INTELLEX Co., Ltd.

8940

Tokyo Stock Exchange Prime Market

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Index

Summary

To restructure earnings base in FY5/24; aiming for growth with energy-efficient renovation product ECOCUBE

INTELLEX Co., Ltd. <8940> (hereafter referred to as "the Company") is a pioneer and the largest company in its industry, specializing in the renovation and sale of pre-owned condominiums. To date, the Company has sold more than 26,000 units. In addition, since FY5/16 it has diversified and stabilized its portfolio through the launch of its Asset Sharing (sales of small-lot real estate) and Leaseback Businesses. Since 2021, the Company has undertaken measures including launching its energy-efficient renovation product, ECOCUBE, and has unveiled its strategy to grow while contributing to the reduction of carbon emissions in society.

1. FY5/23 Results Overview

In the FY5/23 consolidated results, the Company faced challenges despite higher net sales. Net sales grew by 14.1% year on year (YoY) to ¥41,236mn, but ordinary profit declined by 47.9% to ¥710mn. The Company achieved double-digit growth in net sales, thanks to increased numbers of Renovated Condominiums and higher average sales price compared to the previous year. However, the gross profit margin fell due to rising construction costs and disposal of unsold properties that had been on the market for an extended period. Moreover, an increase in upfront expenses, mainly related to promotional expenses for ECOCUBE, negatively impacted overall profit. Despite accounting for 13% of the total sales (with 150 units sold out of a total 1,152 Renovated Condominiums), ECOCUBE fell short of its initial target of 500 units. This was largely attributed to the Company's ineffective communication regarding ECOCUBE's added value, which includes energy efficient, eco-friendly features, and health benefits. To address these challenges, the Company plans to boost sales by launching a more competitively priced product. ECOCUBE L* in FY5/24.

* ECOCUBE comes with insulation materials, inner windows, a high-performance ventilation system, and a highly efficient air conditioner tailored to unit-specific heat calculations. ECOCUBE L on the other hand is designed for properties with a floor space of 50m^2 or more, which meet new seismic standards. Its application enhances insulation effects through inner windows and similar elements, all based on the unit-specific heat calculations. What sets ECOCUBE L apart, is that it achieves additional cost savings on interior work by omitting insulation materials, resulting in a reduction in overall construction time.

2. FY5/24 Results Outlook

The forecast for FY5/24 consolidated results calls for net sales and profit growth, with net sales expected to increase 17.7% YoY to ¥48,543mn and ordinary profit increasing 52.3% to ¥364mn. To achieve this, the Company has devised a strategy focused on improving efficiency and profitability. This entails restructuring the Renovated Condominium Business and expanding investment in upfront ventures. In 1H, the Company expects to incur an ordinary loss of ¥143mn due to inventory optimization efforts in the Renovated Condominium Business. However, it anticipates a turnaround in 2H, driven by a recovery in gross profit margins. In terms of the Renovated Condominium Business, the Company aims for a 16.2% YoY increase in sales value, reaching ¥34.3bn, and an 8.5% increase in the number of units sold, totaling 1,250 units (including 400 ECOCUBE units). While the pre-owned condominium business may face challenges such as rising sales prices and inventory build-up in FY5/24, the Company is committed to achieving rapid earnings recovery through proactive inventory management and streamlining the property purchase-to-sales timeline. Furthermore, the Solutions Business is expected to contribute to net sales and profit growth. This will be achieved through the sale of income property buildings (¥4.0bn), securitization of leaseback properties (¥1.9bn), and sales of the Asset Sharing series (¥2.0bn).

