COMPANY RESEARCH AND ANALYSIS REPORT

Samty Co., Ltd.

3244

Tokyo Stock Exchange First Section

24-Sept.-2019

FISCO Ltd. Analyst

Ikuo Shibata

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

Results are currently steadily increasing due to the growth of the hotels business, etc.
Concluded a capital and business alliance agreement with the Daiwa Securities Group

1. Company profile

Samty Co., Ltd. <3244> (hereafter, also "the Company") is a comprehensive real estate company that operates a nationwide business, centered on the Kansai region and Tokyo metropolitan area. Its business is based on the twin axes of its Real Estate Business (including development and sales of large-scale leasing condominiums for real estate funds and hotels) and Property Leasing Business (including leasing condominiums), while it also manages hotel business and other related operations. A feature of the Company is that it is able to respond flexibly to changes to its business environment from its balance of realizing stable income from its Property Leasing Business and accelerating growth from its Real Estate Business, and it achieved sustainable growth even while overcoming major financial crises. It also has a superior business model in which it combines both businesses to handle every aspect of the property business, and presently it is continuing to achieve high growth. In June 2015, it entered into the J-REIT business*. The Company has solidified the foundations of its business model for further business expansion.

* Samty Residential Investment Corporation <3459> (hereafter, "SRR"), which was established in March 2015, is listed on the TSE J-REIT market.

From this fiscal period, the Company is progressing the new medium-term management plan, the Samty Toughening Plan (three years), based on a new management regime. In May 2019, it concluded a capital and business alliance agreement with Daiwa Securities Group Inc. Through this alliance, it is aiming to make a leap forward to a new stage by incorporating the creditworthiness of the Daiwa Securities Group.

2. Business result for FY11/19 1H

In the FY11/19 1H results, both sales and profits increased for new record highs (on a 1H basis), with net sales rising 3.3% year-on-year (YoY) to ¥47,827mn and operating income growing 53.0% to ¥13,941mn. Results steadily grew in the Real Estate Business, benefiting from the favorable real estate market. In particular, sales were strong for the S-RESIDENCE series, for which investment demand, including from overseas funds, continues to be strong, particularly in Tokyo metropolitan area, as well as sales of properties developed in-house, such as hotels, which the Company has been focusing on recently. Results in Other Businesses also grew significantly due to the increase in sales as new hotels opened for business. Profits increased significantly as well, because of the higher sales prices and sales of developed properties with high profit margins. Steady progress was also made for the purchasing conditions (and the development pipeline), which will lead to growth in the future.

3. FY11/19 forecast

For the FY11/19 results, the Company has upwardly revised the forecasts for each profit item, based on factors including the progress made up to the 1H. After the revisions, it is forecasting that net sales will increase 2.0% YoY to ¥86,000mn and operating income will rise 14.0% to ¥16,000mn (extent of the revision, +¥1,000mn). Net sales in both the Real Estate Business and the Property Leasing Business will be basically unchanged YoY, but in Other Businesses, the increase in sales from the growth of the hotels business is expected to contribute. In particular, the reason the Company upwardly revised the profits forecasts is the sale in the 1H of properties with high profits margins, such as hotels developed in-house. At FISCO, we think that it is fully capable of achieving its forecasts when considering the 1H results, the favorable external environment (the real estate market) and internal factors (including the pipeline conditions and the steady launch of the hotels business).

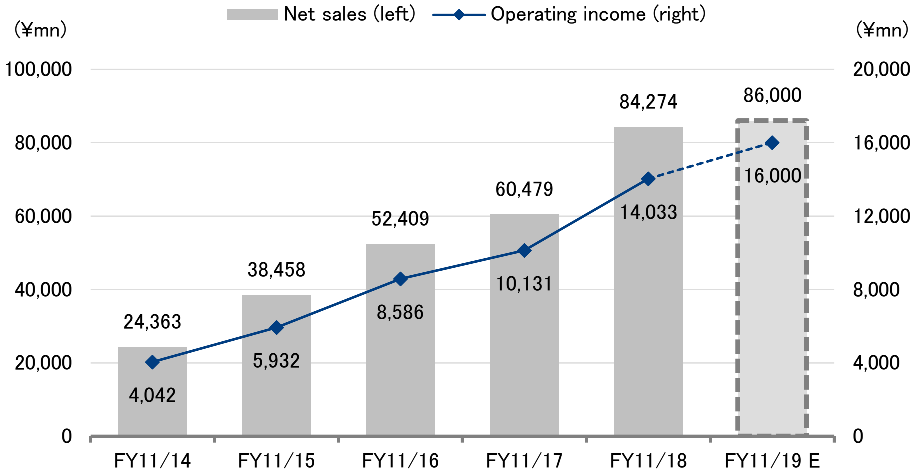
4. Growth strategy

Since the Company already achieved its medium-term management plan covering the five-year period from FY11/16 through FY11/20, two years ahead of schedule, it has been progressing a new medium-term management plan, the Samty Toughening Plan, which will run through FY11/21. There have been no major changes to the overall direction of the plan, as the key priority measures include: 1) Developing a business model centered on SRR (strengthening the fee income business); 2) Strategically investing in regional metropolitan areas (expanding business area); and 3) Expanding the hotel development and office building development businesses. One key aspect of the new medium-term management plan is to place more of a focus on managing the balance sheet in order to prepare for a future correction phase. As a part of this, the Company is putting maximum emphasis on strengthening its financial base, centered on rental cash flow. The Company will aim for operating income around the ¥20.0bn level, ROE around the 15.0% level, and ROA around the 7.0% level, while maintaining an equity ratio of at least 30%. We shall pay attention to the results of this capital and business alliance with Daiwa Securities Group Inc.

Key Points

- In FY11/19 1H, sales and profits increased and steady progress was made toward achieving the full fiscal year forecasts.
- Upwardly revised the FY11/19 full fiscal year forecasts (for profits only). Expects the increases in sales and profits to continue.
- In May 2019, concluded a capital and business alliance agreement with Daiwa Securities Group Inc.
- Started the new medium-term management plan from this period. By placing more of an emphasis on balance sheet management, the Company aims to grow profits by boosting productivity and capital efficiency while maintaining an equity ratio of 30% or higher.

