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FYE March 2025 Q3 Earnings Call

February 13th, 2025

Attendees:
Hiroyuki Ohashi, Managing Executive Officer
Naomi Imoto, Head of Financial Strategy, Investor and Public Relations

■ Financial Results Presentation

P1

Five-year average growth rate. The recurring operating profit from our in-house products in the third quarter amounted to 39.8 billion yen. It was 22 billion yen five years ago in the third quarter, achieving an annual average growth rate of 12%. Operating profit from our in-house products reached 27.9 billion yen, compared to 11.2 billion yen five years ago, resulting in a 20% growth.

P2

Net cash asset, asset, net asset, net asset before shareholder return, and equity have all grown at a rate of approximately 20% or more. Similarly, per-share indicators have also achieved growth exceeding 20%.

P3

We announced an upward revision to our guidance yesterday. Revenue was revised upward to 670 billion yen, operating profit to 105 billion yen, and net income to 115 billion yen.

P4

For the cumulative performance for the nine-month period, revenue, recurring operating profit, operating profit, and net income all reached record highs. The results are as follows: revenue of 498.8 billion yen, recurring operating profit of 124.5 billion yen, operating profit of 86.5 billion yen, and net income of 102.7 billion yen. The full-year performance forecast reflects the revised figures.

P5

Regarding the segment profitability, electricity & gas, beverage, insurance, finance, and solution businesses are all experiencing steady growth. In telecommunication business, the recurring operating profit had reached a bottom, but due to increased customer acquisition costs, operating profit decreased from a year earlier.

P6

We have been seeing steady growth in customer acquisition in each category.

P7

Pre-tax profit excluding foreign exchange gains was 125.6 billion yen. In addition to operating profits of 86.5 billion yen, dividend income and interest income grew from 7.1 billion yen in FYE March 2020 to 33 billion yen, observing a 40% year-over-year increase.

P8

Cash flow. Accounts receivable increased due to an expansion in the customer base, leading to a negative cash flow impact. Additionally, investment cash flows were negative due to increased investments in publicly listed stocks.

P9

Changes in equity capital. Equity capital was 910.8 billion yen at the end of this third quarter, up 33% from a year earlier.

P10

Key indicators of pure investment. The IRR before tax over the past seven years is 17%. At present, the book value (amount at cost) of investments was 697.8 billion yen with the unrealized gain reaching 490 billion yen. Additionally, the look-through earnings are more than 100 billion yen, and EY remains over 15%. The dividend yield is approximately 4%, with the dividend income increasing year on year as I previously noted.

P11

As of the end of September, there were 34 publicly listed equity method affiliates. However, due to the reclassification of T-Gaia as an asset held for sale, the number decreased by one, resulting in a total of 33 affiliates as of the end of December.

P12

Dividend and dividend forecast. The company increased the dividend per share to 167 yen as disclosed yesterday.

P13

Shareholder returns development. The full-year total shareholder return ratio is projected to be 44%.

P14

Summary of the third quarter's financial results. In our business operations, we have achieved record highs in sales, recurring operating profits, and operating profits and have been making good progress. In terms of pure investment, we maintain an EY of more than 15%, with dividend income and interest income reaching 33 billion yen, growing year on year. We have also been maintaining good performance on the pure investment front. As for shareholder returns, we have resolved to increase dividends, which will result in an all-time high annual dividend per share if things proceed as expected.

Appendix
We have outlined our pure investment and M&A achievements.

Appendix P1
TOB is recently significantly active, and among our pure investment portfolio companies, four companies have conducted TOBs from April to the end of December of this fiscal year.

Appendix P2
We are also proactively conducting M&A, particularly relevant to our businesses. Figures are stated on the number of users and the recurring operating profits for the electricity, the sales agency, and the water dispenser businesses. We aim to drive future growth by conducting M&A in these types of businesses and companies.

Appendix P3
Finally, we have introduced two companies as part of our investment portfolio. Since we manage our investments over the long term, we have been able to achieve an average IRR of over 20%, considering unrealized gains, dividend incomes, and realized gains against the book value.