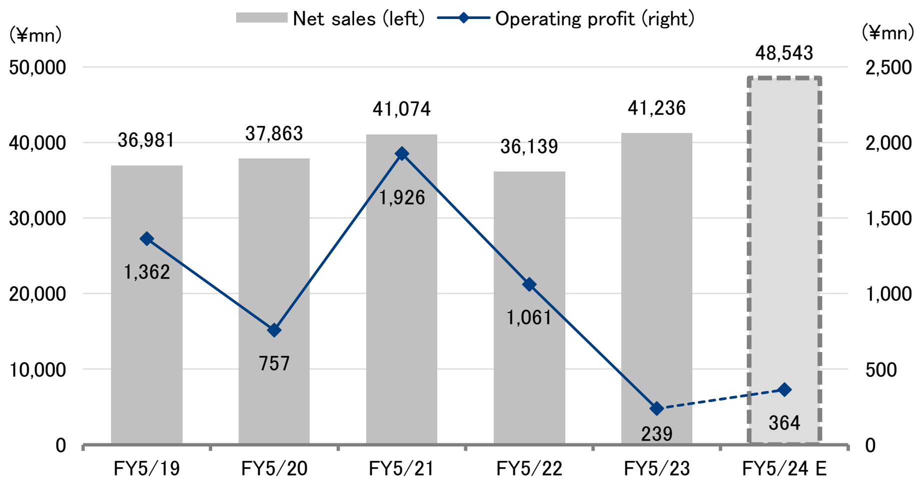
3. Growth strategy

In response to the increasing uncertainty in the real estate market and recent earnings trends, the Company has announced a revision to its three-year Medium-term Management Plan, effective from FY5/23. While its Circular Renovation Model remains a central focus, the Company has decided to adjust its numerical earnings targets based on FY5/24 results. With a strategic focus on increasing its market share, the Company plans to leverage ECOCUBE as a strategic product. This strategic move is motivated by the expected rise in demand for energy-efficient renovations, even for pre-owned condominiums, as Japan strives towards achieving a decarbonized society. Additionally, the Company has submitted an application to change its stock market classification from the current Prime Market to the Standard Market effective October 20, 2023.

Key Points

- In FY5/23, there was a slight YoY increase in the sales and purchase numbers of Renovated Condominiums
- The Company aims to complete inventory adjustment in 1H FY5/24 to facilitate profit recovery in 2H
- Embracing an ambidextrous management approach that involves revitalizing existing core businesses while simultaneously expanding upfront investment initiatives
- The Company's strategic focus is on achieving medium- to long-term growth by leading in the market for energy-efficient renovated condominiums, capitalizing on the expected demand increase driven by the push for a decarbonized society

Results trends



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

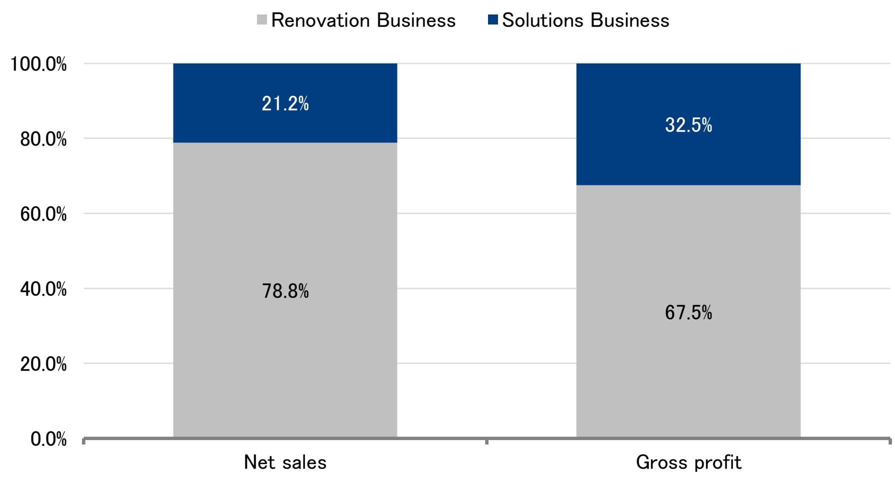
Business Overview

The Company is emphasizing the development of its Solutions Business, including Leaseback and Asset Sharing, with the Renovation Business as core focus

1. Business Segments Description

The Company operates two business segments: the Renovation Business, which involves purchasing, renovating and reselling individual pre-owned condominium units, and the Solutions Business. In FY5/23, the Renovation Business Field accounted for 78.8% of net sales and 67.5% of gross profit, making it the mainstay, but the Solutions Business has a higher profit margin.

Percentage of results by business segment (FY5/23)



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

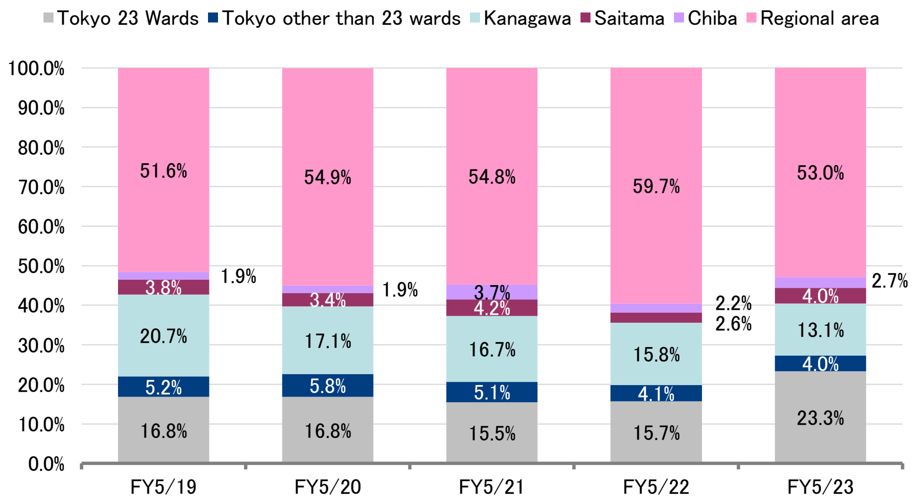
(1) Renovation Business Field

The Renovation Business involves resale, leasing, and brokerage of Renovated Condominiums and detached housing, as well as Renovation and Decoration Business, and the FLIE platform for real estate transactions. Renovated Condominium sales account for over 90% of segment sales.

