HEIWA REAL ESTATE CO., LTD.

8803 Tokyo Stock Exchange First Section

5-Jan.-17

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Aims to Submit the Urban Plan for Revitalization Projects in Nihonbashi Kabutocho and Kayabacho in Early 2017, Profits Increased in 1H FY3/17

Heiwa Real Estate Co., Ltd. (8803) started by leasing buildings to stock exchanges, including those in Tokyo, Osaka, and Nagoya, and it now develops, leases, manages and operates office buildings primarily, but also commercial buildings and residential buildings in major Japanese cities. The leasing business, which accounts for 59.7% of operating revenues (1H FY3/17), owns numerous properties, primarily located in the financial districts of major urban centers, and features low vacancy rates because many are leased out as entire buildings. The real estate solutions business, which represents 33.7% of operating revenues (1H FY3/17), provides a stable source of earnings through a value chain that includes Heiwa Real Estate REIT, Inc. <8966>.

Heiwa Real Estate reported higher profits on a decline in operating revenue in 1H FY3/17 with ¥15,425mn in operating revenue (-10.1% YoY) and ¥4,209mn in operating income (+0.9%). Operating revenue decreased due to the absence of the previous year's building sales revenue (about ¥2.7bn for the Nagoya Marunouchi Heiwa Real Estate Building) in the leasing business, thus the decrease is a one-time factor. While a rebound from the previous year's building sales also affected operating income in the leasing business, the overall income increased YoY thanks to a steep increase from property sales in the real estate solutions business. The company maintained initial targets of increases in operating revenue and income for the FY3/17 outlook at ¥41,000mn in operating revenue (+10.8%) and ¥8,500mn in operating income (+2.8%). It expects to offset the impact from the absence of building sales with expansion of leasing assets in the leasing business and to broaden income scope by booking revenue from property sales and residential developments in the real estate solutions business. Heiwa Real Estate envisions a growth trajectory from FY3/17 after hitting the lowest point in FY3/16.

Heiwa Real Estate is close to submitting the urban plan proposal for phase one of the Nihonbashi Kabutocho and Kayabacho Revitalization Project, the centerpiece of its growth strategy. It completed concept development, additional designation as urban redevelopment projects in the National Strategic Special Zone for Greater Tokyo, and property acquisitions in the target zones for the phase-one projects in FY3/16 and is making final adjustments to the urban plan proposal in FY3/17. While it is steadily advancing in related adjustments without major issues, Heiwa Real Estate implemented a further review of the project's contribution to the area (including living convenience and disaster prevention). The timing of urban plan proposal submission hence is slightly delayed, but the company has not altered its schedule for completion of phase one (FY3/21). We expect Heiwa Real Estate to submit the urban plan proposal at some point from January 2017 in light of this background.

Heiwa Real Estate has also started implementing the soft side of the initiatives. "CAFE SALVADOR BUSINESS SALON," which opened on the first floor of the Tokyo Shoken Kaikan Building in March 2016 is actively used as an information hub with seminars and other events hosted by asset management firms as part of the redevelopment concepts of "interaction among investors and companies" and "support for development of venture financial firms." The company established the General Incorporated Association International Asset Management Center Promotion Agency in October 2016, contributing to a framework of "supporting start-ups in the asset management business" and "conducting promotions to attract overseas asset management firms."

Heiwa Real Estate had been replacing its leasing assets in the leasing business, the company's main segment, over the past few years, and is now shifting gears to expansion of asset scale as replacement of portfolio has run its course. It concluded a purchase contract in November 2016 to acquire the KDX Nihonbashi Kabutocho Building (with a floor area of 11,705.49 m^2) for ¥12.4bn with the aim of expanding assets in the leasing business. This building, which is adjacent to the Tokyo Stock Exchange and Kabutocho Heiwa Building No.1, will obviously contribute to leasing revenue for the time being and is a candidate site for phase two and further development of the Nihonbashi Kabutocho and Kayabacho Project (the official transfer date is set for February 1, 2017).

