officer, the executive in charge, and the Public Relations and IR Department carry out interviews with both Japanese and overseas institutional investors, and analysts, upon their request. • Although the Public Relations and IR Department is primarily in charge of IR activities, other departments including the Finance and Accounting Department, Management Audit Department, and General Affairs Department cooperate with the Public Relations and IR Department to provide information with higher effectiveness. • Our company announces our financial statements, arranges financial

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results briefings for investors, and participates in IR events for individual investors hosted by stock exchanges and the like to hold explanatory meetings.

- Our company publishes on our website explanatory material we used at the above-mentioned events and the like (the English-version of such material is also published as needed).

- Our company creates an integrated report for every fiscal year and publishes such reports both in Japanese and in English through our website.

- Our company conducts activities which contribute to enhancement of our shareholders' understanding about various items, including our management strategy, business environment, business progress, and financial information, through direct communication and material published on our website.

- Our company responsibly utilizes opinions obtained from interaction with our shareholders and investors for administrative improvement through The Public Relations and IR Department.

- Our company properly deals with the management of insider information in accordance with the regulations for the management of insider trading (regulations for the prevention of insider trading), by assiduously managing unpublished material facts.

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