The subsidiary INTELLEX Space Plan Co., Ltd. creates renovation plans based on real estate broker information and performs the interior renovations after which the properties are sold through real estate brokers or direct sales. To ensure profitability, the Company sets a target project period of approximately 120 days from purchase to sale, and sets a gross profit margin of 12-13% as the appropriate level. If the period exceeds this timeframe, the Company's policy is to adjust the sales price and complete the sale early, as a longer stock retention period poses a higher risk in declining profitability. The Company also contracts interior renovations to partner companies.

The Company started its sales in the metropolitan Tokyo area, and has gradually expanded to major regional cities (Sapporo, Sendai, Nagoya, Kyoto, Osaka, Hiroshima, and Fukuoka) since 2013. In the metropolitan Tokyo area, there is an increase in companies entering the market, including major real estate sales companies, which has led to intense competition. However, outside of the metropolitan area, there are still only a few companies involved in renovating condominiums, indicating the steady development of this market. Since FY5/19, over 50% of the number of units has come from outside the metropolitan area. Given that half of the country's condominium stock is located in the metropolitan Tokyo area, the Company deems a sales ratio that distributes sales equally between the metropolitan Tokyo area and other regions as an appropriate level. However, it strengthened purchase of properties in Tokyo's 23 wards (where demand is strong) amid a general slowdown in demand in other regions since 2022. As a result, the sales share of condominiums in the Tokyo 23 Wards area was 23.3% in FY5/23, exceeding 20% for the first time in eight years, and this trend looks set to continue for some time.

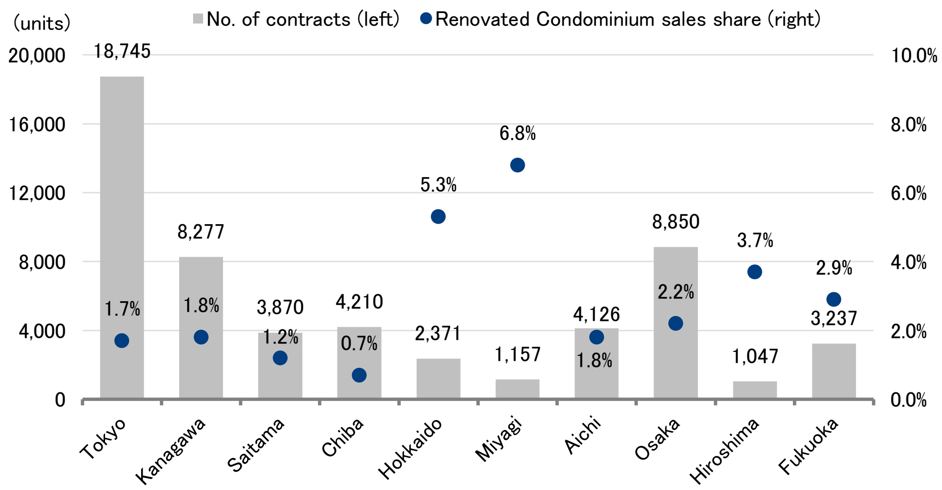
Percentages of units sold by area



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

The company's share in the pre-owned condominium sector across different areas currently stands at around 1% in the metropolitan Tokyo area and fluctuates between 2% and 6% in other regions. This suggests that there is significant room for expansion, even if the market were to remain relatively static.

No. of pre-owned condominium contracts
and Renovated Condominium market share (FY5/23)



Note: Sales share: Number of units sold at each branch divided by the number of pre-owned condominium contracts in the prefectures where the branches are located.
Source: For pre-owned condominiums, "Monthly Market Watch Summary Report (National)," Real Estate Information Network for East Japan

The Company's Renovation and Decoration Business services both individual customers and companies in the same industry that specialize in selling renovated condominiums. This accounted for about 5% of total sales in FY5/23. Due to the need for expertise in condominium interior renovation work for each property, the Company receives numerous inquiries from major real estate companies including MITSUBISHI ESTATE RESIDENCE CO., LTD. and other industry players. Recently, there has been an increase in cases of REIT management companies placing orders with the Company for renovations to increase the value of their portfolio properties.

