Financial Review: Management's Discussion and Analysis

The forward-looking statements in this section are based on the Group's assumptions as of the end of the current consolidated fiscal year.

(1) Significant accounting policies and estimates

The consolidated financial statements of the Group have been prepared in conformity with accounting principles generally accepted in Japan ("Japanese GAAP"). Prior to the presentation of these consolidated financial statements, the Company used its most relevant accounting principles in accordance with the Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance No. 28 of 1976). The statements of estimates have been prepared in view of past results and reasonable assumptions, however, they involve uncertainties and actual results may differ from the estimates presented.

(2) Analysis of the Group's financial position

Current assets

Current assets as of March 31, 2016 were ¥55,330 million, up ¥3,782 million from the end of the previous fiscal year. This change mainly comprised an increase of ¥9,822 million in cash and deposits, a decrease of ¥984 million in trade notes and accounts receivable, a decrease of ¥2,068 million in inventories, and a decrease of ¥2,268 in other receivables.

Non-current assets

Non-current assets as of March 31, 2016 were ¥54,275 million, down ¥17,141 million from the end of the previous fiscal year. Major factors for this decrease were a ¥14,180 million decrease in property, plant and equipment, a ¥1,941 million decrease in investment securities and a ¥985 million decrease in deferred tax assets.

Current liabilities

Current liabilities as of March 31, 2016 were ¥41,990 million, down ¥5,129 million from the end of the previous fiscal year. This change mainly consisted of a ¥1,008 million decrease in trade notes and accounts payable, a ¥646 million decrease in short-term borrowings, and a ¥2,354 million decrease in the current portion of long-term borrowings.

Non-current liabilities

Non-current liabilities as of March 31, 2016 were ¥38,851 million, up ¥1,629 million from the end of the previous fiscal year. The major factor in this increase was ¥1,597 million in lease obligations.

Net assets

Net assets as of March 31, 2016 were ¥28,764 million, down ¥9,859 million from the end of the previous fiscal year. Major factors for this decrease were a ¥4,935 million increase in capital surplus due to the issue of class A preference shares through a third-party allotment, an ¥11,712 million decrease in retained earnings and a ¥2,978 million decrease in foreign currency translation adjustments.

(3) Analysis of business results

1) Net sales

The Group's business performance during the fiscal year under review was boosted by robust sales of PCBs (printed circuit boards) for automotive products on the back of globally strong demand for automobiles, and by favorable sales of PCBs for smartphones to Chinese manufacturers, mainly through orders from existing customers. As a result, net sales were ¥95,287 million, up ¥4,392 million, or 4.8%, from the previous fiscal year.

2) Cost of sales and selling, general and administrative expenses

Cost of sales decreased ¥962 million, or 1.2%, from the previous fiscal year to ¥82,101 million, reflecting a rise in productivity due to an improvement in product yield, as well as efforts in structural reforms such as a reduction in fixed costs. As a result, gross profit increased ¥5,354 million, or 68.4%, from the previous fiscal year to ¥13,186 million. The gross margin increased 5.2 percentage points, from the previous fiscal year to 13.8%.

Selling, general and administrative expenses decreased ¥837 million, or 7.8%, from the previous fiscal year to ¥9,861 million, primarily due to a decrease in personal expenses and packing and freight expenses.

3) Operating income

Operating income increased ¥6,191 million to ¥3,325 million from an operating loss of ¥2,866 million in the previous fiscal year, owing to an increase in net sales and the fruits of structural reforms for the improvement of the revenue structure. Operating margin was 3.5% compared with −3.2% for the previous fiscal year.

4) Non-operating income and non-operating expenses

Non-operating income decreased ¥5,047 million from the previous fiscal year to ¥301 million, primarily due to foreign exchange gains in the previous fiscal year turning into foreign exchange losses.

Non-operating expenses increased ¥2,711 million from the previous fiscal year to ¥4,118 million, mainly due to the recording of foreign exchange losses.

5) Ordinary loss

Ordinary loss was ¥492 million, compared with an ordinary income of ¥1,075 million in the previous fiscal year, due primarily to the increase in non-operating expenses, despite the recording of an operating income.

6) Extraordinary income (loss)

Extraordinary income decreased ¥228 million from the previous fiscal year to ¥33 million. This primarily reflected the recording of gain on sales of non-current assets of ¥12 million and compensation income of ¥13 million from Tokyo Electric Power Company (currently Tokyo Electric Power Company Holdings, Incorporated), for the fiscal year under review.

Extraordinary loss decreased ¥622 million from the previous fiscal year to ¥9,074 million. This mainly reflected the recording of a net loss on sales and disposal of property, plant and equipment of ¥388 million, and an impairment loss of ¥7,978 million for the fiscal year under review.

