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FYE March 2025 Q2 Earnings Call

November 13th, 2024

Attendees:
Hideaki Wada, President and Representative Director
Akihiro Sueyoshi, Executive Officer, Head of Financial Strategy & Investor and Public Relations

■ Financial Results Presentation

P1

Average growth rate over 5 periods. From left to right, sales, recurring operating profit, and operating profit are presented. Regarding our in-house products in the middle, recurring operating profit grew from 21.3 billion yen in the second quarter five years ago to 38.8 billion yen, with an average growth rate of about 12%. The in-house products have also shown remarkable progress in operating profit, growing from 13 billion yen five years ago to 26.7 billion yen, achieving an average growth rate of 15%. Overall, we confirmed that sales, recurring operating profit, and operating profit are generally increasing smoothly.

P2

Net cash assets increased from 190.4 billion yen five years ago to 793.8 billion yen, with an average growth rate of 33%. The total assets have grown from 916.5 billion yen five years ago to 2 trillion 122.4 billion yen, with an average growth rate of 18%. Equity has increased from 291.3 billion yen five years ago to 829.6 billion yen, with an average growth rate of 23%. Please also refer to the indicators per share.

P3

Financial results. Sales, recurring operating profit, and operating profit have all marked record highs. Furthermore, pretax profit excluding foreign exchange gains and losses has also hit a record high of 83.1 billion yen, a 32% increase year on year. Additionally, progress rates against the full-year performance forecast exceeded 50% in all indicators, indicating steady development.

P4

Profit and loss by business segment. In terms of sales, electricity and gas grew by 33%, and insurance by 17% year on year. In recurring operating profit, electricity and gas increased by 5%, beverages by 3%, insurance by 15%, and solutions by 139%. The solutions segment has seen significant improvements in recurring operating profit compared to last year, as the EPARK business restructuring was completed. Operating profit also increased in all sectors year on year, except for telecommunications.

P5

Customer acquisition. New businesses such as high-voltage electricity, LP gas, and beer servers grew significantly in particular year on year, while growth was seen in overall businesses.

P6

Pretax profit. Pretax profit excluding foreign exchange losses was 83.1 billion yen. Operating profit was up approximately 10 billion yen, and dividend and interest incomes were up 10 billion yen, totaling an increase of 20 billion yen year on year. Foreign exchange losses stood at minus 14 billion yen. One dollar bought 151 yen at the end of the previous fiscal year. With the current trend of 153 yen against the dollar, it is likely to recover by the third quarter. If it ends at 151 yen at the end of this fiscal year, a profit of 5 billion yen is expected. Due to significant volatility in exchange rates, figures excluding them are presented.

P7

Cash flow was a surplus of 21.7 billion yen. We have recorded minus 42.6 billion yen in a change in accounts receivable and payable, primarily due to the increase in accounts receivable from growth in the electricity business, especially in the high-voltage segment. Additionally, dividend and interest incomes have resulted in 24.2 billion yen.

P8

Changes in equity capital. The equity capital was 829.6 billion yen, with an increase of 39.1 billion yen for the current period. Net profit was a positive 48.2 billion yen.

P9

Various indicators of pure investment. At the end of the first half, the book value of investments was 669.4 billion yen, the market value was 1 trillion 123.6 billion yen, and the unrealized gain was 454.1 billion yen. Additionally, the look-through earnings (note: calculated by multiplying the operating profits of each investee by our ownership ratio) are 96.7 billion yen, and EY (earnings yield, calculated by dividing look-through earnings by investment book value) is 14.4%. The dividend yield is 4.3%, with gains on securities of 10.7 billion yen.

P10

Introduction to companies that we invest in. We have listed the dividend yield, unrealized gain and rate of value change for your reference. We invested in Fullcast Holdings at a very opportune time, which resulted in this amount of dividend yield.

P11

Regarding publicly listed equity method affiliates. There are currently 34 companies, from ZAPPALLAS to FreeBit.

P12

The quarterly dividend is 161 yen, making the annual dividend amount to 639 yen, which is a record high.

P13

The total shareholder return is planned to be 40 billion yen, with an estimated total shareholder return ratio of 44%.

P14

Summary of the first half financial results. In our business operations, we have achieved record highs in sales, recurring operating profits, and operating profits. We are seeing progress exceed our initial forecasts and can confirm that we are generally on a favorable track. In terms of pure investment, we maintain an EY of 14.4%, indicating that our investees are growing with relatively good performance. As for shareholder returns, we aim to continue providing stable returns to our shareholders while growing the business.

Appendix 1

Regarding our telecommunications and insurance businesses. We have presented information about products and services related to mobile phones, as well as the small-amount, short-term insurance services for your reference.