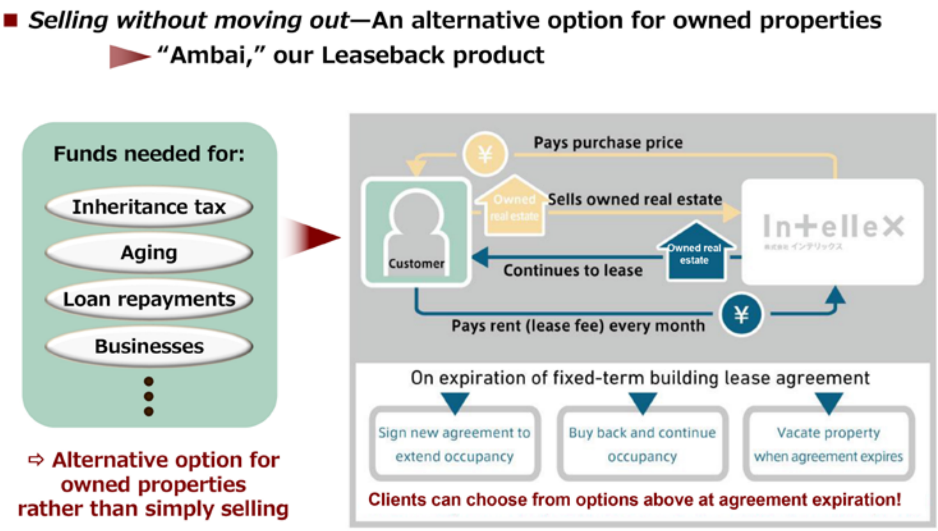
(2) Solutions Business Field

The Solutions Business Field comprises various services such as development, sales, leasing, management, brokerage, etc. for revenue-generating real estate such as buildings and land. It also includes the development and sales of newly built condominiums, leaseback, asset sharing, and hotel and accommodation businesses.

a) Leaseback Business

The Leaseback Business is a service that the Company began providing in FY5/17. In this service, the Company purchases owned real estate (homes, homes combined with retail stores, condominium buildings, etc.) from users while simultaneously concluding a fixed-period property rental contract (two years) with them and collecting the rent. The contract allows users to choose whether to re-sign and continue to live in the home, to leave it, or to purchase the owned real estate as their contract period approaches its end. The market for this service has grown in recent years, as it allows homeowners to sell their property and continue to live in it, enabling them to raise funds for purposes such as inheritance tax, retirement, or loan repayment.

Leaseback Business Framework



Source: The Company's results briefing materials

The Company's revenue is derived from contract fees at the time of property acquisition, rental income, which is obtained every month, and sales income upon property sale. It is thus a hybrid business model that combines recurring revenue and one-time revenue. On the other hand, costs are incurred upon acquisition, including acquisition tax, registration and depreciation costs. As a result, the business model incurs costs over a fixed period after acquisition, but time profit margins increase when the property is sold due to the progress of depreciation. Although individual unit sales are possible, the Company increases funding efficiency by bundling multiple units and selling them to a real estate fund as real estate trust beneficiary rights.

&Do Holdings Co., Ltd. <3457> was a pioneer in the industry, when it launched the leaseback business in 2013. Since then, more companies, including finance companies, have started participating in this business. For this reason, the Company intends to expand this business by increasing purchase and sales routes, as well as building stronger partnerships with major real estate companies such as CENTURY 21 REAL ESTATE OF JAPAN LTD. <8898>

b) Asset Sharing Business

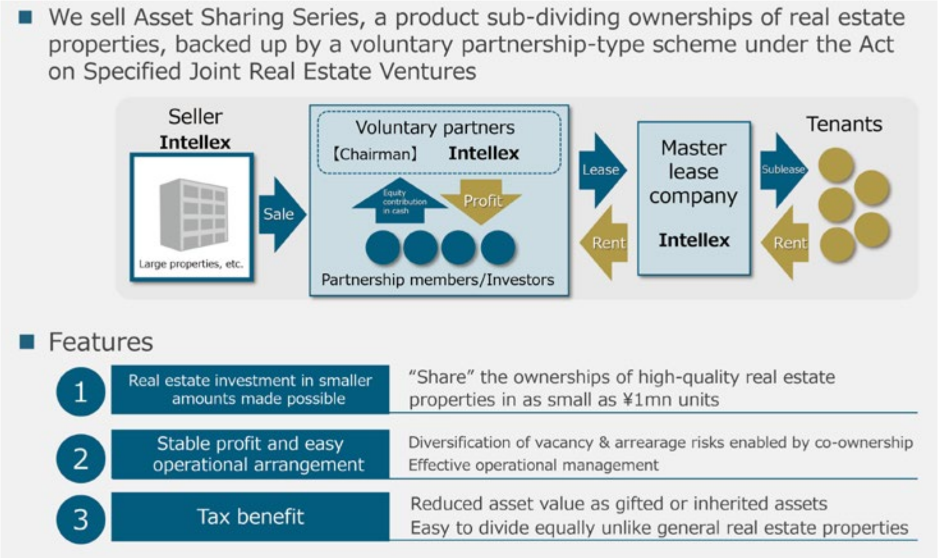
The Asset Sharing Business is a business selling small-lot real estate products using the "voluntary partnership-type" scheme specified in the Act on Specified Joint Real Estate Ventures. These products have several features, such as enabling the acquisition of high-quality real estate properties, newly built or pre-owned, through joint ownership on units of ¥1.00mn per lot, dispersing the risk of vacancies and non-payment of rent, being expected to stably generate earnings, and keeping the asset value down as an inheritance or gifted asset.