Results trends



Source: Prepared by FISCO from the Company's financial results

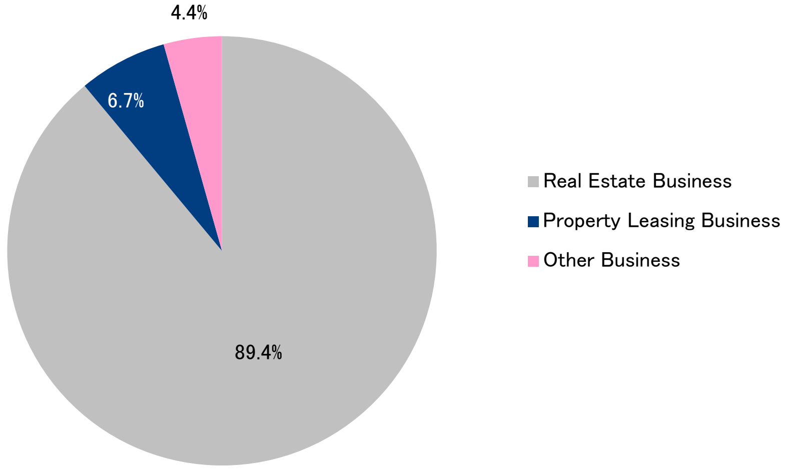
Company profile

Balanced business portfolio based on Real Estate Business and Property Leasing Business Entered J-REIT market in 2015 Focusing on hotel business

1. Business overview

The Company has three business segments: The Real Estate Business, the Property Leasing Business, and the Other Business. The Real Estate Business trended favorably contributing 89.4% of net sales (before adjustment) in the FY11/19 1H results. However, it is necessary to be aware that in contrast to the steady growth of the Property Leasing Business, results in the Real Estate Business tend to increase and decrease greatly due to various factors, including the business environment. Since its foundation, the Company's strength has been its leasing capabilities in its area of expertise of residential properties (condominiums, etc.), that can be expected to stably maintain high occupancy rates. Recently, the Company has been focusing its efforts on the hotel business, which is expected to have a high occupancy rate.

Percentages of net sales by business in FY11/19 1H (before adjustment)



Source: Prepared by FISCO form the Company's financial results

Also, in March 2015 it established SRR, which was listed on the TSE J-REIT market in June of the same year. The Samty Group plays the role of sponsor of SRR (supplying it with properties) and is responsible for the subsequent asset management and other operations. SRR's current asset scale is approximately ¥90.8bn.

For its sales bases, in addition to its Osaka Head Office (Yodogawa-ku), it has branch offices in Tokyo (Chiyoda-ku), Fukuoka (Hakata-ku), Sapporo (Chuo-ku) and Nagoya (Nakamura-ku), and it is establishing a nationwide system centered on the major regional cities.

* The Company has seven branch office locations in total, including the Shinjuku and Yokohama Business Offices opened in April 2019. It also plans to open the Hiroshima Branch Office in December 2019.

The Samty Group is comprised of the Company and 15 consolidated subsidiaries, including 10 special purpose companies (SPC) and general incorporated associations established and receiving investment in the processes of carrying out for the Real Estate Business and Property Leasing Business in relation to schemes to acquire, own, and develop land, properties, and trust beneficiary rights. The main consolidated subsidiaries include Samty Asset Management Co., Ltd. (asset management, etc.), Suntoa Co., Ltd. (hotel management, etc.), and Samty Property Management Co., Ltd. (property management, etc.).

Overviews of each business are as follows.

(1) Real Estate Business

This business supports the Company's growth and is divided into four sub-segments: "development securitization," "renovation securitization," "investment unit sales in lots," and "asset management."

"Development securitization" refers to the planning, development, and sales of leasing condominiums for real estate funds (including of the S-RESIDENCE series, the brand developed in-house). Basically, the properties are large-scale, studio-type condominiums with a total number of around 200 units, and include features such as stairwell entrances and luxurious designs. Recently, demand has been considerable from real estate funds and other clients regardless of building size, so sales of medium-sized properties have also increased. The Company has granted SRR preferential transaction negotiating rights (first refusal rights) for the S-RESIDENCE series and mainly supplies properties to SRR. It has also been working on planning, development and sales of hotels and office buildings as a new focus field.

S-RESIDENCE series

Source: The Company's website and materials supplied by the Company

"Renovation securitization" refers to the revitalization and sales of existing income properties. The Company aims to improve occupancy rates by utilizing its leasing capabilities and expertise for the income properties and upgrading properties through renovating facilities, which generates earnings over the period of ownership. In addition, its final objective is to record gains on sales through selling its holdings and investment properties to real estate funds, business companies, and wealthy individuals. It also carries out warehousing* for SRR. During the ownership period, leasing income is recorded in the Property Leasing Business.

* Properties acquired to incorporate into REIT

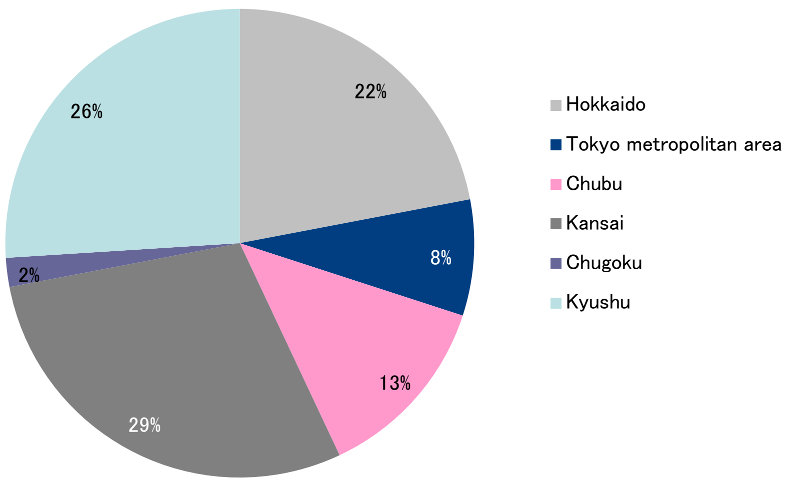
"Investment unit sales in lots" involves the planning, development, and sales of studio-type condominiums for investment, mainly to individual investors. A feature of the Company is that it does not have an in-house sales team, and it conducts wholesales (selling units or entire buildings) to sales companies. Through building a network with sales companies that have a sales track record in the business area and consulting with sales companies at the planning and development stages, it is able to supply properties that meet client (user) needs. Also, excluding the Tokyo metropolitan area, which has an active trend of purchasing before the condominium is ready by sales companies due to their sense of the scarcity of properties, the Company's excellent leasing expertise (wholesale sales after leasing a property) differentiate it from its competitors and results in it being trusted by and having negotiating power with the sales companies.

The objectives of "asset management" are obtaining commission income, from the Company being commissioned (outsourced) to operate and manage real estate as the asset manager by real estate funds, and also dividend income from the Company's own investments in real estate funds. Through the smooth launch of SRR, it would seem that the asset management business will also expand in the future, alongside the expansion in the asset scale of SRR. The revenue structure in this business comprises management commissions (0.45% of the balance of assets under management), acquisition commissions (1.0% of the property acquisition value), sales commissions (0.5% of the property sales value) and other components. Notably, management commissions can be expected to provide a source of steady revenue every fiscal year based on the balance of assets under management.

(2) Property Leasing Business

This business is the foundation that ensures stability, and the segment profit margins are also maintaining high levels. It owns around 72 properties nationwide (non-current assets only), centered on the Kansai region, Tokyo metropolitan area and government ordinance designated cities such as Fukuoka, Sapporo, and Nagoya. In addition, it conducts diversified investment in a variety of assets, including condominiums, office buildings, and commercial facilities. The Company utilizes its leasing expertise to realize high occupancy rates above 90% when averaged over the year. While the scale of the real estate it owns amounts to around ¥91.8bn (book value), this is divided into ¥35.8bn of inventory assets that it intends to eventually sell (real estate for sale), and ¥56bn of non-current assets that it intends to continue to own (all results are as of the end of May 2019).