Appendix 2, P1

We have outlined the methods for setting executive compensation. We use a certain coefficient applied to the shareholder equity entrusted to us by our shareholders as the base amount for compensation, and this is distributed according to the responsibilities of the executives.

Appendix 2, P2

Directors, executive officers, and employees maintain a strong sense of ownership by holding shares of Hikari Tsushin and manage the business with this sense of responsibility.

Appendix 2, P3

Financial Discipline. We are presenting the concept of conducting business while maintaining certain financial standards. Basically, our stance is to always retain cash reserves to repay interest-bearing liabilities due within three years.

That concludes my brief explanation. I would like to open the floor to questions.

■ Q&A Session

(1) Earnings call for Japanese investors

[Question] Regarding recurring operating profits. While there is no guidance for 10% growth in recurring operating profits for this fiscal year, considering the conservative nature of the guidance and the recovery in recurring operating profits from electricity and gas, I believe we are off to a good start towards achieving an average annual growth of 10% in recurring operating profits for the next and following fiscal years. Although recurring operating profits in telecommunications and beverages have not increased much this quarter, which could be a source of concern, could you please share your outlook for the first half of the progress, the second half forecast, the forecasts for the next fiscal year and beyond, in terms of achieving an average annual 10% growth rate in recurring operating profits?

[Answer] Recurring operating profits saw slower growth in the current first quarter due to the strong performance in the previous first quarter, influenced by changes in the electricity contract terms. In the second quarter, recurring operating profits are steadily growing. They are expected to show steady growth in the third and fourth quarters as well. Although it might be misleading to say there are no issues, we generally expect a robust growth of 10%. The recurring operating profits in the telecommunications sector have recently bottomed out, reducing potential concerns for the next and following fiscal years. We aim to grow recurring operating profits by targeting at least 10% growth, and if including M&A, aiming for 15%.

[Question] If that's the case, is my understanding correct that the guidance of recurring operating profits falling below 10% is due to unusual circumstances this fiscal year, and there is a sense of security because electricity is expected to grow significantly from the next fiscal year?

[Answer] Even if there might be slight discrepancies, we believe we can achieve around a 10% growth in recurring operating profits this fiscal year, and we anticipate a growth of around 10% in the next fiscal year as well.

[Question] Regarding shareholder returns. Thank you for the dividend increase. Considering your company's business structure where recurring operating profits accumulate, I believe there is no problem with committing to progressive dividends. Is there a potential for such a commitment in the future, or are there any reasons why it can't be done?

[Answer] We have maintained progressive dividends continuously so far, and going forward, the premise is to continue this approach. The method of shareholder returns, and capital allocation are what we regularly discuss among the top management, and we wish to maintain flexibility. The idea is that we are growing our business, surpassing a hurdle rate where the returns on customer acquisition costs reach 200% over five years. On the other hand, if that growth slows significantly, we might consider a substantial increase in dividends, and if growth stagnates completely, we aim to approach a 100% payout ratio.

[Question] The high-voltage electricity segment has seen significant growth, and this financial result is also very strong. Could you explain the factors behind this growth in the financial results and how you view the potential of the market and competitors going into the next fiscal year?

[Answer] After completing enhancements and adjustments to the low-voltage segment, we began designing market-linked plans for the high-voltage segment. Additionally, since our customer base has traditionally been strong among small and medium-sized enterprises, we established a new sales team targeting factories, large facilities, and major buildings. Essentially, over the past two to three years, we have successfully established product designs and the sales channels suitable for them. We believe that the high-voltage segment can continue to grow with high growth potential in the next year and onwards.

[Question] As you expand the LP gas area next fiscal year, how confident do you feel about it growing into a large-scale business akin to electricity?

[Answer] The high-voltage segment is growing at a very high growth rate. Given the excellent performance of the electricity segment, it is less likely that the LP gas segment can catch up with the electricity segment. On the other hand, we would like to grow the LP gas into one of our core businesses and to the size approximately equivalent to half of the profits size of the low-voltage segment in the electricity business. We are confident that the LP gas market has the potential to attain the targets. We are also steadily expanding our area, mainly in the Kanto region, and plan to maintain this high growth rate into the next fiscal year.

[Question] Could you explain the background of the book value of investments increasing from 590.2 billion yen in March to 669.4 billion yen in September? Does this mean you have made new investments of 80 billion yen over the six months?

[Answer] Please refer to page 7 of the cash flow statement. Listed equity investments and bond investments constitute a total of approximately 90 billion yen. The breakdown is roughly 60 billion yen in equity investments and about 30 billion yen in bond investments. These figures represent the net amounts of investments bought and sold, resulting in investments of this scale.