The Group's subsidiary INTELLEX Property Co., Ltd. mainly manages the real estate properties. The Group can obtain flow income from small-lot sales as well as stock (recurring) income from voluntary partnership chairperson fees and property management fees. The Company aims to target an expected distribution yield* of at least 3% for its products as investors' expected rate of return.

* Annual income from deducting actual costs generated (administrative expenses, etc.) from rental income ÷ investment amount

This business sector includes other companies, such as Aoyama Zaisan Networks Co., Ltd. <8929> and Financial Products Group Co., Ltd. <7148>, which have launched their businesses before the Company. But the Company has its own strengths, including its ability to utilize its existing network and expertise as a real estate company, enabling it to develop a wide range of products, of both newly built and pre-owned properties and catering to both residential and commercial needs. In terms of sales, the Company employs various channels, such as conducting seminars, utilizing its own website, and collaborating with professionals, such as tax accountants, financial institutions, and other organizations.

Asset Sharing Business Framework (sales of real estate small-lot products)



Source: The Company's results briefing materials

The Company's Strengths lie in its internally developed renovation expertise and a rapid purchasing system

2. Company's Strengths

The Company has two strengths in the Renovation Business Field. The first strength is its ability to purchase profitable properties within a short time frame. The company receives about 2,500 to 3,000 cases of property sales information from real estate brokerage companies every month. The staff in charge verifies the conditions on site within 1 or 2 days and makes a final purchase decision. In contrast, other major real estate companies usually take around a week to make a decision. Therefore, the Company is able to acquire excellent properties ahead of its competitors. However, due to increasing competition in the metropolitan Tokyo area, it has become more challenging to purchase properties at reasonable prices. The Company is starting to strengthen its direct purchase system from sellers.

The second strength of the Company lies in its expertise in renovating individual condominium units. Unlike detached houses, renovations of individual condominium units require careful consideration for the adjacent units, meaning that the renovation must be conducted with minimal noise and vibrations within a short period. Leveraging its extensive experience renovating many properties to date, the Company has developed unique renovation methods specifically designed for condominiums. Its in-house methods include conducting quiet renovations to minimize noise when drilling holes and fastening screws, as well as utilizing subflooring and sheathing materials and streamlining infrastructure, such as header pipes that collect water supply in one location. By utilizing these specific condominium renovation methods, the Company ensures consistent quality of renovation, as well as efficiency in subsequent maintenance work. Moreover, as the living infrastructure such as water and electrical systems are shared with the other condominium units, it is crucial to handle these elements with care when conducting construction work that could potentially impact them. The Company has therefore prepared a comprehensive renovation manual, and is dedicated to maintaining and improving the quality of services by its partner companies who carry out the renovation work. Its innovative renovation technologies have received high praise within the industry, resulting in many renovation consignment projects from major real estate companies.

Condominium renovation methods

Quiet renovation

Header pipes

Source: reprinted from the Company's website

Results Trends

Lower profit on higher sales due to increased costs and upfront investment in FY5/23

1. FY5/23 Results Overview

The consolidated results for FY5/23 showed an increase in net sales by 14.1% YoY to ¥41,236mn, and declines of 47.9% in operating profit to ¥710mn, 77.4% in ordinary profit to ¥239mn, and 84.3% in profit attributable to owners of parent to ¥100mn, with profit down at all levels on higher sales. Net sales grew 16.8% YoY in the Renovation Business and 5.0% in the Solutions Business, but gross profit fell 4.0% in the Renovation Business to ¥4,128mn and grew 9.8% in the Solutions Business to ¥1,984mn, with little change overall (up 0.1% YoY) to ¥6,112mn. Operating profit was negatively affected by several factors, notably a significant YoY increase of 13.9% in SG&A expenses, totaling to ¥5,402mn. This increase was mainly driven by ¥320mn in promotional expenses for ECOCUBE, which included costs related to TV commercials and outdoor advertising. Additionally, upfront investments in new businesses including the FLIE platform, contributed to this growth in expenses. The non-operating profit/loss also worsened, increasing by ¥168mn YoY. This was mostly attributed to a ¥109mn increase in interest expenses related to interest-bearing debt and ¥57mn incurred in sustainability-linked loan origination costs.