7) Loss attributable to owners of parent

The total amount of income taxes–current and income taxes–deferred increased ¥505 million from the previous fiscal year to ¥1,718 million.

As a result of the above, the loss attributable to owners of parent was ¥11,250 million, compared with a loss attributable to owners of parent of ¥9,573 million for the previous fiscal year.

(4) Analysis of source of funds and liquidity

1) Cash flows

Cash and cash equivalents (hereafter, “net cash”) as of March 31, 2016 increased ¥9,822 million from the previous fiscal year, to ¥19,313 million.

Of the above amount, net cash that increased due to the inclusion of Meiko Electronics Thang Long Co., Ltd., previously a non-consolidated subsidiary, into the scope of consolidation was ¥364 million.

Cash flows of each category and their causes during the consolidated fiscal year ended March 31, 2016 were as follows.

Net cash provided by operating activities for the fiscal year under review was ¥9,932 million, up ¥7,694 million from the previous fiscal year.

Increases were mainly from depreciation and amortization of ¥6,471 million, an impairment loss of ¥7,978 million, foreign exchange losses of ¥2,141 million, and proceeds from insurance income of ¥1,764 million. The major decreases comprised a loss before income taxes and minority interests of ¥9,533 million.

Net cash used in investing activities was ¥1,737 million, down ¥5,249 million from the previous fiscal year. The major outflow was ¥2,395 million for the purchase of property, plant and equipment. The major inflow comprised proceeds from liquidation of subsidiaries and associates of ¥524 million.

Net cash provided by financing activities was ¥1,967 million, down ¥2,894 million from the previous fiscal year. The major inflows comprised proceeds from long-term borrowings of ¥12,627 million and proceeds from issuance of common stock of ¥4,812 million. The major outflows comprised payments for long-term borrowings of ¥14,328 million, repayments of lease obligations of ¥695 million and payments for installment liabilities of ¥559 million.

Trends in cash flow indicators of the Group are as follows:

	Year ended March 31, 2014	Year ended March 31, 2015	Year ended March 31, 2016
Equity ratio *(%)*	38.7	31.4	26.0
Market value equity ratio *(%)*	14.7	7.9	8.2
Cash flows versus Interest-bearing debt ratio	21.2	27.5	6.1
Interest coverage ratio *(times)*	2.5	2.1	7.8

Equity ratio = Equity capital / Total assets
Market value equity ratio = Stock market capitalization / Total assets
Cash flow versus interest-bearing debt ratio = Interest-bearing debt / Operating cash flow
Interest coverage ratio = Operating cash flow / Interest payment

Notes:
1. Each indicator is calculated based on consolidated financial values.
2. The stock market capitalization is calculated as follows: term-end closing stock price x term-end number of shares issued (after deducting shares of treasury stock). Common stocks are subject to the calculation.
3. The operating cash flow represents the cash flow provided by (used in) operating activities as indicated in the consolidated statements of cash flows. Of the liabilities posted on the consolidated balance sheets, the interest-bearing debt covers all the liabilities for which interest was paid. The interest payment represents the payment of interest indicated in the consolidated statements of cash flows.

2) Financial policy

The Group procures funds for its operations from internal reserves or borrowings. The Group has a policy of procuring funds for investment and loans and funds to acquire manufacturing equipment inside and outside Japan via long-term borrowings. With regard to procuring such funds and the conditions of procurement, the Group strives to select the most favorable timing and conditions.

Business Risks

Below are some of the major risks from among those described in the securities report (provided/filed in Japanese only) which may significantly affect any decisions made by investors.

Forward-looking statements are based on the Group's best judgment during the consolidated fiscal year under review.

(1) The Group's major customers' business performance

The Group's major customers are manufacturers of automobile electronic control equipment, communications equipment and devices, digital household appliances, and personal computers, among others. The Group's major business is the manufacture and sale of PCBs, which are parts that constitute a core function of finished products. Should a natural disaster or global economic turmoil occur and thus adversely impact the markets of the industries in which the Group's major customers operate, or lead to sluggish sales of their finished products, such factors could impact the volume of orders received by the Group and affect the Group's business performance.

(2) Risks related to the timing of capital investments

The Group conducts appropriate capital investment to enhance productivity and maintain product competitiveness. Although overseas and domestic capital investments are carefully determined considering brand manufacturers' business performance and market trends, should manufacturers change strategies or the Group's capital investments become excessive upon a downturn in the economy, or the operation of new facilities be delayed, factors such as the burden of depreciation costs could adversely affect the Group's business results and financial position.

(3) Possibility of product defects

PCBs are mounted with electronic components and then embedded in finished products by brand manufacturers. The Group manufactures PCBs in compliance with globally accepted quality control standards. In addition, brand manufacturers conduct inspections upon receipt of the finished product checking for product defects. However, should a large-scale recall or a product liability claim occur, such an incident would incur significant costs and harm the value of our corporate brand, which could adversely affect the Group's performance.