[Question] What is your outlook on the investment climate? With major elections now over in the

US and Japan, and concerns about risks associated with President Trump, as a value investor, your company may not be overly concerned with these issues, but we imagine you have some perspective on market conditions. In terms of your equity investment stance, which areas are drawing your attention, and what opportunities are you identifying? Moreover, are you tending to decelerate or accelerate the pace of equity investments in the short term, or double down on investment in your operating business such as electricity business? Could you provide an explanation of your company's overall investment stance?

[Answer] As a basic principle, cash is primarily used for our operating business. We have a standard of spending acquisition costs to generate approximately 200% returns over five years. We do not scale our business by sacrificing this standard. With our current business, the acquisition cost we can spend while complying with this standard is around 50 to 60 billion yen, which is the upper limit. The surplus funds are then managed in investments in securities. Our fundamental approach is value investing, so although external factors such as elections may occur, we strictly invest in individual stocks of excellent companies that have strong financials, are undervalued considering their Price-to-Book Ratio and engage in a recurring type of business. However, we recognize that while the Nikkei average is currently hovering just under 40,000 yen, there is a possibility that the entire market could crash if the Nikkei drops significantly. From this perspective, we do not consider the current phase is an opportune time for aggressive investment. With interest rates expected to rise, the phase of procuring funds at low interest rates has ended. While we conduct cautious investments, we hold a cash position close to 400 billion yen. If the market significantly declines in the future, we plan to deploy funds substantially to invest cheaply in fundamentally excellent companies' recurring businesses and therefore wish to retain funds at this stage.

[Question] The business plan appears to have been conservatively set. Are there any concerns for the second half? What risk factors have been conservatively factored in when keeping the business plan unchanged? Please explain your perspective.

[Answer] There are potential external factors such as wars, pandemics such as COVID-19, and unexpected currency fluctuations. Therefore, we have maintained the current plan. Business is generally going well, but with potential uncertainties, we have not made any revisions.

[Question] Although it may not be something to comment on now as it could happen at the end of the fiscal year, are you factoring in one-off losses to increase returns?

[Answer] Regardless of the fiscal year-end, any quarter, or monthly results, we record all losses conservatively according to prudent accounting principles. Similarly, we provide reserves conservatively.

[Question] In the first half, both the recurring operating profits and operating profits of the telecommunications business decreased. Could you provide your outlook for the future of the telecommunications business?

[Answer] I cannot assure a V-shaped recovery in telecommunications, as the competitive environment remains challenging. Although profits declined in the first half, they have already passed the bottom. We anticipate slight growth heading into the second half or the next fiscal year. We do not intend to forcibly increase acquisition costs to pursue growth at the expense of lower returns. The best performance is seen as achieving slight growth while maintaining high returns in the business.

[Question] Regarding investment in securities, we have noticed a significant increase in dividend and interest incomes. Since year-end dividends are recorded in the first quarter, there is a decrease in the second quarter, but considering the interim dividends in the third quarter, is it correct to assume that the annual figures will roughly double the current numbers?

[Answer] Dividends are larger in the first half, so they will be slightly less in the second half. We expect dividend and interest incomes to amount to over 40 billion yen.

[Question] Regarding financing, you mentioned that you will closely monitor the interest rate conditions and the market situation, such as the Nikkei index. I think your basic idea is to reinvest in the business, but could you share again the basic approach to funding and investment?

[Answer] First and foremost, our business delivers the highest yield. Our business doubles in five years. Some recurring businesses have a long lifetime value of 10 to 15 years, but even when considering just five years, IRR is nearly 30%. Therefore, we would like to invest everything in the business if we could. We hold about 1.6 trillion yen, combining around 1.2 trillion yen in securities and about 400 billion yen in cash, which we have procured at low interest rates. However, the acquisition cost we can spend each year is approximately 60 billion yen, and since we cannot invest all of it in the operating business in the current fiscal year, we spend it on investments in securities. Essentially, if there is a business where we could invest about 1 trillion yen and achieve an IRR of around 30%, we would like to allocate everything there. Regarding procurement, with interest rates on a slight upward trend, long-term borrowings are becoming shorter term. While we still consider buying individual stocks when they are affordable, we do not think this is a phase for pure investment on a large scale. We believe the time when our interest-bearing debt will decrease is near, and we have no intention of placing investment in securities at the core of our business, nor do we have an intention of increasing borrowing to finance investment in securities even with rising interest rates. Our primary focus remains on our operating business. Within this context, we are aiming to achieve maximum performance from pure investment.