Consolidated results for FY5/23

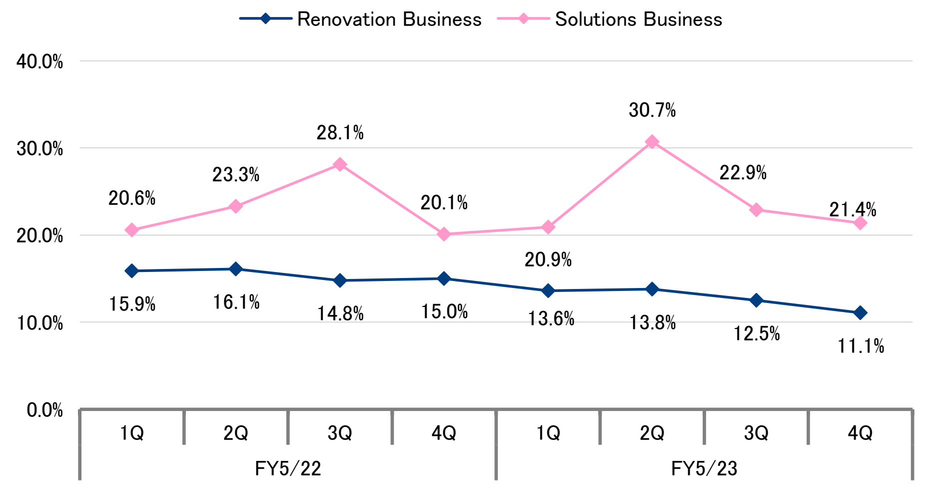
(¥mn)

	FY5/22		FY5/23				
	Results	% of sales	Company forecast	Results	% of sales	YoY	vs. forecast
Net sales	36,139	-	42,417	41,236	-	14.1%	-2.8%
Gross profit	6,109	16.9%	6,984	6,112	14.8%	0.1%	-12.5%
SG&A expenses	4,745	13.1%	6,054	5,402	13.1%	13.9%	-10.8%
Operating profit	1,364	3.8%	930	710	1.7%	-47.9%	-23.6%
Ordinary profit	1,061	2.9%	601	239	0.6%	-77.4%	-60.2%
Extraordinary profit/losses	-45	-	-	-1	-	-	-
Profit attributable to owners of parent	643	1.8%	420	100	0.2%	-84.3%	-76.0%
Renovated condominium							
No. of sales (units)	1,129	-	1,247	1,152	-	2.0%	-7.6%
Average sales price (¥1,000)	23,242	-	24,680	26,298	-	13.1%	6.6%

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

Net sales and profit across all levels fell short of the Company's initial forecasts. The decline in net sales can be attributed to a 7.6% YoY decrease in the number of Renovated Condominiums sold, despite a 6.6% increase in the average sales price. Regarding profitability, one key factor was the drop in the gross profit margin within the Renovation Business from 15.5% in FY5/22 to 12.7% in FY5/23. This decline had a negative impact, despite the Company's effort to reduce SG&A expenses compared to the plan. Several factors contributed to this decline in gross profit margin. Firstly, there were increasing purchase costs for pre-owned condominiums in an increasingly competitive market. Additionally, construction costs per property increased due to a higher proportion of older properties and the inclusion of ECOCUBE. Moreover, prices in building materials increased, and the Company was unable to fully pass on these cost increases to the sales prices. Another factor that negatively affected profit was the disposal of properties that had remained unsold for an extended period, a trend that began accumulating in 4Q. The quarterly trends in gross profit margin declined from 12.5% in 3Q to 11.1% in 4Q within the Renovation Business. This decline was mainly due to the necessity of disposing excess inventory.

Gross profit margin by segment



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

In FY5/23, slight YoY increase in sales and purchases of Renovated Condominiums

2. Trends by Business Segment

(1) Renovation Business Field

The Renovation Business Field saw a 16.8% YoY increase in net sales to ¥32,500mn and gross profit decreased 4.0% to ¥4,128mn, while operating profit declined 43.8% to ¥750mn. Property sales rose by 16.0% to ¥30,321mn due to an increase in the number of Renovated Condominiums sold and an increase in sales prices, while rents were down 2.9% to ¥146mn. Other income increased by 32.3% YoY to ¥2,032mn, due in part to Renovation and Decoration Business orders increasing by 16.6%. Gross profit can be categorized into two components: property sales, which amounted to ¥3,807mn (down 5.6% YoY), and rents, totaling ¥101mn (down 6.7%). These declines were partially offset by other income, which saw a substantial 37.6% YoY increase, reaching ¥219mn, due to the impact of increased sales.