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

■ Q&A Session

(1) Earnings call for Japanese investors

[Question] There are two points regarding the electricity business. FT Group Co., Ltd. (hereinafter referred to as "FT") has significantly lowered its mid-term outlook and announced a rather severe forecast for the retail electricity market. Your company, on the other hand, continues to show strong and solid performance this quarter as well. However, we have also heard concerns about increasing competition in the retail electricity market. How do you view the actual competitive environment? Considering this, what kind of growth do you expect for the electricity and gas business over the next 3 to 5 years? Could you share your perspective on the mid-term market environment?

[Answer] First, while FT has announced a downward trend in its mid-term plan, it is important to note that FT conducts its electricity business through its subsidiary, Fene Co., Ltd., and has already ceased new sales activities. FT's current operations mainly revolve around its original commission-based sales of NTT, which, akin to the decline in our commission-based sales, have resulted in a downward trend in its performance. Therefore, we believe that FT’s electricity business is not directly linked to ours.
Secondly, regarding the market environment in the electricity sector, as our customer acquisition and profits are steadily growing, it is natural that our competitors are also generating profits. While new market entrants had temporarily decreased, we expect that new entries will increase again. We anticipate intensified competition in the market, and in response, we plan to refine our product offerings and sales channels, focusing our strategy on securing longer-term contracts and reducing churn rates.

[Question] Has the intensification of competition started recently, or has it been ongoing for about a year? Additionally, given this environment, do you plan to shift the focus in your electricity and gas business portfolio? For example, will you strengthen the gas sector or the high-voltage sector? Or do you believe that maintaining the current business structure will be sufficient?

[Answer] With regard to the competitive landscape of the market, we have observed new players entering the market and an increase in sales agents. However, the market share of electric retailers who entered the market after the deregulation (less traditional regional power companies) is still relatively small, meaning that the overall market remains significantly large. We have no plans to change our portfolio and will continue to focus on the electricity business. Additionally, within the electricity sector, our strategy is to conduct more detailed analyses and clarify our approach in terms of regions, scales, and industries where long-term usage is expected. We will also continue to strengthen our efforts in both city gas and propane gas.

[Question] The recurring operating profits from the electricity and gas business of this quarter were stronger than I had expected, and the finance business also delivered solid profits. Regarding the recurring operating profits in the electricity and gas business, could you clarify whether this was caused by an increase in gross margin per kilowatt-hour or by successful customer acquisition or any other reasons? Additionally, could you also explain why the finance business showed strong performance?

[Answer] The electricity and gas business remains strong, primarily due to an increase in the number of customers we serve. While usage fluctuates seasonally, it generally rises during colder months. This quarter's growth is purely driven by an increase in the number of customers. As for the finance business, both lending and collection have been progressing smoothly, allowing for compound growth over time.

[Question] Since acquisition costs have also increased in the third quarter, can we simply view this as a positive outcome where both spending for future growth and generating profits were achieved?

[Answer] Since we have been able to spend acquisition costs, I believe that understanding it in that way is appropriate at this point.

[Question] You mentioned that competition in the electricity business is increasing, but I believe there are also many companies that have stopped new sales. As for the difference between those companies and yours, is it correct to understand that your company sources electricity from the wholesale market, giving you competitiveness at a retail price, whereas many other companies procure electricity from regional power companies, making them less price competitive? What is the most significant difference between your company and those that have stopped sales?

[Answer] Among the companies that have stopped sales, there are a certain number that procure electricity at fixed rates through bilateral contracts with regional power companies rather than sourcing from the market, which makes them less competitive in terms of pricing. Additionally, even if a company sources electricity from the wholesale market, its cash flow can deteriorate significantly, meaning that a certain level of financial resources is required to enter the market. Acquiring customers individually requires considerable effort, time, and money, so without an established sales network, it is difficult to grow the customer base even after entering the market. As a result, some companies have decided to halt their sales activities.

[Question] Does this mean that there are companies that have successfully met the necessary requirements to enter the market?

[Answer] The new entrants in the market are companies that already have an existing sales and distribution network, as well as sufficient financial resources. However, considering the overall scale of the market, there is still significant room for expansion.

[Question] M&A has been increasing. Do you believe there will be many opportunities to acquire companies that have ceased their operations?

[Answer] We will continue to keep our information network active and pursue M&A at a fair price whenever opportunities arise.

