Results of Operations

During the fiscal year under review, the Japanese economy remained on a moderate recovery track, with corporate earnings remaining at a high level and personal consumption spending picking up amid continued improvement in employment and income conditions. However, at the end of the fiscal year, the economy was severely depressed by the impact of the novel coronavirus (COVID-19) pandemic. The outlook is expected to remain grim due to the effects of this infectious disease.

Against this backdrop, the Odakyu Group carried out aggressive marketing in its respective segments, but consolidated revenue from operations rose only 1.4% from the previous fiscal year, to ¥534,133 million. This reflected the impact of COVID-19 despite higher sales in the Real Estate and other segments.

In addition, due to these factors as well as higher expenses in the Transportation and other segments, operating income decreased 21.1% to ¥41,104 million, and ordinary income fell 22.9% to ¥38,300 million. Net income attributable to owners of the parent totaled ¥19,923 million, down 38.6% year on year.

Cash Flows

(1) Outline of capital expenditures

The Odakyu Group undertakes continuous capital expenditures in its railway business and each of its other businesses. These expenditures aim mainly to provide comfortable and speedy railway services and enhance the attractiveness of areas along the Odakyu lines. In addition, we take an active approach to implement the appropriate safety measures and prevent accidents. In the fiscal year ended March 31, 2020, capital expenditures, including the investment amount in intangible assets, amounted to ¥91,599 million, up 11.4% from the previous fiscal year.

Capital expenditures in the Transportation segment totaled ¥40,941 million, used primarily in railway operations. To make transportation services even more comfortable, in this segment, the Group invested ¥4,009 million to the building of new commuter trains and ¥2,031 million to the installation of platform doors to enhance passenger safety on station platforms.

In the Merchandising segment, the Group invested ¥5,498 million, primarily to open new stores and renovate existing ones. Major items included ¥1,994 million for construction of a distribution center at Shirohato Co., Ltd.

The Real Estate segment spent ¥29,548 million, mainly for the acquisition of leasing commercial facilities, construction of new buildings and refurbishment of existing ones. Major items included ¥1,862 million for the Company's Ebina Station Area Development Plan.

The Other Businesses segment was allocated ¥15,612 million, primarily for new construction and renovation of hotel facilities, such as Hotel Hakone Yutowa and HOTEL CLAD operated by ODAKYU Resorts Co., Ltd.

(2) Analysis of capital resources and liquidity

The Group's primary cash demand is for investments in facilities and equipment that are indispensable for ensuring railway use in a safe, convenient and comfortable manner, as well as for capital expenditures such as investments in development projects that enhance the value of the area along the Odakyu railway lines. As for future trends, we believe that capital expenditures will continue to account for the highest proportion of cash demand.

The Group takes a comprehensive view of the market environment and interest rate changes before selectively determining fundraising methods for capital expenditure in its railway business. These include the use of funding schemes from the Development Bank of Japan Inc. as well as the issuance of corporate bonds and borrowing from private-sector financial institutions.

To boost the efficiency of fundraising across the board, the Group has introduced a cash management system (CMS). When there is a need for funds over the short term due to cash flow fluctuations, the Group uses its internal CMS funds to the greatest extent possible and also issues commercial paper (CP).

As the Group generates daily revenue, primarily in its railway and merchandising businesses, it is possible to maintain a sufficient level of liquidity. This capital is utilized effectively within the Group by centralized management based on the CMS.

Although the outbreak of the COVID-19 pandemic has affected its cash flow, the Group has been able to secure sufficient cash liquidity on hand through the issuance of CP and corporate bonds. The Group has also established a system that enables it to quickly raise additional funds in the event of a sudden deterioration in its cash position.

Financial Position

Total assets at March 31, 2020 stood at ¥1,328,304 million, representing an increase of ¥15,870 million from a year ago. This was attributable mainly to an increase in cash and time deposits.

Liabilities rose ¥14,868 million, to ¥938,121 million, due mainly to an increase in interest-bearing debt.

Net assets, including non-controlling interests, rose ¥1,002 million from the end of the previous fiscal year, to ¥390,183 million. This reflected higher retained earnings resulting from net income attributable to owners of the parent.