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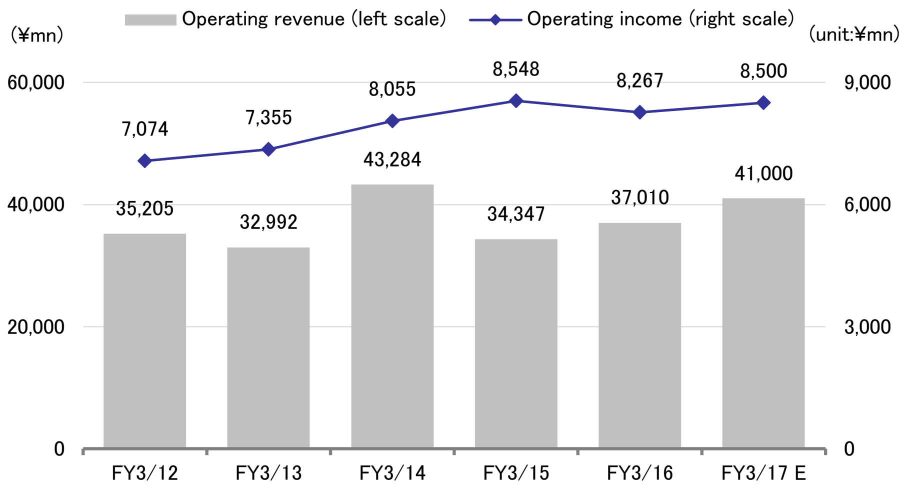
Check Point

- Intends to submit the urban plan proposal for phase one of the Nihonbashi Kabutocho and Kayabacho redevelopment from January 2017
- Shifting to expansion of real estate assets, plans to acquire the KDX Nihonbashi Kabutocho Building (¥12.4bn)
- Profits increased in 1H FY3/17 as income from real estate solutions business offset a decline in leasing business revenue

Full-Year Results Trends



Results Trends

Profits increased in 1H FY3/17 as income from the real estate solutions business offset a decline in leasing business revenue

(1) Results trends in 1H FY3/17

Heiwa Real Estate reported 1H FY3/17 results with ¥15,425mn in operating revenue (-10.1% YoY), ¥4,209mn in operating income (+0.9%), ¥3,599mn in ordinary income (+7.0%), and ¥2,266mn in net income attributable to owners of parent (+5.4%). Operating revenue fell primarily due to the absence of the previous year's building sales revenue (about ¥2.7bn for the Nagoya Marunouchi Heiwa Real Estate Building). While a rebound from the previous year's building sales also affected operating income in the leasing business, overall income increased YoY thanks to a steep increase from property sales in the real estate solutions business. Ordinary income strengthened on lower financing costs, and quarterly net income attributable to owners of parent increased with help from smaller extraordinary losses. Heiwa Real Estate posted gains in all profit items.

1H FY3/17 Results

(unit: ¥mn)

		1H FY3/16	1H FY3/17			
		Results	Results	Share (%)	Value change	YoY
Operating revenue	Leasing Business	12,049	9,206	59.7%	-2,843	-23.6%
	Real Estate Solutions Business	4,030	5,198	33.7%	1,168	29.0%
	Other Businesses	1,069	1,020	6.6%	-49	-4.6%
	Total	17,150	15,425	100.0%	-1,725	-10.1%
Operating income	Leasing Business	4,054	3,727	88.5%	-327	-8.1%
	Real Estate Solutions Business	649	1,059	25.2%	410	63.2%
	Other Businesses	51	69	1.6%	18	35.3%
	Eliminations	-583	-647	-	-64	
	Total	4,172	4,209	100%	37	0.9%
Ordinary income		3,363	3,599	23.3%	236	7.0%
Net income attributable to owners of parent		2,150	2,266	14.7%	116	5.4%

Source: Prepared by FISCO from company's financial results

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Maintained FY3/17 guidance at the initial level of increases in operating revenue and profits

(2) FY3/17 outlook

Management maintained initial targets of increases in operating revenue and income for FY3/17 at ¥41,000mn in operating revenue (+10.8%), ¥8,500mn in operating income (+2.8%), ¥7,000mn in ordinary income (+4.3%), and ¥4,500mn in net income attributable to owners of parent (+2.1%). It expects to offset the impact from the absence of building sales with expansion of leasing assets in the leasing business, and to broaden income scope by booking revenue from property sales and residential developments in the real estate solutions business. Heiwa Real Estate envisions a growth trajectory from FY3/17 after hitting the lowest point in FY3/16.