Distribution of properties owned by area (based on total floor space)



Source: Prepared by FISCO from the Company's results briefing materials

(3) Other Business

This business mainly involves the ownership and management of hotels, the condominium management business, and the construction and renovation business. The hotels business operates and manages 11 hotels nationwide, including 4 hotels developed in-house. Other than conducting the hotel business, the subsidiary Samty Property Management also conducts condominium management (including external properties, mainly the Company's condominiums), construction and renovation, and other work. Important strategies going forward will be to grow the hotel development business (secure rental income) and handle hotel management operations in-house (strengthen the fee income business).

Hotels in which the Company participates

Hotel name	Location	No. of rooms
Center Hotel Tokyo	Chuo-ku, Tokyo	108
Amano Hashidate Hotel	Miyazu-shi, Kyoto	86
GOZAN	Higashiyama-ku, Kyoto	21
S-PERIA HOTEL Nagasaki	Nagasaki-shi, Nagasaki Prefecture	155
Hotel Sunshine Utsunomiya	Utsunomiya-shi, Tochigi	160
SMART HOTEL kutchan	Abuta-gun, Hokkaido	67
S-PERIA HOTEL Hakata	Hakata-ku, Fukuoka-shi	287
S-PERIA INN Nihombashihakozaki	Chuo-ku, Tokyo	114
S-PERIA INN Osaka Hommachi	Nishi-ku, Osaka	125
S-PERIA HOTEL Kyoto	Shimogyo-ku, Kyoto	165
NEST HOTEL Hiroshima Hatchobori	Naka-ku, Hiroshima-shi	126
Total		1,414

Source: Prepared by FISCO from the Company's financial results briefing materials

2. Features

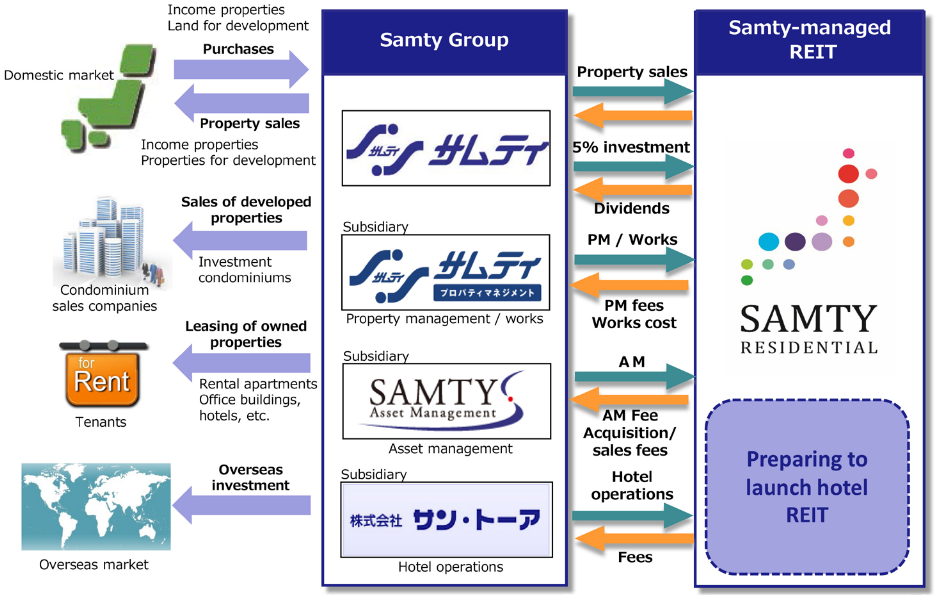
A feature of the Company is that it handles all aspect of the property business with its business model combining two businesses, the Real Estate Business and the Property Leasing Business. This forms its strength in terms of the superiority of its business and revenue structure.

(1) A superior business model

A feature of the Company's business model is that every phase of the property business, of land purchases, development, leasing, sales, and after-sales, are conducted within the Group, and by connecting these respective functions, it creates value (a value chain) that is unique to the Company. In particular, it utilizes its sophisticated leasing expertise, which it has cultivated in the Property Leasing Business, in the Real Estate Business. In addition to improving the value of income properties, this has positive effects for the superiority of its bargaining power when purchasing land, as well as for establishing relationships based on trust and negotiating with buyers.

The Company also has a competitive advantage for its business model, centered on SRR. SRR will become a stable supply destination, and in addition, the expansion of the after-sales fee business (commissioned asset management operations and contract property management operations) can be expected to become a stable source of revenue in the future.

Business model overview



Source: The Company's results briefing materials

(2) The profit structure as a strength

One of the Company's strengths is that it can respond flexibly to changes to its business environment while maintaining a balance between stable income from its Property Leasing Business (a stock-type business) and growth acceleration from its Real Estate Business (a flow-type business). In other words, during a period of economic recession, its results can be supported by its Property Leasing Business, and then during a period of economic expansion (recovery), it can accelerate its growth through its Real Estate Business. In addition, its ability to withstand periods of recession is strengthened by the fact that it keeps down fixed costs by not having an in-house sales team and instead utilizing external resources (it has networks and expertise to do so). The reasons why in the financial crises up to the present time (such as following the collapse of the bubble economy and from the impact of the 2008 financial crisis), its results deteriorated comparatively little, is due to the fact that they were supported by its Property Leasing Business and the fact that it kept its fixed costs down. On the other hand, in the current situation of a continuingly favorable business environment, the Real Estate Business is the main driving force behind the growth in the Company's results.

3. History

The Company was established in December 1982 in Higashiyodogawa-ku, Osaka, as Samty Development Co., Ltd. (it changed to its current company name in June 2005). Centered on three people, Mr. Shigeru Moriyama (current chairman), Mr. Ichiro Matsushita, and Mr. Kiyoharu Taniguchi, it launched a real estate sales, leasing, and management business. It initially started from consignment sales of condominiums, but subsequently it steadily accumulated results in areas such as sales of entire condominium buildings for investment and sales of units in condominium buildings for families.

After launching sales in May 2001 of its Samty series of studio-type condominiums for investment, in March 2005 it launched sales of its S-RESIDENCE series of leasing properties for real estate funds, which spurred on its business expansion. In August 2006, it entered into the hotels business by acquiring the shares of Suntoa, which owns and manages business hotels. In July 2007, it was listed on the Osaka Hercules market (now the TSE JASDAQ market).

Next, in order to further expand its business and disperse it over different regions, it opened branch offices in Tokyo in February 2011, in Fukuoka in June 2012, in Sapporo in May 2015, and in Nagoya in March 2016, and over this 5-year period it steadily expanded the regions in which it does business.

The Company has also actively taken steps to expand its business area. In August 2006, it acquired the shares of SUNTOA Co., Ltd., which owns and manages business hotels to enter into the hotels business. In December 2011, it established Samty Kanri (now Samty Property Management) to enter into the property management business; in November 2012, it made Samty Asset Management a wholly owned subsidiary to enter into the asset management business; and in June 2015, Samty Residential Investment Corporation was listed on the TSE J-REIT market. In such ways, it has established a system for growth to accelerate in the future. Its listing was changed to the TSE First Section in October 2015. In May 2019, it concluded a capital and business alliance agreement with Daiwa Securities Group Inc.