Renovation Business Field results

(¥mn)

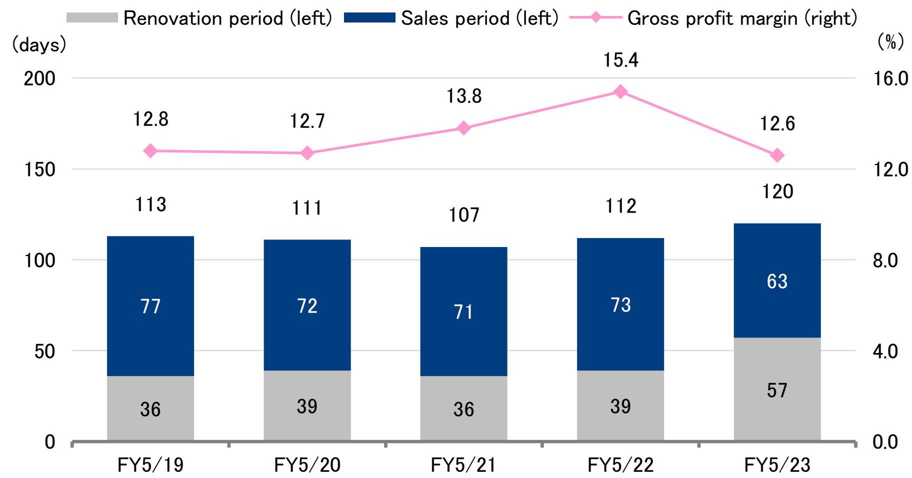
	Net sales			Gross profit			Gross profit margin	
	FY5/22	FY5/23	YoY	FY5/22	FY5/23	YoY	FY5/22	FY5/23
Property sales	26,129	30,321	16.0%	4,033	3,807	-5.6%	15.4%	12.6%
Rents	150	146	-2.9%	108	101	-6.7%	72.0%	69.2%
Other income	1,535	2,032	32.3%	159	219	37.6%	10.4%	10.8%
Total	27,816	32,500	16.8%	4,301	4,128	-4.0%	15.5%	12.7%

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

The project period of Renovated Condominiums increased by eight days from 112 days in FY5/22 to 120 days in FY5/23. These figures exclude unsold properties held by the Company for over 180 days, which could potentially extend the project period further. When analyzing the project period, we can see a breakdown of these changes. The sales period contracted from 73 days to 63 days. In contrast, the construction period increased by 1.4 times, moving from 39 days to 57 days. As noted above, this extension in the construction phase is mainly attributable to the growing share of older properties and the inclusion of ECOCUBE units. Renovating older properties typically requires more extensive remedial work, including plumbing, which necessitates the involvement of specialized tradespeople. Additionally, the semiconductor shortage had an impact, causing procurement difficulties for housing equipment in 2Q. Supply chain issues related to building supply appear to have been resolved. Furthermore, there has been an increasing demand for inner windows, especially following the launch of the Ministry of the Environment's Advanced Window Renovation Project*. This heightened demand has resulted in a shortage of window sashes, which has further contributed to project delays.

*A project run by the Ministry of the Environment promoting energy-efficient renovations for existing residences. Under this initiative, the central government offers subsidies to cover a portion of the expenses related to window insulation improvements. These improvements may include the installation of inner windows, replacement of outer windows, or window glass replacement, among others. Homeowners opting to install inner windows can apply for a subsidy of ¥30,000 to ¥124,000 per window depending on window size and performance. The subsidy application period runs from March 31 to December 31, 2023, or until the allocated budget of ¥100.0bn is exhausted.

Renovated Condominium project period and gross profit margin



* Excludes properties held by the Company for over 180 days
Source: Prepared by FISCO from the Company's results briefing materials

The sales performance of Renovated Condominiums increased 15.5% YoY to ¥30,295mn. This rise represents the first positive growth in two years. The number of properties sold also went up 2.0% YoY, reaching a total of 1,152 units, accompanied by a substantial 13.1% increase in the average sales price to ¥26.29mn. Looking at sales volume by area, the metropolitan Tokyo area recorded a 19.1% YoY increase, totaling 542 units. Other areas saw a 9.5% decline, resulting in 610 units sold, highlighting the growth disparity between the Tokyo area and other regions. This growth in the Tokyo area was mainly attributed to the Company's proactive acquisition of properties in relatively higher price ranges to expand ECOCUBE sales. Notably, sales in Tokyo's 23 wards surged by 51.4% YoY to 268 units. Additionally, sales were also up in Saitama and Chiba prefectures, strengthening the overall sales structure. However, in other regions such as Sapporo, Sendai, Nagoya, and Fukuoka, sales declined, while they increased in Osaka and Hiroshima. During the same period, the total number of pre-owned condominium contracts in other regions fell 5.0% YoY to 55,890 units*. Nevertheless, the share of Renovated Condominiums increased slightly from 1.9% to 2.1%. ECOCUBE sales totaled 150 units, accounting for 13% of total sales. However, this figure fell short of the initial target of 500 units. An analysis conducted by the Company identified that the challenge lay in its failure to effectively communicate to its customers how the added value of ECOCUBE, such as energy efficiency, eco-friendly features, and health benefits, justifies the ¥1.00–1.50mn price premium.