[Question] Regarding the hire purchase financing for motorcycles in Cambodia and Malaysia under the finance business. The finance business profit for 3Q exceeded expectations. However, I am not certain whether simply multiplying this quarter's profit by four would be appropriate. Do you consider this level of profit to be sustainable, or was this quarter particularly strong due to favorable conditions? How do you assess the situation?

[Answer] In our overseas finance business, both lending and collection are currently growing steadily. As for whether this trend will continue, we expect it to do so; however, we will proceed while carefully monitoring factors such as the default rate.

[Question] Does this mean that the local management team is successfully handling the operations?

[Answer] We dispatched Japanese personnel to the local sites and are overseeing operations from Japan.

[Question] You introduced your equity-method affiliates earlier. The accounting principle is that when the ownership exceeds 20% as a result, the investment is classified as an equity-method affiliate, whereas anything below is categorized as investment securities, but in terms of your awareness, is it correct to understand that you do not particularly distinguish between them and that you purely evaluate investments and returns based on their pure investment nature?

[Answer] That understanding is correct.

[Question] When the ownership exceeds 20%, you can exit if the chance arises, but cashing out would have a significant market impact. How do you consider this aspect?

[Answer] Of course, such opinions exist, but our fundamental stance is to assess the difference between a company's intrinsic value and its market capitalization. If the valuation is low, we continue to buy. Even if an exit is not possible, we believe that assets will steadily grow, and stable returns will be generated through dividends and share buybacks.
Additionally, for example, Nakano Refrigerators Co., Ltd., which was classified under the equity

method, was exited through an over-the-counter transaction. When we hold a significant stake, more shareholders tend to express interest in acquiring the shares, which in turn increases exit opportunities. When the ownership ratio reaches a certain level, there are more buyers interested in purchasing in blocks, so we do not necessarily believe that exceeding 20% shareholdings makes it difficult to sell.

[Question] When long-term interest rates rise, it becomes difficult to issue long-term and super-long-term bonds at as low rates as before. Therefore, rather than an expansion-only approach, it is necessary to maintain balance and exercise some control—this is what CEO Mr. Wada mentioned previously. On the other hand, the stock market and the Nikkei Average have been continuously rising, so does this mean it is not yet the time to slow down? Of course, this assessment may change monthly or quarterly, but what is your current perspective on this matter?

[Answer] We will make decisions in the long run while monitoring interest rates and other factors each time. However, at this stage, we are not planning to stop anything immediately. Instead, we will continue to invest while carefully checking individual cases and indices.

[Question] Please provide the factors contributing to the decline in sales of the beverage business.

[Answer] We made a subsidiary sales company off-balance sheet in the previous year, which resulted in a decrease in revenue. However, we continue to strive for cost reduction and customer acquisition, and we expect sales in the beverage business to grow in the future.

[Question] The progress rate of high-voltage power has declined compared to the 2Q cumulative results. Could you please explain the factors behind this? Additionally, if there is a main target segment for high-voltage power, we would appreciate your insights.

[Answer] Regarding high-voltage power, our main users are commercial buildings and small factories. We have traditionally focused on small to mid-sized enterprises, where we have a strong presence, but we are also making progress in acquiring slightly larger companies. There is a certain time lag between receiving customer applications and completing the switchover, which may cause some fluctuations on a quarterly basis. However, fundamentally, the number of customers has been steadily increasing each quarter.

[Question] M&A has been carried out this quarter. Could you explain how such M&A activities impact your business and outlook? Additionally, if you have any insights into the pipeline of future deals or whether acquisition opportunities are becoming more accessible, please share your thoughts.

[Answer] We have highlighted M&A as a key topic this time, but rather than having just started recently, we have been focusing on it for a long time, executing various business and company acquisitions over the years. Recently, we have been putting even more effort into this area, aiming for 15% growth through a combination of organic growth and M&A, with a view to increasing the recurring operating profits. In that sense, we disclosed this information to demonstrate our strong commitment to M&A. Regarding whether acquisitions are becoming easier or more difficult, it naturally depends on the counterparties. Therefore, we remain vigilant in gathering information, ensuring that we do not overpay, and carefully managing yields while making acquisitions at appropriate prices.

[Question] Looking at the appendix, it seems that recurring operating profits will increase by approximately 1.8 billion yen annually with the addition of the three acquired companies. Given the size of your company, M&A of this scale may not significantly boost the overall growth rate. However, do these steady accumulations contribute to enhancing your organic growth rate? Alternatively, while it may not happen immediately, are you also considering a pipeline of opportunities that could lead to a substantial increase in the growth rate in the future?

