

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended March 31, 2014 and 2015

## Results of Operations

During the fiscal year ended March 31, 2015, the Japanese economy continued to experience a gradual recovery with signs of improvement in corporate earnings, employment and private income. This occurred despite the lack of a full-fledged recovery in personal consumption reflecting a backlash from the rush demand ahead of the consumption tax hike.

In this operating environment, despite aggressive sales activities carried out in the Group's respective segments, consolidated revenue from operations fell ¥4,472 million (or 0.9%) year-on-year to ¥518,715 million. The result was attributable mainly to a decrease in operating revenue in the Transportation segment, the Merchandising segment, and the Real Estate segment, where the amount of housing sold decreased. However, operating income grew ¥481 million (or 1.0%) to ¥49,858 million reflecting mainly lower expenses in the Transportation segment, and ordinary income rose ¥2,036 million (or 4.8%) to ¥44,098 million due mainly to a decrease in interest expenses. Net income totaled ¥30,147 million, up ¥5,098 million (or 20.4%), due to the absence in this fiscal year of the loss on sale of property and equipment that was recorded in the previous fiscal year.

## Cash Flows

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. We also take an active approach to implement appropriate safety measures to prevent accidents. In the fiscal year ended March 31, 2015, capital expenditures including the investment amount in intangible assets amounted to ¥54,612 million, up 16.4% from the previous fiscal year.

Capital expenditures in the Transportation segment totaled ¥31,130 million, which was used primarily for railway operations. To further enhance the safety of train operation, we invested ¥4,533 million, primarily for construction to introduce the new train control system D-ATS-P. We also launched the construction of multiple double tracks between Higashi-Kitazawa and Izumi-Tamagawa stations to maximize the effects of the augmented passenger-carrying capacity. The project was allocated ¥3,991 million, including ¥3,390 million for a Japan Railway Construction, Transport and Technology Agency project.

In the Merchandising segment, the Group invested ¥6,731 million, primarily to renovate existing stores and construct new locations. Major project is the renovation of underground grocery stores (¥4,094 million) at the Machida store of Odakyu Department Store Co., Ltd.

The Real Estate segment spent ¥12,375 million, mainly for the construction of new buildings for lease and refurbishing of existing ones. Major project is the Company's construction of a compound rental complex (¥2,892 million) at Ebina Station.

The Other Businesses segment was allocated ¥4,376 million, primarily for the renovation of the guest rooms and others (¥602 million) at the Odakyu Hotel De Yama operated by Odakyu Resort Co., Ltd.

The Group takes a comprehensive view of the market environment and interest rate changes before selectively determining fundraising methods for capital investment 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. For the construction of multiple double tracks currently in progress, the Company utilizes public subsidy programs, such as the Special Reserve for the Expansion of Railway Transport Facilities and the Private Railway Method from the Japan Railway Construction, Transport and Technology Agency.

To boost the efficiency of fundraising across the board, the Group has introduced a cash management system (CMS). When funds are needed 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.

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 thanks to centralized management based on the CMS.

## Financial Position

Total assets at March 31, 2015 stood at ¥1,253,849 million, representing an increase of ¥9,504 million from a year ago. This was attributable mainly to a rise in investment securities reflecting the appreciation in fair value of shares held. Liabilities fell ¥31,132 million, to ¥945,639 million, due mainly to the redemption of corporate bonds.

Net assets including minority interests rose ¥40,636 million from the end of the previous fiscal year, to ¥308,210 million due to growth in retained earnings as a result of posting net income.

## Critical Accounting Policies and Estimates

The Odakyu Group's consolidated financial statements are prepared in conformity with accounting practices 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 determinations made by the Group at the date of this report.

### (I) 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). Additionally, the Company records land acquired for the construction of multiple double tracks as fixed assets. If it is determined that this land can be used for subdivided housing after completion of the multiple double tracks, the land is reclassified as inventory and the valuation is determined in the same manner as explained above.

## (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, retirement ratio, mortality rate, and long-term rate of return on pension plan assets. 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.

## Takeover Defense Measures

The Company has adopted a policy regarding mass purchases of the Company's shares (a takeover defense plan), based on the belief that the party which controls the Company's financial and business policy decisions must be one that has a thorough understanding of the Company's financial and business conditions and undertakings as well as the sources of its corporate value as well as an ability to safeguard and enhance the corporate value and common interests of shareholders on a continuing and sustainable basis.

For more details on the plan, please read the press release issued on May 20, 2015 titled "Continuation of Takeover Defense Policy Regarding Mass Purchases of Company Shares (Takeover Defense Plan)," available at <http://www.odakyu.jp/ir/index.html> (in Japanese only).

## 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, targeting a consolidated dividend payout ratio of 30% based on the principle of distribution of returns in accordance with consolidated operating results.

The Company intends to continue its policy of making two dividend payments each year, at the end of the first half of the fiscal year and at the end of the fiscal year. The dividend from the capital surplus for shareholders 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 resolution at the general meeting of shareholders.

Based on this policy, the Company paid a year-end dividend of ¥4.5 per share for the year ended March 31, 2015, and an interim dividend of ¥4.0, resulting in an annual payout of ¥8.5.

## 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.

### (I) Disasters

#### (a) Large-Scale Earthquake and Tsunami

The Odakyu Group's businesses are concentrated in Tokyo and Kanagawa prefectures primarily along the Odakyu lines. 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 shortage 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 the zone designated as an area requiring the implementation of enhanced earthquake preparatory measures with respect to the Tokai region.

#### (b) Natural Disasters

The Odakyu Group has implemented a range of measures to anticipate potential natural disasters, such as torrential rains and windstorms. However, in the event of a large-scale natural disaster that causes direct damage to the Group's personnel, premises and equipment or leads to an increase in costs due to the restoration of damaged premises and equipment, as well as reduces the earnings reflecting mainly a drop in consumer confidence due to the probability of the occurrence, the Group's results of operations and financial conditions could be adversely affected.

#### (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 disease epidemic such as swine influenza should occur in the Group's business area, it would be feared that this causes customers to refrain from utilizing its facilities, or even result in its operations being unable to continue, particularly its railway operations. Such a

situation may have an impact on the Group's results of operations and financial conditions.

## **(2) Accidents**

### **(a) Occurrence of Accidents**

The Odakyu Group has put in place a number of measures to ensure the safety of its transport services and food items, and to prevent fire in its buildings and other facilities. However, in the event of 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 conditions.

### **(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 financial conditions.

### **(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 a human error may have an adverse effect on the financial conditions.

## **(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 social sanctions may have an adverse effect on the Group's results of operations and financial conditions.

### **(b) Management of Personal Information**

The Group operates 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 its reputation with potential impact on the Group's operating results.

### **(c) Disclosure**

The Odakyu Group has undertaken appropriate disclosure on a timely basis by bolstering and conducting internal control in accordance with the characteristics of its respective operations. However, in the event of an inappropriate disclosure due to human errors 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 conditions.

## **(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 a healthy and worker-friendly one. However, in the event of a failure to realize these goals, the Group's results of operations and financial conditions could be adversely affected.

### **(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 conditions.

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).

### **(c) Interest Rate Fluctuations**

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

### **(d) Significant Litigation**

No significant lawsuit is pending against the Company. An administrative lawsuit is pending in connection with the Company's multiple double tracks project. It is an administrative lawsuit with the Kanto Regional Development Bureau Chief as the defendant, in which the annulment of the approval given to the urban planning project for the segment between Yoyogi-Uehara and Umegaoka stations is sought.