The capital and business alliance with the Daiwa Securities Group

Intends to collaborate in areas such as the formation of a hotel REIT, overseas business development, and crowdfunding

As of May 30, 2019, the Company concluded a capital and business alliance agreement with Daiwa Securities Group Inc. Its aims for this alliance include diversifying project information, increasing the scale of projects, and reducing financing costs by incorporating the strengths of the Daiwa Securities Group, such as its creditworthiness and information capabilities. It can be said that it was a decision aimed at a new growth stage. On the other hand, for the Daiwa Securities Group, it has the major advantage of strengthening its real estate business, so the agreement was concluded because it benefits both parties. The Company also allocated its treasury shares and unsecured convertible bonds with stock acquisition rights to the Daiwa Securities Group to strengthen its financial base.

1. Details of the business alliance

(1) Collaboration on a large-scale hotel development fund
Based on a concept of targeting inbound demand and domestic travelers, they will fully utilize the Company's development capabilities and the Daiwa Securities Group's finance functions to consider investments up to ¥30bn. Samty Asset Management (hereafter, Samty AM) will be entrusted with the development fund's asset management operations.

(2) Aiming to form a hotel RIET by FY2020
The Company's pipeline has already exceeded ¥100bn, mainly including properties owned or under development by the Company's Group, and it plans to incorporate the properties into the RIET as they are completed. The hotels developed for the hotel development fund described above in (1) will also be incorporated into the RIET. Similar to the development fund, Samty AM will be entrusted with the asset management operations, which will lead to increases in fee income for both SRR and asset management operations.

(3) Receive information on CRE (corporate real estate) held by the Daiwa Securities Group

For the real estate related to the information provided, the Company' Group will acquire properties, when both sides judge to be appropriate, and effectively utilize and redevelop the real estate, with the aim of incorporating it into SRR and the hotel RIET described above in (2) according to its type and purpose.

(4) Collaboration for business development in Asia

The Company's Group has already invested a total of US$30 million in two local developer companies in Ho Chi Minh City, Vietnam, while it will utilize the Daiwa Securities Group's network to further accelerate investment and business activities.

(5) Collaborations on real estate sales to the wealthy and crowdfunding

The Company will sell real estate to the wealthy who are customers of the Daiwa Securities Group. It will also utilize crowdfunding through a collaboration with Fintertech Co., Ltd. which was established by the Daiwa Securities Group in March 2018. It intends to flexibly create next-generation financial services.

2. Details of the capital alliance

In order to strengthen its relationship with the Daiwa Securities Group (shared interests) and enhance its financial base, the Company has allocated to the Daiwa Securities Group its treasury shares and unsecured convertible bonds with stock acquisition rights. As a result, it raised funds of approximately ¥12.7bn in total, of around ¥2.7bn from the disposal of treasury shares and ¥10bn from the issue of unsecured convertible bonds with stock acquisition rights. After the implementation of this issue, the Daiwa Securities Group's shareholding ratio became 29.9% (includes Daiwa PI Partners' shareholding ratio of 2.67%)*.

* Calculated from the 1,737,068 shares acquired through the disposal of treasury shares, the 5,813,953 shares issued in the event that all of the unsecured convertible bonds with stock acquisition rights are converted at the conversion price of ¥1,720, and also the 5,204,074 shares transferred from sales by the Company's shareholders (12,755,095 shares in total).

Industry environment

Conditions continue to be favorable in the real estate market

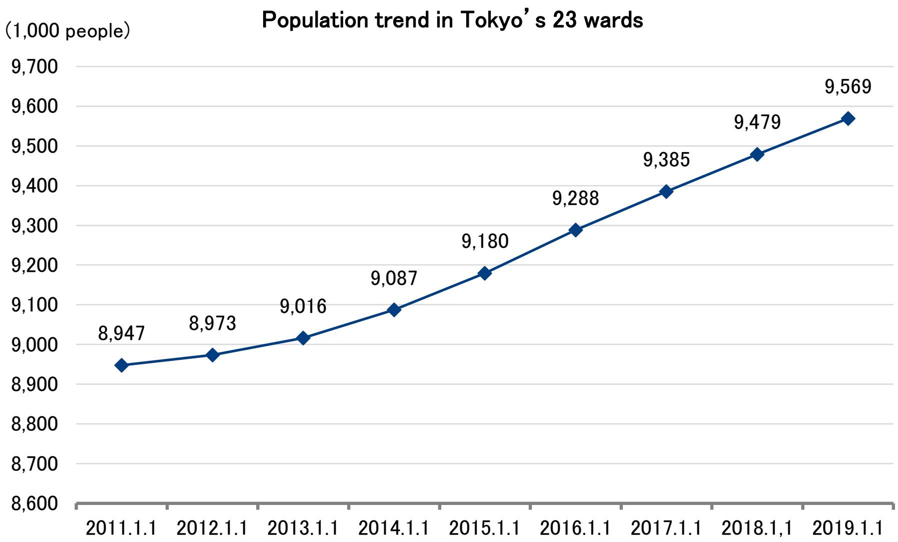
The J-REIT market will have an important influence on the Company's growth strategy in the future. As of the end of June 2019, its market capitalization stood at around ¥15,196.2bn, and there were 63 J-REITs listed. Although there was a phase in which the market was temporarily sluggish due to the impact of the credit tightening and related factors following the 2008 financial crisis, since 2012 it has steadily trended upward thanks to the recovery of the domestic economy and the effects of long-term monetary easing. Although we currently see sluggish growth in property acquisition due to the rise in real estate prices, there has been a diversification of investment targets, such as hotels and commercial facilities with an eye to the increase in inbound demand, long-term care facilities that are being built in response to the aging of society, and logistics facilities and infrastructure (solar power plants, etc.) So a variety of investment opportunities are being created, yet at the same time there remains considerable room for the market to grow.

The TSE REIT index is trending firmly due to a robust domestic real estate market (rising rents, etc.) More specifically, demand for J-REITs remains strong from domestic and overseas institutional investors seeking strong yields and relatively stable cash flow based on the view that the Bank of Japan will maintain its policy of monetary easing and the expectation that office demand will rise going forward. In addition, the medium-term outlook for J-REITs looks strong amid continued monetary easing and a strong real estate market (improving vacancy rates and rising rents).

Trends in the TSE REIT index

Source: Prepared by FISCO from various materials

The market for condominiums for investment is also trending favorably, supported by the strong demand from both tenants (users) and investors. According to data published by the Tokyo Metropolitan Government Bureau of General Affairs, the population of Tokyo's 23 wards, which constitutes most of the region to which the Company supplies properties, is continuing to increase against the backdrop of the large number of people moving to metropolitan Tokyo. In particular, there has been a noticeable increase in the number of single-person households, including among the young, which is occurring in the context of later marriages and the increase in the divorce rate, and it is thought that this will also support lease demand for studio-type condominiums in the future. This trend can also be seen not only in Osaka and Nagoya, but also in regional metropolitan areas such as Fukuoka and Sapporo, and while on one hand the population of Japan is declining, on the other hand it continues to be concentrated into cities. On the investor side also, demand is increasing from individual investors in their twenties and thirties who are anxious about their futures in terms of their pensions and lives in their old age, and also from the elderly as an inheritance-tax measure following the reduction in the basic exemption amount. In addition, we also see intensified demand from overseas funds and other investors for properties in Tokyo's prime locations with many inquiries about entire buildings rather than individual unit purchases.