(4) Technological development and price competition

Although the Group expects long-term expansion of demand for PCBs due to the worldwide spread of digital household appliances and the further advancement of electronic automobile components, to address intensifying global competition stemming from downward pressure on prices from Southeast Asia, Japanese manufacturers need to differentiate their products by adding more value. To this end, the Group is developing technologies such as element technologies to make wires thinner and hole diameters smaller, as well as cost-reduction technologies. However, should such technologies diverge from market needs and not be accepted, the Group may get embroiled in a price war, which could affect its business performance.

(5) Impact of disasters

The Group's major manufacturing bases are the Fukushima Factory, the Yamagata Factory (Yamagata Meiko Electronics Co., Ltd.) and the Ishinomaki Branch Factory (Yamagata Meiko Electronics Co., Ltd.), which are all located in the Tohoku region. The Group endeavors to prevent damage from natural disasters by securing the safety of its employees and protecting facilities against earthquakes and tsunami. However, the Great East Japan Earthquake and subsequent tsunami, which were beyond our capability to predict, seriously affected the Group's business performance. Should a disaster of that scale occur in the future, it could adversely affect the Company's business performance again, despite the fact that we reviewed our risk management system following the disaster.

In addition, although the Group conducts regular inspections and maintenance works on its production equipment in manufacturing bases inside and outside Japan and strives to minimize the occurrence of fire, equipment failures, accidents, etc. which may result in the suspension of line operations, there is no guarantee that these will be prevented or reduced completely.

Should production and shipping be suspended for a long period of time due to these factors, the Group's business performance and financial position could be adversely affected.

(6) Potential risks inherent in plant operations in China and Vietnam

To expand productivity and reduce production costs, the Group has established local corporations in Hong Kong, Guangzhou and Wuhan in China, and in Vietnam, conducting manufacturing and sales activities.

The following difficulties might occur in these countries:

1: Hygiene-related issues such as infectious diseases
2: Change or introduction of environmental regulations, legal restrictions and the tax system
3: Failure of infrastructure such as electricity, water and transportation
4: Political uncertainty and public security-related issues
5: Anti-Japanese demonstrations and/or labor disputes

Should unexpected events such as changes in the political or legal environment, economic situation or environmental regulations occur, the Group's business performance and financial position could be adversely affected as a result of the issues which might arise in the management of production facilities and equipment and in the execution of other operations, or a large amount of liabilities or obligations associated with the compliance of environmental conservation and other regulations.

(7) Foreign currency exchange rate fluctuation risk

To operate plants in China and Vietnam, we need to hold U.S. dollars and other foreign currency-denominated assets. Therefore, the Group is exposed to yen-to-yuan and yen-to-U.S. dollar exchange rate fluctuations. These fluctuations could result in losses.

(8) Raw materials market fluctuation risk

The Group purchases the raw materials necessary for manufacturing from external materials manufacturers and trading companies. The surge in prices of crude oil, copper, gold, etc., could influence the prices of the raw materials the Group purchases and adversely affect the Group's business performance and financial position.

(9) Financial risks

The Group has made aggressive capital investments of amounts higher than the funds it has acquired from operating activities to prepare for the anticipated medium- and long-term increase in demand for digital household appliances and automobiles, as well as responses to new products in line with technological innovation.

As a result, the ratio of borrowings to total assets as of March 31, 2016, was 51.7%. Should we make further aggressive capital investments to fulfill our business strategies, an increase in borrowings and/or interest rates could affect the Group's business performance and financial position.

(10) Intellectual property rights

The Group recognizes intellectual properties as its significant management resources and seeks to acquire intellectual property rights by applying for patents, etc. for proprietary technologies, etc. developed by the Group with the aim of protecting intellectual properties. However, not all applications may be approved and it is also possible that obtained rights may be rendered void due to objections by third parties.

Although the Company's external relations and affairs department manages obtained intellectual properties and pays attention to violation of rights by external parties, anticipated profits could be lost in the event of illegal use, etc.

Meanwhile, should a lawsuit be filed against the Group with regard to a violation of intellectual property rights of third parties, the Group's business performance and financial position could be adversely affected as a result of the compensation or damages paid to customers due to the suspension of production and payment of license fees, etc., related to patent use in order to resume production.

(11) Risks associated with production activities

The Group may continue to build new plants or establish new production lines in order to expand its production capacity in the future in accordance with demand of major customers around the world. However, should such construction works be delayed or new production lines not launched smoothly, it could result in a delay in delivery of products to customers or a decline in plant productivity, and the subsequent drop in sales might adversely affect the Group's business performance.