FY3/17 Results Outlook (Consolidated)

(unit: ¥mn)

	FY3/16		FY3/17			
	Results	Ratio to operating revenue	Guidance	Ratio to operating revenue	YoY change	1H progress rate
Operating revenue	37,010	100%	41,000	100.0%	10.8%	37.6%
Operating income	8,267	22.3%	8,500	20.7%	2.8%	49.5%
Ordinary income	6,708	18.1%	7,000	17.1%	4.3%	51.4%
Net income attributable to owners of parent	4,408	11.9%	4,500	11.0%	2.1%	50.4%

Source: Prepared by FISCO from company's financial results

Strengthened financial stability indicators by lowering the interest-bearing debt balance and reducing the D/E ratio

(3) Financial and management indicators

Total asset value decreased by ¥7,205mn from the end of FY3/16 to ¥286,816mn, mainly due to ¥3,503mn in sales of marketable securities. Total liabilities dropped by ¥7,284mn to ¥191,909mn, primarily because of a decline of ¥4,470mn in interest-bearing debt.

Heiwa Real Estate's management indicators at the end of September 2016 showed further reinforcement of the financial base since the end of FY3/16. Indicators for financial stability improved with interest-bearing debt declining from ¥160,232mn (at the end of FY3/16) to ¥155,762mn (at the end of September 2016), the D/E ratio (interest-bearing debt/net assets) declining from 1.69x to 1.64x, and the equity ratio climbing from 32.3% to 33.1%.

Financial and Management Indicators

(unit: ¥mn)

	The end of March 2016	The end of September 2016	Value change
Current assets	33,008	29,659	-3,349
(Cash and deposits)	10,983	10,494	-489
(Marketable securities)	4,503	1,000	-3,503
(Real estate for sale)	13,679	15,584	1,905
Fixed assets	260,584	256,768	-3,816
(Tangible fixed assets)	215,616	214,308	-1,308
Total assets	294,021	286,816	-7,205
Current liabilities	59,658	45,170	-14,488
Fixed liabilities	139,536	146,739	7,203
Total liabilities	199,194	191,909	-7,285
Total net assets	94,827	94,906	79
Total liabilities and net assets	294,021	286,816	-7,205
<Measures of financial stability>			
D/E ratio (interest-bearing debt/net assets; times)	1.69	1.64	-
Interest-bearing debt balance	160,232	155,762	-4,470
Equity ratio (total equity ÷ total assets)	32.3%	33.1%	-

Source: Prepared by FISCO from company's financial results

Growth Strategy

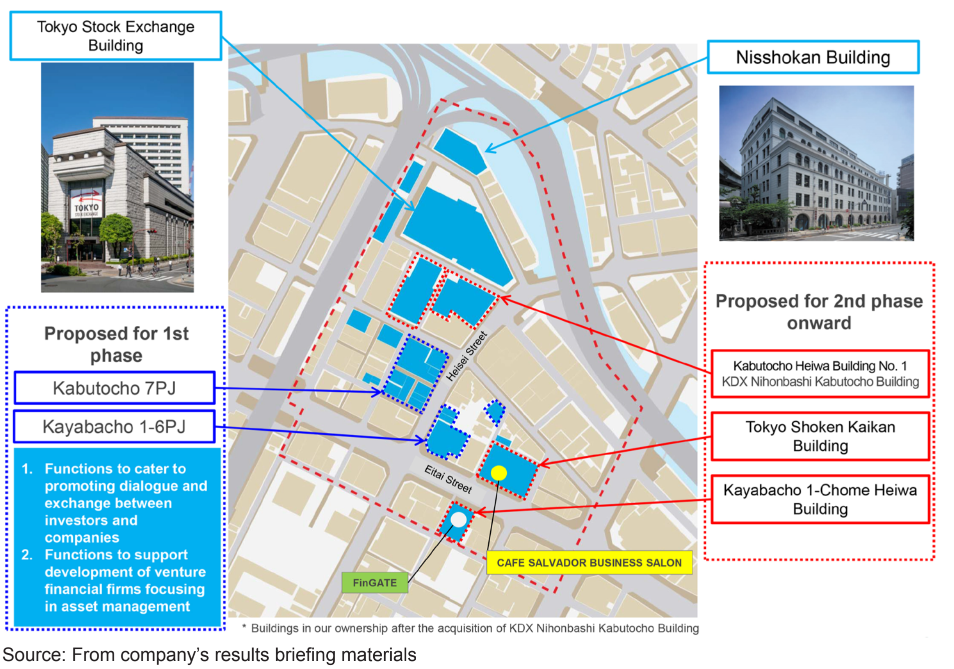
Intends to submit the urban plan proposal for phase one of the Nihonbashi Kabutocho and Kayabacho Revitalization Project from January 2017

(1) Nihonbashi Kabutocho and Kayabacho Revitalization Project

This project is part of the Tokyo Global Financial Center plan being pursued by the Tokyo Metropolitan Government. For the project, Heiwa Real Estate plans to complete new buildings and thereby expand its leasing assets and profitability. It has presented a corporate vision of pursuing urban revitalization with the Nihonbashi Kabutocho and Kayabacho Revitalization Project as the starting point.