Source: Prepared by FISCO based on materials issued by the Tokyo Metropolitan Government Bureau of General Affairs

Meanwhile, looking at the hotel development and office building development businesses, which are expected to be new growth engines going forward, hotel occupancy rates remain high with the backdrop of increased inbound demand. Some in the market are concerned about a deterioration in the supply-demand situation after the Tokyo Olympic and Paralympic Games, but we basically think that hotel management can remain stable, as the Japanese government will continue with its policy of making Japan a major destination for tourism. With respect to office buildings, the decline in vacancy rates in central urban areas (an increase in the sense of a shortage of office space) is currently receiving a lot of attention, but the shortage of office space regional metropolitan areas (where the Company is also active) is also a serious situation, so we believe that there are sufficient business opportunities when it comes to office building development.

The problems that the industry is facing include that it has become more difficult to purchase land in city centers, the rise in land prices, soaring construction costs and insufficient personnel numbers.

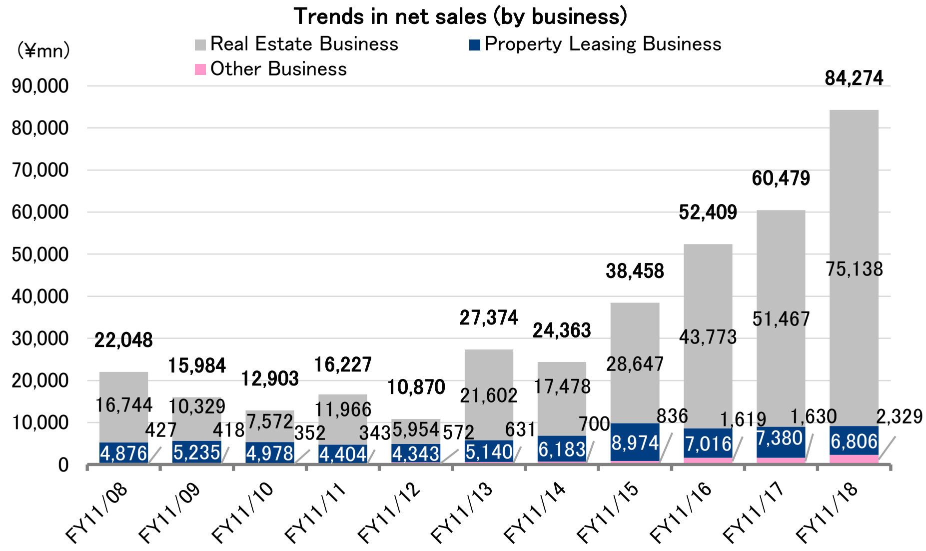
Results trends

Substantial growth in Real Estate Business amid strong real estate market

1. Past results trends

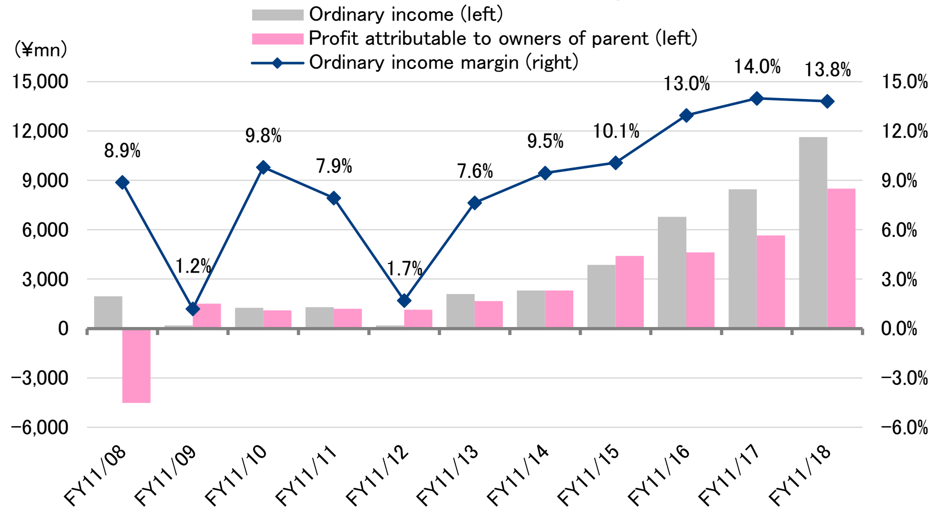
Looking back on the Company's results since FY11/07, which was the year it listed on the Osaka Stock Exchange Hercules market (currently, the TSE JASDAQ market), immediately after it listed it was impacted by the 2008 financial crisis, and there was a period in which its results trended at a low level. The major contraction of its Real Estate Business due to the credit tightening by financial institutions had a particularly adverse impact on its results. However, the points we should focus on are that results in the Property Leasing Business have trended stably even when within a severe industry environment, which has supported the results of the Company as a whole. The fact that it does not have its own in-house sales team and has kept down fixed costs has also had a positive effect, and it can be highly evaluated on the point that it has secured profits in every fiscal year expect FY11/08, when it recorded a net loss due to declaring impairment.

Since FY11/13, the Real Estate Business has greatly recovered due to the change in financial institutions' attitude toward financing, which has occurred against the backdrop of the recovery of the domestic economy and monetary easing, and the Company's results have entered an expansion phase. In terms of profit and loss also, the ordinary income margin has been improving year by year thanks to the progress in the highly profitable development securitization, and in FY11/18 it has maintained a high ordinary income margin of over 13.0% for three consecutive years.



Note: Excluding internal sales
Source: prepared by FISCO from the Company's financial results

Trends in ordinary income, profit attributable to owners of parent, and the ordinary income margin



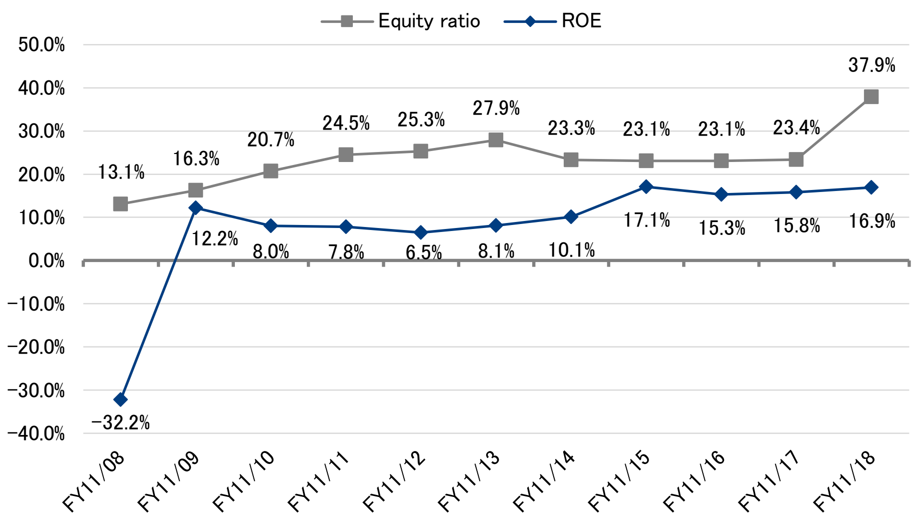
Source: prepared by FISCO from the Company's financial results

Although the equity ratio increased to 27.9% in FY11/13 following the implementation of a capital increase through a public offering (approximately ¥2bn), it has been at a level of around 23% since FY11/14 due to the Company's active accumulation of assets and other factors. However, the Company bolstered its financial base in October 2018 by issuing stock acquisition rights* (approximately ¥15.0bn), and this boosted the equity ratio to 37.9% as of November 30, 2018.