[Answer] We conducted M&A on a larger scale than this in the past and continue to approach M&A with a long-term perspective. In addition to organic growth, the companies acquired through this M&A will also benefit from cross-selling Hikari Tsushin's products. By incorporating the growth of the acquired companies, we will continue to drive growth from multiple angles.

[Question] Is acquiring approximately three companies through M&A over nine months a typical pace for your company? Would you consider this speed to be fast, slow, or average?

[Answer] I believe it is a typical pace. The number of deals is also neither particularly many nor few, and we proceed with M&A as appropriate when the time and price are right.

[Question] Could you please explain the difference between the operating profit and the profit before tax in the revised full-year guidance?

[Answer] We take a conservative stance in calculating these figures.

[Question] As the electricity sales expand, are you also considering investments in power sources?

[Answer] We have been considering it as appropriate. We are still studying whether investment in power generation can lead to significant growth.

[Question] Regarding the revised company plan for operating profit, there was not much of an upward revision, taking into an account one-time gain of 3.4 billion yen. Does this mean that in the fourth quarter, you are planning impairments or a significant investment in customer acquisition costs, resulting in this kind of revision plan? Or is it more of a conservative estimate at this stage, given the uncertainty of potential factors? I would like to confirm the nuance.

[Answer] It does not mean that there is a possibility of significant impairments or other major factors; rather, we have taken a conservative approach for now.

[Question] Dividend income has increased relatively this fiscal year, showing strong performance. As to the difference between profit before tax and operating profit, is it correct to understand that there are no significant one-time factors other than foreign exchange effects, and that the increase is simply due to the steady growth of various financial assets held? Additionally, can we assume that this growth is stable and unlikely to decline suddenly?

[Answer] That is correct.

[Question] The insurance business has also shown a significant increase in both revenue and profit. Which specific products have experienced growth?

[Answer] Our strongest products, mobile insurance and warranty services, have been steadily growing.

[Question] Please provide the bond balance as of the end of December.

[Answer] As of the end of December, the bond balance stands at 126.3 billion yen.

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

(2) Earnings call for overseas investors

[Question] I have noticed that the market value of your investment portfolio appears to be quite substantial relative to your company's share price. Given this, I suspect that your stock may be greatly undervalued, and I have seen similar observations in past transcripts. As I am not fully familiar with Japanese accounting standards, could you clarify how your company's accounting book value reflects your actual intrinsic value? Additionally, I am particularly impressed with your investment philosophy, which in many ways reminds me of Berkshire Hathaway.

[Answer] Regarding our investment policy, we compare the intrinsic value of a target company with its current market capitalization. If the market capitalization is lower, we buy; if it becomes significantly overvalued, we sell. Our investment decisions are made based on a thorough assessment of the company's intrinsic value. Additionally, we have studied and deeply respect Berkshire Hathaway. As for how our investees are reflected on the balance sheet, they are marked to market each quarter as investment securities, rather than being recorded on the profit and loss statement but instead reflected in comprehensive income. As a result, when unrealized gains increase, retained earnings also grow. In terms of how intrinsic value exceeding market capitalization is accounted for, since investees are recorded at market value under accounting principles, there may be portions that are not reflected on the balance sheet.

[Question] Could you give us an idea of how the tax in Japan work on share sales?

[Answer] Gains on sales of publicly traded stocks are taxed at 20%.

[Question] Did the acquisition boost revenue growth in your electricity retail business this quarter? If so, what was organic growth like?

[Answer] The customer acquisition has grown by 20% organically year-over-year. In addition to this, the M&A contribution will be added.

[Question] Could you please elaborate on the increase in accounts receivables?

[Answer] As the number of users has increased compared to last year, accounts receivable have also grown.

[Question] Could you please elaborate on the large increase in investments in listed securities? What was the motivation? Where did you invest in?