Critical Accounting Policies and Estimates

The Odakyu Group's consolidated financial statements are prepared in conformity with accounting principles generally accepted in Japan. The preparation of these financial statements requires the use of estimates by management, which affects the reported amounts of assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses for the period presented. These estimates are based on rational judgments taking the historical results and circumstances into consideration. Because such estimates involve particular uncertainties, the actual results may differ. Critical accounting policies and estimates are included in the following paragraphs. Forward-looking statements contained in this section are based on the information available to the Odakyu Group at the time of submission of this report.

In addition, the impact of the COVID-19 infection on accounting estimates is described in "Impact of the Novel Coronavirus Infection on Accounting Estimates in NOTE 4 "ADDITIONAL INFORMATION."

(1) Valuation of inventories

The Odakyu Group retains a large volume of inventory and has adopted "Accounting Standard for Measurement of Inventories" (Accounting Standards Board of Japan [ASBJ] Statement No. 9, issued on September 26, 2008). The cost method (in which the book value on the balance sheet is written down to reflect the effect of lower profit margins) has been adopted for land and buildings for sale, and there is a possibility that costs will be incurred due to the write-down of the book value in the event of a decline in market prices.

(2) Impairment of securities

The Odakyu Group holds securities issued by various financial institutions and business partners. The Group records an impairment on marketable securities if their market value declines by 50% or more below their respective carrying value. For securities whose market value has declined by more than 30% but less than 50% below the carrying value, the Group considers the possibility of recovery and records the amount expected to be unrecoverable as an impairment. There is a risk that market prices of these securities could fluctuate and the Group could thus incur a loss on these securities.

(3) Impairment of fixed assets

The Odakyu Group owns numerous fixed assets. The recoverable value of these assets is calculated based on multiple assumptions such as future cash flows, the discount rate, and the residual net sale value. Therefore, changes to any of these assumptions could result in a loss on impairment of fixed assets.

(4) Deferred tax assets

The Odakyu Group recognizes a valuation allowance to reduce deferred tax assets to their highly probable realizable value. Taxable income for future fiscal years is considered in determining the appropriate valuation allowance. However, in the event that the anticipated future taxable income declines or increases due to a change in future business results, it could become necessary to revise the valuation allowance accordingly.

(5) Retirement benefit obligations and costs

Calculation of obligations and costs arising from retirement benefits is based on actuarial assumptions. These assumptions include the discount rate, long-term rate of return on pension assets, and expected salary increase rate. However, any difference between the actual results and the assumptions or a change in those assumptions could have an impact on the stated obligations and costs arising from retirement benefits.

Dividend Policy

Internal reserves have been invested in important and growing fields to further improve business performance, and dividends will be provided in a stable and continuous manner. A consolidated dividend payout ratio of 30% is targeted based on the principle of distribution of returns in accordance with consolidated operating results.

The Company intends to continue its policy of making dividend payments twice a year, at the close of the fiscal-year first half and at the fiscal year-end. The dividend during a fiscal year is stipulated in the articles of incorporation, according to which the Company can provide the interim dividend by a resolution of the Board of Directors in addition to the dividend by a resolution at the general meeting of shareholders.

Based on this policy, the Company paid a year-end dividend of ¥10.0 per share for the fiscal year ended March 31, 2020, and an interim dividend of ¥11.0, resulting in an annual payout of ¥21.0.

Basic Policy Regarding How a Person Controlling Decisions on Financial and Business Policies of the Company Should Act

The Company believes that since we, as a public corporation, allow the free purchase and sale of shares of the Company, if a specific person intends to conduct a large-scale purchase aiming at acquiring such number of shares of the Company that may affect the decisions of the Company's financial and business policies, the shareholders of the Company should make the final decision regarding whether or not to accept such a large-scale purchase.

However, this is the case, for example, with acquisitions that would obviously negatively affect corporate value and the common interests of shareholders, such as a sale or disposal of important operating assets, actions that may effectively force shareholders to sell their shares, and actions that do not provide sufficient information for shareholders to make the best choice.

The Company believes that it is necessary to secure the Company's corporate value as well as the common interest of shareholders by taking necessary and substantial countermeasures against this kind of hostile large-scale acquisition.

Business and Other Risks

A risk management structure for the entire Odakyu Group has been in place based on the Odakyu Group Risk Management Policy. Risks with potentially material impact on corporate management are referred to the Group, which in turn conducts further reviews and creates and undertakes measures to circumvent such risks. The following risks have been identified by the Group as major risk factors that could significantly impact the investment decisions of investors.