[Question] The progress in acquiring high-voltage contracts is strong, but how are the customer acquisition costs doing on a year-on-year basis? Could you comment on the profitability of the high-voltage segment?

[Answer] In terms of acquisition costs, there have been no significant increases or decreases compared to the previous fiscal year. The average revenue per user (ARPU) in terms of electricity usage of existing customers has not significantly decreased, and the discount rate has not increased. Therefore, we are achieving high growth while maintaining customer acquisition costs and yields. We operate our electricity business focusing on acquiring certain customers with high profitability. While maintaining a certain level of yield, we have achieved a year-over-year growth rate of 295%.

[Question] In the second quarter, you reduced your cash on hand to 493.8 billion yen for purposes such as repaying gross interest-bearing debt and making investments. How do you consider the levels of cash on hand and interest-bearing debt during a period of rising interest rates?

[Answer] Amid rising interest rates, our strategy will not change, and we will leverage opportunities of long-term financing at low interest rates whenever possible. We believe this will contribute to our competitive edge. We will continue our stance of investing in securities when there is surplus fund available. However, as interest rates rise, the funding environment is changing. If interest rates double or more when we aim to do the same things that we accomplished over the last decade, we are discussing whether this is something we should undertake. Currently, the pace of increase in interest-bearing debt is slowing down, which is something you may have already noticed. We intend to continue assessing each project's circumstances individually, as we have always done. We are mindful of maintaining an equity ratio of around 30% and will continue to monitor various metrics.

That concludes today’s earnings call. Thank you very much.

(2) Earnings call for overseas investors

[Question] What kind of impact is there is in your investment portfolio amid the strong dollar and robust U.S. economy? Also, do you foresee additional interest rate hikes in Japan?

[Answer] We hold one-third of our liquid assets in U.S. dollars, so there is some impact from currency fluctuations, but this is primarily part of our strategy to diversify our cash position. The business itself is hardly impacted by exchange rate changes. Looking forward, interest rates in Japan are on an upward trend, so securing funding over long periods, such as 10 years at low interest rates, will become increasingly difficult. Consequently, we do not expect the balance of interest-bearing debt or the book value of investments to increase at the same pace as before.

[Question] Could you explain why margins have decreased in the electricity business?

[Answer] The previous year's first quarter performance was exceptionally strong due to price revisions (reductions), which makes the current figures look less favorable in comparison. However, looking at the results of the current and previous second quarters, there is an increase of approximately 10% year-over-year. For the full year, we anticipate electricity recurring operating profits to expand by about 10% compared to last year.

[Question] Are you considering new investment opportunities in Japan?

[Answer] There are many undervalued investment targets in Japan. We aim to identify and focus on the most undervalued and excellent companies.

[Question] In the next five years, which core business do you think will capture the largest market share?

[Answer] Over the next five years, we expect the electricity business to grow the most. Our current market share is approximately 1.3%, and we believe there is significant room for growth in our market share over the next five years.

[Question] What are the sources of competitive advantages and differentiation for your electricity business?

[Answer] Our strength lies in our ability to cross-sell leveraging the customer base we have in other businesses such as telecommunications and water, which is a unique advantage that sets us apart from our competitors.

[Question] Regarding publicly listed companies in which you hold a 20 to 49% stake, what are the reasons for not taking them private?

[Answer] We hold them for a purely investment purpose, and whether to go private is a decision for each issuing entity to make.

[Question] Are there any updates to your valuation?

[Answer] The enterprise value is 1.8 trillion yen, with net cash assets of 0.8 trillion yen, totaling 2.6 trillion yen. This has increased slightly since the last announcement, but it remains undervalued.

[Question] Between investing in other companies' stock and buying back your own shares, which do you see as a better investment opportunity?

[Answer] It is ideal that we execute about 100 billion yen in share buybacks immediately. However, due to the limitation of the free float ratio, we only have room for 100 billion yen in share buybacks. Consequently, we plan to continue executing buybacks cautiously when the timing is favorable, and the price is low. This fiscal year, we have conducted share buybacks of 10 billion yen.

[Question] Are there employees who receive shares as part of their compensation?

[Answer] We have a system where loans are provided to management to purchase shares, and there is also an option in which part of their salary is paid in shares. However, shares are not granted for free, and there are no stock options. Officers hold a significant amount of Hikari Tsushin shares, and key employees purchase Hikari Tsushin shares every month. This fiscal year, we provided loans to 63 people to use for purchasing Hikari Tsushin shares. Both employees and executives are encouraged to take their own risks in purchasing our shares. This aligns their interests with those of shareholders, allowing management to be conducted from a shareholder-centric perspective.

This concludes our earnings call. Thank you very much for your attendance today.