[Answer] We do not have a specific target for investment amount. If a good company is undervalued, we will buy it; if it is overvalued, we will not. We have established clear investment criteria, so if the stock prices of our investment targets decline, our holdings naturally increase. This does not mean we have slackened our criteria; rather, our holdings increased this quarter because of our policy of buying when prices are low and not buying when prices are high. Since concentrating investments in a single industry or stock increases volatility, we maintain a highly diversified approach across industries and sizes. Fundamentally, we invest in liquid publicly listed companies and focus on financially stable companies with strong cash flows and a high cash coverage ratio relative to their market capitalization while thoroughly researching undervalued companies.

[Question] Your revised revenue guidance implies Q4 growth of 10%. This is lower than Q2 and Q3 growth of 15%. Could you please explain the reason for the conservative growth guidance for Q4?

[Answer] The reason is that we are taking a conservative approach.

[Question] I noticed that spending on customer acquisition decreased year-on-year. Is there any reason for that? How have you been driving revenue growth without spending on customer acquisition? Has something changed to make you more efficient?

[Answer] We identify customer acquisition costs per contract and are striving for cost reduction and return improvement. We set a clear benchmark for customer acquisition costs and have been working to lower the cost per acquisition to achieve more efficient management than last year. With improved operational efficiency, customer acquisition costs have been decreasing, and we are continuously mindful of customer acquisition costs. We review customer acquisition costs per contract, recurring operating profits and future value every month. As a result of ongoing monthly improvements, we have built a structure where customer acquisition costs decrease annually while profits continue to rise.

[Question] Could you please give us some more details on the LP Gas business? The growth is truly impressive.

[Answer] The gas market in Japan is composed of approximately 50% city gas and 50% propane gas. Given the size of this market, Hikari Tsushin has entered the industry. Since this is still a new business area for us, we are currently limiting the regions and sales methods. However, we believe there is significant growth potential moving forward and we will continue to focus on this business.

[Question] Your investments reported as book value has increased by almost 110 billion Japanese yen in the last nine months. Will this trend continue considering higher interest rates?

[Answer] Rather than having a specific numerical target, our policy is to invest whenever we find undervalued opportunities, if we have excess cash available. We reinvest the operating cash flow, which serves as the source of excess cash, along with dividend incomes and interest incomes from our investments.

[Question] How much capacity in percentage of shares outstanding do you have left for your buyback program before you reach the minimum float requirement?

[Answer] We can conduct a share repurchase of up to 7% of the outstanding shares assuming cancellation, which amounts to approximately 110 billion yen at the current stock price. We will carefully consider share buybacks going forward.

[Question] What is the key message you wish to send to shareholders with the additional presentations of investment and M&A performance?

[Answer] We created this appendix to convey the message that we will focus on M&A as much as organic growth and drive business expansion through a combination of organic growth and M&A.

[Question] Could you give us some insights into your investment process, especially how you keep up to date with the many listed companies that you own?

[Answer] We check all the stocks in our portfolio. We have created a database which contains each company's financial performance and other key metrics, allowing us to assess whether each stock is undervalued.

[Question] Could you further elaborate on how the growth in customers has resulted in increased receivables and payables?

[Answer] The impact is significant in the electricity business. As the number of customers increases, the amount also rises, leading to an increase in accounts receivable. Additionally, for example when temperatures are particularly low or high, electricity usage increases, causing accounts receivable to grow rapidly.

[Question] I'm curious if we can find out more about your investment managers, their philosophy and principles and values. How many managers are there and how did they acquire their knowledge?

[Answer] We have designed our operations to be efficient with a small team, managing the investment portfolio with around 10 members. We have established clear criteria for investment decisions based on the difference between a company's intrinsic value and its market capitalization. We review disclosure materials to understand intrinsic value every quarter, and if necessary, we visit target companies for interviews to make informed investment decisions. We monitor where and what we are investing in, as well as the performance of those investments on a daily basis.

[Question] On the acquisition of the electricity retailer, can I confirm it is an electricity retail or LP gas company? Will this increase or decrease your exposure to the high voltage segment?

[Answer] The acquiree this time is an electricity retail company, not an LP gas company. Additionally, since this electricity retail business operates in the low-voltage power segment, the acquisition will not impact the exposure to the high-voltage power segment.

[Question] Is there a plan to cancel your treasury shares? If yes, please tell us the timing. If no, please tell us the reason.

[Answer] We intend to consider it as appropriate.

[Question] Has competition changed in any of your businesses?

[Answer] There are no particular changes, but we will respond appropriately while monitoring the trends of our competitors.

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