Forward-looking statements contained below are based on the information available to the Odakyu Group at the time of submission of this report. Please note that the following does not cover all the risks with potential impact on the Group.

(1) Disasters

(a) Large-scale earthquake and tsunami

In the event of a large-scale earthquake or other natural calamities causing direct damages of its premises and equipment, as well as indirect damages such as constraints to business activities due to electric power shortages and lower revenues due to a downturn in consumer confidence, the Group's business results could be adversely affected. It should be noted that a part of the geographical territory where the Group operates is located in a zone designated as an area requiring the implementation of enhanced earthquake preparatory measures with respect to the Tokai region.

As countermeasures against such risks, the Group has formulated a business continuity plan (BCP) and promoted seismic retrofitting of buildings and facilities. It has also posted guides indicating evacuation sites in the event of a disaster and guides in foreign languages at some stations, carried out drills in cooperation with administrative organs, and implemented measures such as preparing disaster stockpiles at all stations and related facilities.

(b) Natural disasters

Due to Typhoon No. 19, which occurred in October 2019, some sections of Hakone Tozan Railway remain out of service, and this has had an impact on the Group's results of operations in the Hakone area (the Group aims for recovery around the end of July 2020). In the event of large-scale natural disasters, such as localized torrential downpours and storms that cause direct damage to the Group's personnel, premises and equipment or lead to an increase in costs due to the restoration of damaged premises and equipment, as well as reduce earnings reflecting mainly business constraints such as train cancellation and a drop in consumer confidence, the Group's results of operations and financial condition could be adversely affected.

In response to these risks, the Group has implemented a variety of measures, including the implementation of a warning system based on its disaster prevention plan, strict operational regulations, reinforcement work for various structures, the installation of rain gauges and anemometers, and the use of fixed-point observation cameras to monitor dangerous areas.

(c) Outbreaks of infectious diseases

The Group has managed a large number of facilities for customers of its railway, bus and commercial institutions. If a massive infectious epidemic such as swine influenza should occur in the Group's six business areas, this could cause customers to refrain from utilizing the Group's facilities or make it impossible for the Group to carry out its operations, particularly its railway operations if there is a high incidence of employee infections. Such a situation may have an impact on the Group's results of operations and financial condition.

The Group has formulated a BCP to mitigate these risks, and is implementing measures such as stockpiling of masks and alcohol disinfectants and establishment of an information collection system.

As a result of the spread of the novel coronavirus, the railway, department store and hotel businesses have experienced a fall in the number of foreign visitors to Japan and domestic customers have refrained from going out. Some stores have faced lower sales due to temporary closures and shorter operating hours. In the event of further or prolonged infection, there is a possibility that the impact will increase, particularly in the above businesses.

(2) Accidents

(a) Occurrence of accidents

If there is a large-scale accident or a fire caused by human error, malfunctioning of equipment or an act of terrorism, these could result in human damage and disruption of the Group's operations, as well as expenses incurred to compensate for damages to victims and to reconstruct damaged buildings and facilities, and these could reduce customers' trust in the Group and impair the Group's image in society. Such a situation may have an impact on the Group's results of operations and financial condition.

As countermeasures against such risks, the Group has taken measures to prevent the occurrence of similar incidents and to strengthen its operational response capabilities against such incidents. Such measures include establishing a BCP, sharing risk cases, systematically updating and inspecting facilities, and enhancing training and education.

(b) Defects/flaws in the Group's assets and merchandise

If a defect or flaw is discovered in assets held by the Group, or if it is found that these assets have the potential to cause an adverse effect on human health or the surrounding environment, the Group may incur expenses to rectify the situation, restore conditions to their original status or compensate for damage. If a defect or flaw is discovered in a product sold by the Group, expenses incurred to rectify the situation or compensate for damage, as well as reduced trust in the Group, may adversely affect the earnings and financial condition of the Group.

In response to these risks, the Group has implemented a variety of measures, including statutory inspections of structures, sanitary inspections, labeling inspections, bacteriological inspections and external audits.

(c) Disruption of information systems

The Group relies heavily on information systems, such as computer systems and communication networks, in its operations. As such, the Group has undertaken necessary measures to ensure the steady operation of the systems and networks that are critical for its operations. However, in the event of a major disruption of its information systems due to a computer virus or other acts of third-party sabotage, a natural disaster or human error may have an adverse effect on the Group's results of operations and financial condition.