The Nihonbashi Kabutocho and Kayabacho area is the center of the securities industry in Tokyo, housing the Tokyo Stock Exchange, many other buildings owned by Heiwa Real Estate, and the company's main office. The area is within walking distance of Tokyo Station, is served by five subway lines, is close to the business districts of Nihonbashi, Otemachi and Marunouchi, and has easy access to both of Tokyo's international airports, Haneda and Narita. However, the area has gradually lost its vitality over time due to several factors, including total automation of stock transactions, prolonged economic weakness since the collapse of the bubble economy, and moves and consolidations by securities firms, and many buildings were getting older. Heiwa Real Estate aims to restore the area's vibrancy through the revitalization project. About 100,000 m^2 of Nihonbashi Kabutocho are targeted for redevelopment and, Heiwa Real Estate plans to take on Kabutocho 7 project and Kayabacho 1-6 project, which both front onto Heisei Street avenue, as phase one of the 1st stage (FY3/15-24). These two projects propose themes of 1) catering to promote dialogue and exchange between investors and companies and 2) supporting for development of venture financial firms focusing on asset management.

Owned Properties in the Target Area for Revitalization



Source: From company's results briefing materials

The two projects have advanced considerably since FY3/16. In its interim report of April 2015, the Council on Urban Development for Investment and Economic Growth explained the concept for development of the new district. In June 2015, the district commission for National Strategic Special Zone in Greater Tokyo designated two projects (Nihonbashi Kabutocho 7 project and Kayabacho 1-6 project) which is part of the area the company is redeveloping, as an urban redevelopment project. Heiwa Real Estate had made steady progress in acquiring properties and completed land purchases for phase one. This includes the Kayabacho Kyodo Building, which is well situated in Kabutocho, the Kabutocho No.5 Heiwa Building, the Sanraku Bldg., and other sites during FY3/16.

Heiwa Real Estate opened “CAFE SALVADOR BUSINESS SALON” as an information hub for the redevelopment project on the first floor of the Tokyo Shoken Kaikan Building in March 2016. A key aim of this site is accumulating knowhow through early initiatives with the redevelopment concepts of “interaction among investors and companies” and “support for development of venture financial firms.” The site is having a smooth start with seminar and other events actively hosted by asset management firms. Heiwa Real Estate established the General Incorporated Association International Asset Management Center Promotion Agency in October 2016, establishing a framework to support start-ups in the asset management business and conduct promotions to attract overseas asset management firms.

Heiwa Real Estate is currently (as of December 2016) close to submitting the urban plan proposal for phase one. While it is steadily advancing in related adjustments without major issues, Heiwa Real Estate implemented a further review of the project’s contribution to the area (taking into account living convenience and disaster prevention). The timing of urban plan proposal submission hence is slightly delayed, but the company has not altered its schedule for completion of phase one (FY3/21). We expect Heiwa Real Estate to submit the urban plan proposal at some point from January 2017 in light of this background.

Progress since FY3/16

April 2015	Announcement of the interim report by the Council for Urban Development for Investment and Economic Growth
May 2015	Acquired Kayabacho Kyodo Bldg. (Kayabacho 1-6 Project area) and Kayabacho Heiwa Bldg. No. 5 (formerly Yusen Kabutocho Bldg.)
June 2015	Was added to the National Strategic Special Zone urban revitalization project
October 2015	Participated as an observer in the “Working Group on Asset Management,” a subgroup of the “Forum for Promotion of the Tokyo International Financial Center Concept” hosted by Japan Securities Dealers Association, The Investment Trusts Association, Japan and Japan Investment Advisors Association
March 2016	Opened “Fin GATE,” an event venue to promote Fintech etc., on the 1st floor of Kayabacho Kyodo Bldg. Opened “CAFE SALVADOR BUSINESS SALON”
October 2016	Established the General Incorporated Association International Asset Management Center Promotion Agency