* The Company issued new shares by allotting listed-type stock acquisition rights without contribution to existing shareholders.

On the other hand, ROE, which indicates capital efficiency, has trended upward alongside the improvement in the profit margin. In FY11/18, it maintained the high level of 16.9%.

Trends in the equity ratio and ROE



Source: Prepared by FISCO from the Company's financial results

In FY11/19 1H, the Company achieved higher sales and a major increase in profits. Growth in the hotel development business contributed greatly to the results

2. Overview of FY 11/19 1H results

In FY11/19 1H results, net sales rose 3.3% YoY to ¥47,827mn, operating income grew 53.0% to ¥13,941mn, ordinary income climbed 61.9% to ¥12,803mn, and profit attributable to owners of parent increased 59.9% to ¥9,044mn. For the full fiscal year forecasts, net sales are basically in line with the forecast, while the progress rates are high for each profit item.

Sales steadily grew in the Real Estate Business, benefiting from the favorable real estate market. In particular, sales were strong for the S-RESIDENCE series, for which there is strong investment demand from overseas funds and other investors, mainly in metropolitan Tokyo, as well as sales of properties developed in-house, such as hotels, which the Company has been focusing on recently. Results in Other Businesses also grew significantly due to the increase in sales from hotel openings, etc. Conversely, sales declined in the Property Leasing Business because the Company actively promoted selling properties it owned, but this can be understood to be a temporary factor.

In profits, the operating income margin improved significantly to 29.1% (19.7% in the same period in the previous fiscal year) due to the increases in sales prices and the significant fall in the cost ratio following the sales of development properties with high profit margins, such as hotels. As a result, these factors and the effects of the higher sales led the Company to realize a major increase in profits.

The Company is steadily making purchases which will lead to future growth. The Company acquired 20 development sites (estimated net sales of approximately ¥57.4bn, acquisition price of approximately ¥21.5bn) and 26 income properties (acquisition price of approximately ¥20.1bn). This move has been steadily progressing, including for properties to be acquired in the future*.

* The rates of progress toward the full fiscal year forecasts (based on the acquired monetary amounts) was 86.1% for development sites and 50.2% for income real estate.

For the Company's financial condition, in addition to self-funding through the rights offering and sales of properties conducted in October 2018, it effectively utilized borrowing to actively acquire income real estate. Therefore, there were increases in "real estate for sale," "real estate for sale under construction," and "tangible non-current assets," and total assets were up 18.7% from the end of the previous fiscal year to ¥192,808mn. Meanwhile, shareholders' equity also increased 11.7% to ¥68,748mn due to factors such as accumulation of internal reserves. As a result, the equity ratio declined slightly, but it was still maintained at a level of above 35%. Interest-bearing debt was up 29.3% from the end of the previous fiscal year to ¥115,332mn, mainly from long-term borrowings. But the net D/E ratio* was kept down to a level of 1.04 times. It can be said that the Company maintains a sound financial structure while it aims to expand assets.

* Net D/E ratio = (interest-bearing debt – cash and deposits) ÷ shareholders' equity

Results trends

Overview of FY11/19 1H results

(¥mn)

	FY11/18 1H		FY11/19 1H		Change		FY11/19		Progress rate
	Results	% of net sales	Results	% of net sales		% of change	Revised forecast	% of net sales	
Net sales	46,317		47,827		1,510	3.3%	86,000		55.6%
Real Estate Business	41,869	90.4%	42,743	89.4%	874	2.1%	75,100	87.3%	56.9%
Property Leasing Business	3,616	7.8%	3,203	6.7%	-413	-11.4%	6,800	7.9%	47.1%
Other Business	946	2.0%	2,106	4.4%	1,160	122.6%	4,400	5.1%	47.9%
Adjustment	-115	-	-226	-	-111	-	-300	-	
Cost of sales	33,822	73.0%	29,597	61.9%	-4,225	-12.5%	-	-	-
SG&A expenses	3,382	7.3%	4,288	9.0%	906	26.8%	-	-	-
Operating income	9,112	19.7%	13,941	29.1%	4,829	53.0%	16,000	18.6%	87.1%
Real Estate Business	9,608	22.9%	14,845	34.7%	5,237	54.5%	18,300	24.4%	81.1%
Property Leasing Business	1,046	28.9%	1,174	36.7%	128	12.2%	2,600	38.2%	45.2%
Other Business	-42	-4.4%	5	0.2%	47	111.9%	100	2.3%	5.0%
Adjustment	-1,500	-	-2,083	-	-583	-	-5,000	-	-
Ordinary income	7,908	17.1%	12,803	26.8%	4,895	61.9%	13,500	15.7%	94.8%
Profit attributable to owners of parent	5,655	12.2%	9,044	18.9%	3,389	59.9%	9,500	11.0%	95.2%
Breakdown of net sales in the Real Estate Business									
Development securitization	16,250		32,142		15,892	97.8%			
Renovation securitization	21,940		8,934		-13,006	-59.3%			
Investment unit sales in lots	3,051		1,258		-1,793	-58.8%			
Asset management	620		389		-231	-37.3%			

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

Financial position at the end of May 2019

(¥mn)

	End of November 2018	End of May 2019	Change	
Current assets	107,904	124,512	16,608	15.4%
Cash and deposits	44,510	43,658	-852	-1.9%
Real estate for sale	26,181	35,838	9,657	36.9%
Real estate for sale under construction	34,886	42,574	7,688	22.0%
Non-current assets	54,595	68,295	13,700	25.1%
Property and equipment	46,539	56,008	9,469	20.3%
Intangible assets	172	184	12	7.0%
Investments and other assets	7,883	12,103	4,220	53.5%
Total assets	162,500	192,808	30,308	18.7%
Current liabilities	19,779	21,517	1,738	8.8%
Short-term borrowings	1,340	5,931	4,591	342.6%
Current portion of long-term debt	9,470	9,549	79	0.8%
Non-current liabilities	80,282	101,970	21,688	27.0%
Long-term debt	78,362	99,852	21,490	27.4%
Net assets	62,438	69,320	6,882	11.0%
Total liabilities and net assets	162,500	192,808	30,308	18.7%
Interest-bearing debt	89,172	115,332	26,160	29.3%
Shareholders' equity	61,533	68,748	7,215	11.7%
Equity ratio	37.9%	35.7%	-2.2%	-

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

The results according to each business are as follows.