As countermeasures against such risks, the Group has implemented measures to improve network resilience, measures against unauthorized access such as firewalls, building an information security system, and sharing information on the increasing threat of cyber attacks and the latest security topics.

(3) Corporate social responsibility

(a) Compliance

The Odakyu Group defines compliance as a system of thought and initiatives to comply with rules, including laws and regulations, internal rules and social conventions and to carry out business activities with integrity, and the Group promotes such compliance. However, in the event of an act in violation of compliance that undermines social trust in the Group, the resulting sanctions based on social norms and laws and regulations may have an adverse effect on the Group's results of operations and financial condition.

To address this risk, the Group has implemented a variety of measures, including the implementation of regular compliance questionnaires, the formulation and implementation of action plans based on the results of these surveys, the development of a compliance hotline for the early detection and response of problems, and the enhancement of training programs and seminars.

(b) Management of personal information

The Group operates a credit card business and holds customer-related and other personal information in conjunction with the credit card and other operations. Although stringent control over personal information is in place, any improper disclosure of personal information for whatever reason could result in compensation claims and tarnish the Group's reputation with potential impact on its operating results.

To strengthen the personal information management system, the Group has implemented a range of measures, including the preparation of regulations and personal information management ledgers, security measures, and periodic training and support for the acquisition of qualifications.

(c) Disclosure

In the event of an inappropriate disclosure due to human error or other reasons, the resulting decline in customers' trust and the damage to the Group's image in society could adversely affect the Group's results of operations and financial condition.

The Group strives to disclose information in a timely and appropriate manner by developing and operating internal controls suited to the characteristics of each business.

(4) Business environment

(a) Securing of human resources

Many of the Odakyu Group's operations are labor intensive, and it is vital for the Group to secure capable human resources for its workforce. As such, the Group seeks to secure and nurture qualified human resources and ensure that its working environment is healthy and worker friendly. However, in the event of a failure to realize these goals, the Group's business development could be restricted, and its results of operations and financial condition could be adversely affected.

As countermeasures against such risks, the Group has implemented a variety of measures, including the creation of a recruitment website, the hiring of mid-career personnel and non-Japanese employees, the observance of the 36 Agreement, the enhancement of employee benefits, and the streamlining of operations through the systemization, mechanization and outsourcing of operations.

(b) Legal restrictions

The Group's operations are subject to various laws and ordinances, including the Railway Business Act, the Road Transportation Act, the Act on the Measures by Large-Scale Retail Stores for Preservation of Living Environment and the Construction Standards Act, and regulations including the emission standards, among others. A change in these laws, ordinances and regulations in general or changes applicable to Tokyo and Kanagawa prefectures in particular could affect the Group's results of operations and financial condition.

The Group's railway operations are governed by fare restrictions described below.

A railway business operator is required by law to obtain approval of the Minister of Land, Infrastructure, Transport and Tourism when it wishes to set forth or change the upper limits of its passenger fares (Article 16, Section 1 of the Railway Business Act).

A railway business operator may set forth or change passenger fares within such approved upper limits or add-on charges for express trains and others, provided that advance filing is made to the said Minister (Article 16, Sections 3 and 4 of the Railway Business Act).

To respond appropriately and promptly to legal revisions, the Group has implemented a range of measures, such as sharing information on regular legal revisions and enhancing training and seminars concerning legal revisions.

(c) Interest rate fluctuations

The Group undertakes continuous capital investment centered on its railway business, largely funded by debt financing and the issuance of corporate bonds. Interest rate fluctuations and changes in the Company's ratings could affect the earnings and financial condition of the Group.

By maintaining a high ratio of long-term and fixed debt to interest-bearing debt, the Group seeks to ensure that interest expenses will not increase sharply even if interest rates fluctuate significantly.

(d) Significant litigation

No significant lawsuit is pending against the Company. However, the Company may be subject to litigation and other legal measures from third parties as well as administrative investigation in the ordinary course of business. In addition to the burden of responding to these issues, if judgments and decisions that are unfavorable to the Company are made, the business results and financial condition of the Group may be adversely affected.

To avoid such risks, the Group has taken measures to reduce the risk of lawsuits and to strengthen its legal response capabilities, including the formulation and use of contract forms, the strengthening of partnerships with corporate lawyers, and the enhancement of legal education.