Source: FISCO Ltd. from company materials

Shifting to expansion of real estate assets, plans to acquire the KDX Nihonbashi Kabutocho Building (¥12.4bn)

(2) Strengthening of the building leasing business

Steady replacement of leasing assets in the building leasing business is important in order to raise asset efficiency. Heiwa Real Estate also needs an even stronger earnings foundation to proceed smoothly in revitalization of the Nihonbashi Kabutocho and Kayabacho area. It sold properties worth about ¥16bn and purchased properties totaling roughly ¥18bn from 2014, bolstering portfolio quality. Notable examples of leasing properties purchased include Kayabacho Broad Square, Quatro Muromachi Building, Sakae Center Building, and Hamacho Heiwa Building.

Heiwa Real Estate is shifting gears now to expansion of asset scale as replacement of portfolio has run its course. It concluded a purchase contract in November 2016 to acquire the KDX Nihonbashi Kabutocho Building (with a floor area of 11,705.49 m^2) for ¥12.4bn with the aim of increasing leasing assets. This building, which is adjacent to the Tokyo Stock Exchange and Kabutocho Heiwa Building No.1, will obviously contribute to leasing revenue for the time being and is a candidate site for phase 2 and further development in the Nihonbashi Kabutocho and Kayabacho Project (the official transfer date is set for February 1, 2017).

Progress of Replacement in Portfolio of Buildings for Lease (1)

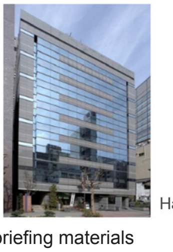
Replacement of portfolio has run its course. We are looking to expand leasing business by stressing quality properties.

Acquired in the course of replacing properties
Four properties: approx. 18 billion yen

Kayabacho Broad Square

Quatro Muromachi Building

Sakae Center Building



Hamacho Heiwa Building

Acquisition to expand holding of properties for lease: 12.4 billion yen

KDX Nihonbashi Kabutocho Building

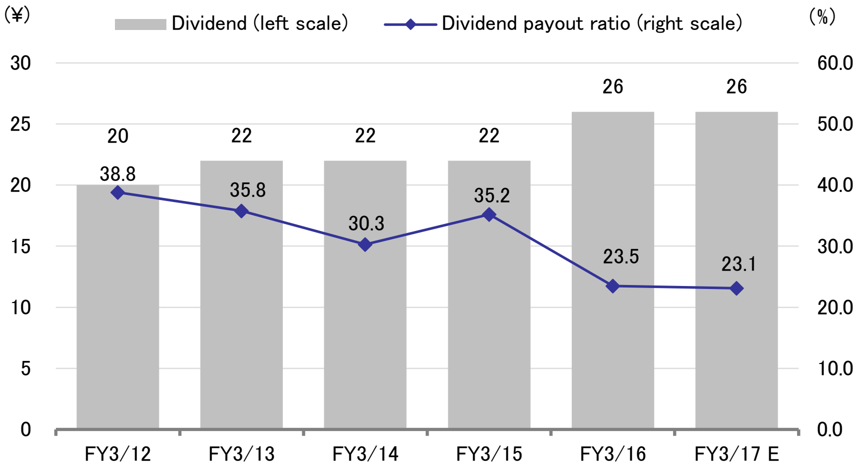
Source: From company’s results briefing materials

Shareholder Returns Policy

Plans to pay a dividend at the same level as FY3/16 in FY3/17 (¥26)

Heiwa Real Estate intends to maintain a dividend payout ratio of around 30% over the longer term, but it remains in a phase in which profit retention is more important than ever in order to achieve stable long-term business growth, including in redevelopment and leasing businesses. It plans to pay a dividend of ¥26 in FY3/17, the same level as FY3/16, for a 23.1% payout ratio.

Dividend Per Share and Dividend Payout Ratio



Note: While the company conducted a reverse split of ordinary shares (from five shares to one share) on October 1, 2012, we calculate the dividend per share as if it took place at the start of FY3/12

Company Overview

Main income sources are leasing business and real estate solutions business

(1) History

In 1947, the Japan Securities Exchange (a semi-private semi-public enterprise with 11 offices throughout Japan) dissolved. That year Heiwa Real Estate was established as in-kind investments to lease buildings to new exchanges and securities companies. Subsequently, the company increased its leased assets by developing or acquiring office buildings and expanded the scope of its business to include asset management and home development. Today, it has five consolidated subsidiaries.