(1) Real Estate Business

Net sales increased 2.1% YoY to ¥42,743mn and segment profit rose 54.5% to ¥14,845mn, for higher sales and significantly higher profits. To these amounts, development securitization contributed significantly, including from sales of 10 properties in the S-RESIDENCE series (11 properties in the same period in the previous fiscal year) and 3 hotels developed in-house (no results in the same period in the previous fiscal year). In particular, against the backdrop of strong investment demand from overseas funds, it can be said that the increases in sales prices and the sales of large-scale hotels contributed to the growth of the results. On the other hand, only 8 properties of renovation securitization were sold (21 in the same period in the previous fiscal year), but this is expected to increase toward the 2H. Meanwhile, sales in condominiums for investment declined due to the drop in units sold to 93 units (195 properties in the same period in the previous fiscal year), but this was within expectations. This is because the purchase needs for single buildings are strong and the Company is selling development securitization properties with high sales efficiency and profitability. Sales declined in asset management as acquisition fees temporarily declined YoY, despite management and administration fees, which are a stable source of earnings, steadily increasing alongside the growth in SRR's asset management balance.

In profits, a major increase in profits was realized from sales of development properties with high profit margins, such as hotels. The rates of progress toward achieving the full fiscal year forecasts are also high.

(2) Property Leasing Business

Net sales decreased 11.4% YoY to ¥3,203mn, while in contrast segment profit increased 12.2% to ¥1,174mn, resulting in lower sales but higher profits. For real estate owned, the high occupancy rates were maintained, but rental income temporarily decreased because the Company actively sold properties owned (this was within the expected range though). At the end of the period, it owned 72 properties (non-current assets; 82 properties at the end of the same period in the previous fiscal year).

(3) Other Business

Net sales increased 122.6% YoY to ¥2,106mn and segment profit was ¥5mn (a loss of ¥42mn in the same period in the previous fiscal year). Significantly higher sales contributed to this positive turnaround. Results in the hotels business grew greatly due to the cruising operations, such as at S-PERIA HOTEL Hakata, and also due to the openings of S-PERIA INN Nihombashihakozaki and S-PERIA INN Osaka Hommachi.

3. The development plan (pipeline) situation

The development conditions of the S-RESIDENCE series and condominiums for investment are that 9 buildings (514 units) will be completed in 2019, 28 buildings (1,764 units) in 2020, and 22 buildings (1,402 units) in 2021, for a total of 59 buildings (3,680 units), and the numbers are steadily increasing. For hotel and office developments, 4 buildings are scheduled to open for business in FY2020, 3 buildings in FY2021, and 1 building in FY2022 (the details are given below).

Topics

Is making steady progress for strategic investments and hotel developments. Is also working to expand the sales areas.

1. Investments made

As previously mentioned, the Company acquired 20 development sites (acquisition amount: ¥21.5bn) and 26 income real estate properties (acquisition amount: ¥20.1bn). Of the 20 development sites (14 residences, 5 hotels, and 1 office), there are 6 in the Tokyo metropolitan area, 6 in Chubu, 7 in Kansai, and 1 in Kyushu. Also, of the 26 income real estate properties, there are 5 in Hokkaido, 5 in the Tokyo metropolitan area, 3 in Chubu, 7 in Kansai, and 6 in Kyushu, and these properties are being developed nationwide. The Company was able to achieve results for investment in regional urban areas as set out in the medium-term management plan. In addition, it is planning investment of a total amount (including construction expenses) of approximately ¥300bn for the 3 years (FY11/19 to FY11/21), and at the current time it is making steady progress toward this, having invested ¥98.2bn (included completed contracts and scheduled payments).

2. Expansion of the hotel business

In terms of expansion of the hotel business, the Company opened S-PERIA INN Osaka Hommachi in February 2019 and S-PERIA HOTEL Kyoto in April 2019, its third and fourth hotel development projects. Besides these, the Company is currently developing six buildings (and it seems there are also a couple of plots of land for other projects). In addition to hotels, the Company has plans to develop office buildings, centered on major cities throughout Japan, and is already developing two such office buildings. The Company has positioned the hotel and office building development businesses as new engines for future growth as those businesses are expected to be highly profitable as the Company is involved from the development stage.

Hotel and office building development plans

Fiscal year of completion	Project name (provisional)		Location	No. of rooms
2020	Mercure Kyoto Station	Hotel	Shimogyo-ku, Kyoto	225
	Ibis Styles Nagoya	Hotel	Nakamura-ku, Nagoya	284
	Yodogawa-ku Nishimiyahara 1cho-me PJ	Office	Yodogawa-ku, Osaka	-
	Chuo-ku Odorinishi 5cho-me PJ	Office	Chuo-ku, Sapporo	-
2021	Kyoto Shijo-karasuma kita HOTEL PJ	Hotel	Kyoto City, Shimogyo Ward	80
	Kyoto Shijo-karasuma minami HOTEL PJ	Hotel	Shimogyo-ku, Kyoto	140
	Kyoto Oike HOTEL PJ	Hotel	Nakagyo-ku, Kyoto	120
2022	Haneda HOTEL PJ	Hotel	Ota-ku, Tokyo	362
Total				1,211

Source: Prepared by FISCO from the Company's results briefing materials

3. Sales areas

To expand the sales areas, which is one of the priority strategies in the medium-term management plan, the Company opened the Shinjuku and the Yokohama Business Offices in April 2019. It also plans to open the Hiroshima Branch Office in December 2019.

Earnings outlook

Upwardly revised the FY11/19 profits forecasts. Expects the higher sales and profits to continue.

For FY11/19, the Company upwardly revised its forecasts considering the progress in 1H and other factors, with net sales of ¥86,000mn, up 2.0% YoY; operating income of ¥16,000mn, up 14.0% (extent of the revision: +¥1,000mn); ordinary income of ¥13,500mn, up 16.0% (extent of the revision: +¥500mn); and profit attributable to owners of parent of ¥9,500mn, up 11.9% (extent of the revision: +¥500mn).

Net sales in both the Real Estate Business and the Property Leasing Business are expected to be roughly flat YoY, while Other Business is expected to contribute to the increase in net sales due to the expansion of the hotel business. As occupancy rates remain high, the hotels that opened in FY11/18 will contribute to net sales from the start of FY11/19, while hotels scheduled to open during FY11/19 (two hotels in 1H) are expected to further boost earnings.

In profits, the outlook is for higher profits to be secured due to the improvement in the profitability of comprehensive transactions, in addition to the effects of the higher sales. In particular, the Company upwardly revised the profits forecasts following the sales in the 1H of properties with high profit margins, including hotels developed in-house.

In the investment plan, approximately ¥25bn is scheduled for development sites and approximately ¥40bn for income real estate.

At FISCO, we think that the Company is fully capable of achieving its forecasts on considering the 1H results the favorable external environment (in the real estate market) and internal factors (including the pipeline conditions and the steady launch of the hotels business). In particular, the rates of progress toward achieving the revised profits forecasts are high, so it is necessary to be aware that the results may even exceeded these forecasts.

FY11/19 forecast

(¥mn)

	FY11/18		FY11/19				Change	
	Results	% of net sales	Initial forecast	% of net sales	Revised forecast	% of net sales		% of change
Net sales	84,274		86,000		86,000		1,726	2.0%
Real Estate Business	75,143	89.2%	75,100	87.3%	75,100	87.3%	-43	-0.1%
Property Leasing Business	6,807	8.1%	6,800	7.9%	6,800	7.9%	-7	-0.1%
Other Business	2,491	3.0%	4,400	5.1%	4,400	5.1%	1,909	76.6%
Adjustment	-167	-	-300	-	-300	-	-133	-
Cost of sales	63,170	75.0%	-	-	-		-	-
SG&A expenses	7,070	8.4%	-	-	-		-	-
Operating income	14,033	16.7%	15,000	17.4%	16,000	18.6%	1,967	14.0%
Real Estate Business	15,547	20.7%	17,300	23.0%	18,300	24.4%	2,753	17.7%
Property Leasing Business	1,907	28.0%	2,200	32.4%	2,600	38.2%	693	36.3%
Other Business	83	3.3%	500	11.4%	100	2.3%	17	20.5%
Adjustment	-3,504	-	-5,000	-	-5,000	-	-1,496	-
Ordinary income	11,635	13.8%	13,000	15.1%	13,500	15.7%	1,865	16.0%
Profit attributable to owners of parent	8,489	10.1%	9,000	10.5%	9,500	11.0%	1,011	11.9%

Source: Prepared by FISCO from the Company's financial results and financial results briefing materials

Growth strategy

Under the new management regime, the Company will promote its new medium-term management plan, the Samty Toughening Plan, and will focus more on the balance sheet

1. New medium-term management plan

The Company had been advancing its medium-term management plan covering the five-year period from FY11/16 through FY11/20. Since it achieved the profit target in the previous fiscal year (FY11/18), two years ahead of schedule, along with its transition to a new management regime led by a new president, the Company has kicked off a new medium-term management plan, the Samty Toughening Plan, which will run through FY11/21. There have been no major changes to the overall aims of the plan, as the priority measures include: 1) Developing a business model centered on SRR (strengthening the fee income business); 2) Strategically investing in regional metropolitan areas (expanding the business area); and 3) Expanding the hotel development and office building development businesses (as a new growth engine). One key aspect of the new medium-term management plan is to place more of a focus on managing the balance sheet in order to prepare for a future correction in the market. As a part of this, the Company is putting significant emphasis on strengthening its financial base, centered on rental cash flow. The Company intends to achieve continuous growth, while maintaining an equity ratio of at least 30% or higher. Specifically, the Company will aim to achieve operating income around the ¥20.0bn level, ROE around the 15.0% level, and ROA around the 7.0% level by emphasizing productivity and capital efficiency, while purposely not setting a net sales target.

New medium-term management plan Samty Toughening Plan (numerical targets)

	FY11/17 results	FY11/18 results	FY11/21 targets	
Operating income	¥10,131mn	¥14,033mn	¥20,000mn	level
ROE	15.8%	16.9%	15.0%	level
ROA	6.6%	8.5%	7.0%	level
Equity ratio	23.4%	37.9%	30.0%	or higher

Note: ROA = operating income ÷ total assets (average of the balances at the beginning and end of the fiscal year)
Source: Prepared by FISCO from the Company's medium-term management plan

2. Key strategies and direction

(1) Development of a business model centered on SRR (bolstering the fee income business)

The Company will continue to proactively supply properties, thereby promoting the accumulation assets by SRR. In addition to adding hotels and office buildings to the lineup of real estate for development and sale, the Company will launch new management funds*1 in addition to SRR, and will thereby increase acquisition fees. Furthermore, in addition to creating a mechanism to acquire MC fees by bringing hotel management operations in-house*2, the Company will bolster the fee income business by growing rental income, acquiring overseas income, along with other initiatives.

*1 As previously mentioned, the Company aims to launch a large-scale hotel development fund jointly with the Daiwa Securities Group and to form a hotel RIET by 2020 (asset management operations will be entrusted to the Company's Group).

*2 The Company will bring hotel management (which the Company has been outsourcing to external management companies) in-house, and create a mechanism to have Samty Group be commissioned to handle hotel management operations (MC) even after the sale of a hotel, thereby acquiring fee income, enjoying the upside, and accumulating management know-how.

(2) Strategic investment in regional metropolitan areas (expanding the business area)

The Company plans to invest approximately ¥300bn over three years. In particular, the Company will pursue hotel and office building development as new growth engines, as well as invest ¥135bn to acquire income properties and accumulate assets in order to acquire stable rental income. The Company will work on further expanding its business area, and will purchase income properties and develop residential buildings, office buildings, and hotels in the Tokyo metropolitan area and other key regional cities throughout Japan.

(3) Expand the hotel development and office building development businesses

In addition to hotels, the Company has positioned the office building development business as a new growth engine and it plans to invest approximately ¥85bn (land + construction expenses) over three years. In the hotel development business, there have been openings up to the 4th project so far, and 6 development projects are currently being progressed. These hotels have room sizes of 25 to 40 square meters, and the Company's policy is to develop them to be a class of one rank higher than businesses hotels under the brand names of well-known foreign hotels. For offices, it intends to supply newly built B/C class* offices, for which there is little supply or competition, after carefully selecting the areas and sites, mainly in major regional cities where the office demand-supply balance is tight.

* In general, grade-B office buildings have between 2,000-9,999 tsubo of total floor space (and at least 200 tsubo or more of floor space on a typical floor), while grade-C office buildings have less than 2,000 tsubo of total floor space (and less than 200 tsubo of floor space on a typical floor).

The direction the Company is taking prioritizes not only a flow type earnings structure from repeated buying and selling, but also converting to a stock-type earnings structure that stably accumulates earnings. At FISCO, we evaluate this strategy to be rational, because it minimizes the impact of the business cycle and enables it to achieve sustainable growth. In addition, toward achieving these aims, an important theme is pursuing economies of scale, such as by progressing the Company's unique business model, as well as by increasing the scale of projects and expanding sales areas. Therefore, it is highly likely that the current capital and business alliance with the Daiwa Securities Group will be a major turning point for the Company to progress toward a different stage it has never faced. Going forward, we shall be paying attention to the progress the Company will make, including new developments from the hotel RIET and crowdfunding through the alliance with the Daiwa Securities Group.

Returns to shareholders

Upwardly revised the FY11/19 dividend forecast. There remains considerable room for the dividend to increase in the future from profit growth.

The Company is aware that retuning profits to shareholders is one of its most important management issues. Its policy is to pay dividends that reflect its business results and also base on a comprehensive consideration of its future business plans and financial condition.

The Company has also upwardly revised its initial forecast for the FY11/19 period-end dividend to a dividend per share of ¥77 (dividend payout ratio, 31.9%), which is an increase of ¥9 YoY. If this is paid as planned, it will be the seventh consecutive fiscal year of higher dividends since FY11/12. It targets a dividend payout ratio of around 30%, but at FISCO, we think that considerable room remains for the dividend to increase in the future from profit growth.

The Company also conducts a shareholder benefits program. It provides shareholders with discounted rates or coupons to stay at three of the hotels* developed and managed by the Company for free (according to the number of shares held).

* Recently changed to three hotels, which include Center Hotel Tokyo, S-PERIA INN Nihombashihakozaki, and S-PERIA INN Osaka Hommachi.

FISCO

Disclaimer

■ For inquiry, please contact: ■

FISCO Ltd.

5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062

Phone: 03-5774-2443 (Financial information Dept.)

Email: support@fisco.co.jp