(2) Business overview

Two main businesses, leasing and real estate solutions, provided 93.4% of total operating revenue and almost all operating income in 1H FY3/17.

As of September 2016, the leasing business owns about ¥212.0bn of assets for lease, including securities exchange buildings, office buildings, commercial facilities, and housing, in Japan's main cities, including Tokyo, Osaka, Nagoya, Fukuoka, Sapporo, and Sendai. Many of these buildings are in the securities industry centers of Nihonbashi Kabutocho in Tokyo, Kitahama in Osaka, and Sakae in Nagoya. Leasing is the company's main business, supplying 59.7% of its total operating revenue and 88.5% of its total operating income before eliminations in 1H FY3/17.

The real estate solutions business has four sources of revenue: 1) management fees, 2) revenue from developed real estate, 3) brokerage fees, and 4) housing development. Management fees are earned by consolidated subsidiary Heiwa Real Estate Asset Management Co., Ltd., which operates assets received from Heiwa Real Estate REIT, Inc., a non-consolidated unit. Management fee income increases as the amount of assets under management expands. Revenue from developed real estate stems mainly from the sales of real estate to Heiwa Real Estate REIT as the exit. Sales tend to fluctuate annually, but because properties are usually sold soon after being acquired, the operating income from these sales varies less than sales. Brokerage fees are collected on real estate transactions conducted by the company across the board. The housing development business constructs condominium buildings and sells the units of these buildings. This business has a short operating cycle. In 1H FY3/17, the real estate solutions business provided 33.7% of the company's total operating revenue and 25.1% of its total operating income before eliminations.

Business Content and Breakdown (1H FY3/17)

Business segments	Segment details	Share of operating revenue		Share of operating income	
Leasing Business	Office buildings	57.9%	59.7%	86.7%	88.5%
	Residential buildings	1.7%		1.8%	
Real Estate Solutions Business	Management fees	3.8%	33.7%	24.9%	25.1%
	Revenue and income from real estate development, etc.	23.2%			
	Brokerage fees	2.4%			
	Housing development	4.0%		0.2%	
Other Businesses	Management and renovation of buildings, etc.		6.6%		1.6%
Eliminations	-		-		-15.3%
Total	-		100%		100%

Source: Prepared by FISCO from company materials

(3) Leasing market environment and company's business model

Building leasing market has been improving. The average vacancy rate of office buildings in the five central commercial wards of Tokyo (Chuo, Chiyoda, Minato, Shinjuku, and Shibuya) decreased from 9.0% in March 2012 to 4.3% in March 2016*, on top of which the average rent in these wards grew higher. The average vacancy rate of office buildings leased in Greater Tokyo by Heiwa Real Estate was 6.4% in September 2016; however, excluding buildings the company had stopped leasing to redevelop, this vacancy rate was only 0.8%, far below the market average vacancy rate. The company practice to lease most of its building as a unit is contributing to this low vacancy rate.

* From Miki Shoji's office market data

In leasing business, to increase the added value, Heiwa Real Estate considers an entire area, not a single building. Because many of its buildings are located in the financial districts of leading cities, it excels at developing urban areas. For example, in the Sakae area of Nagoya, the company redeveloped buildings near the stock exchange over the 10 years from 2004, thereby enhancing the cityscape and increasing the floor area of all buildings leased in the area by 3.5 times from 11,300 m^2 to 39,700 m^2. Its leasing revenue from the area grew accordingly. The Nihonbashi Kabutocho and Kayabacho Revitalization Project is also an initiative where the company can leverage its expertise in urban redevelopment.

(4) Business model for real estate solutions business

The company's basic strategy for real estate solutions is to build a value chain that encompasses its entire group, including Heiwa Real Estate REIT Inc. As a sponsor of Heiwa Real Estate REIT, Heiwa Real Estate acquires buildings, raises their value, such as by lowering their vacancy rates, and then supplies the buildings to the REIT. Heiwa Real Estate Asset Management, a consolidated subsidiary, mainly handles related asset management and earns management fees. This structure forms a cycle of organic growth that generates profits, in which Heiwa Real Estate enhances the REIT's asset value by supplying it with quality properties, and as the number of properties consigned by the REIT increases, stable management fees grow. Heiwa Real Estate REIT, which is not consolidated, mainly invests in office and residential buildings located in Tokyo's wards and has been generating healthy earnings in recent years.

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