* Source: Real Estate Information Network for East Japan

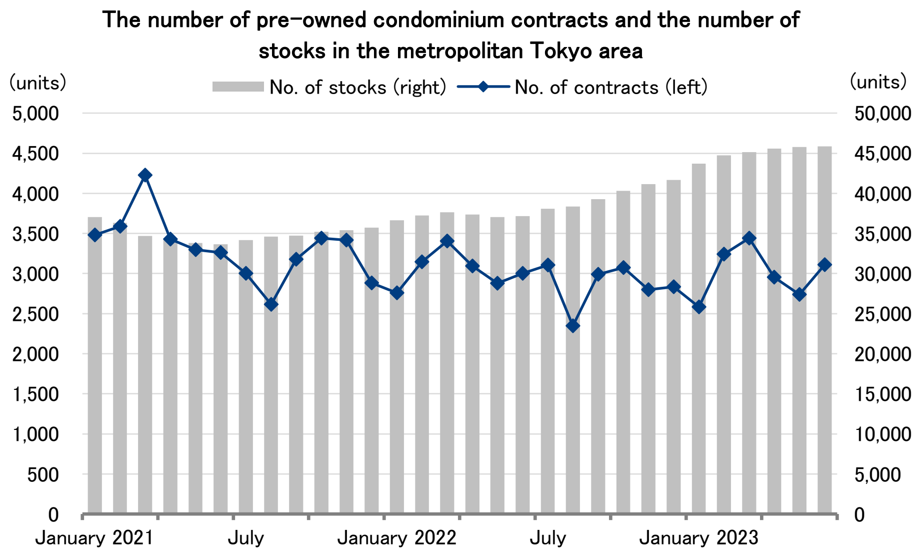
The number of units purchased showed a slight 0.2% YoY increase, totaling 1,271 units, and the total purchase value amounted to ¥23,079mn, up 15.1%, both increasing two years running. However, a closer examination reveals a shift in purchasing patterns, with the Company acquiring 680 units (up 6.9% YoY) in 1H and 591 units (down 6.5%) in 2H, suggesting a slowdown. This change is a result of the Company adopting a more stringent approach to property appraisal as part of its inventory optimization strategy. In terms of geographical distribution, the Company purchased 540 units (down 4.4% YoY) in the metropolitan Tokyo area and 731 units (up 4.0%) in other regions. The average purchase price continued to rise, up 14.8% YoY to ¥18.16mn. This increase in average purchase price can be attributed to the overall uptrend in market prices, not only in the high-priced units within Tokyo's 23 wards, but also in other regional areas. Another contributing factor is the Company's preference for properties in prime locations and relatively new properties, as these tend to require less renovation time. This preference emerged after the Company tightened its appraisal criteria for property acquisitions.

Number of Renovated Condominiums purchased and sold by area, the amount, and the average price

	No. of purchases				No. of sales			
	FY5/21	FY5/22	FY5/23	YoY	FY5/21	FY5/22	FY5/23	YoY
Metropolitan Tokyo area	483	565	540	-4.4%	642	455	542	19.1%
Tokyo's 23 wards	166	247	263	6.5%	220	177	268	51.4%
Other areas in Tokyo	63	56	44	-21.4%	72	46	46	-
Kanagawa	194	200	160	-20.0%	237	178	151	-15.2%
Saitama	41	36	45	25.0%	60	29	46	58.6%
Chiba	19	26	28	7.7%	53	25	31	24.0%
Total of other regional area	698	703	731	4.0%	778	674	610	-9.5%
Sapporo	117	157	150	-4.5%	141	139	125	-10.1%
Sendai	79	88	110	25.0%	83	87	79	-9.2%
Nagoya	185	83	82	-1.2%	135	92	75	-18.5%
Osaka	177	206	210	1.9%	246	191	197	3.1%
Hiroshima	33	40	50	25.0%	36	38	39	2.6%
Fukuoka	107	129	129	0.0%	137	127	95	-25.2%
Total	1,181	1,268	1,271	0.2%	1,420	1,129	1,152	2.0%
Total amount (¥mn)	16,105	20,051	23,079	15.1%	31,299	26,129	30,321	16.0%
Average price (¥10,000)	1,364	1,581	1,816	14.8%	2,204	2,324	2,629	13.1%

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

During the period of June 2022 to May 2023, the pre-owned condominium industry in the Tokyo metropolitan area showed a decrease in the number of contract closings by 5.3% YoY to 35,101, while inventory as of May 2023 increased 23.6% to 45,000 units. This drop in the number of units sold can be attributed to growing economic uncertainty and a decreasing motivation among buyers, largely due to the overall increase in sales prices. Despite these market trends, there remains strong demand, particularly within Tokyo's 23 wards. This indicates a clear polarization between popular and less popular locations within the metropolitan area. Notably, the Company's sales volume in the metropolitan Tokyo area saw a remarkable 19.1% YoY increase, with its market share in this region recovering slightly from 1.2% to 1.5%. While the Company did not achieve its initial target, it is likely that its market share increased due to concerted efforts to increase ECOCUBE sales. FISCO recognizes the potential for ECOCUBE to become a differentiating product that could further expand the Company's market share. This potential hinges on better informing about the advantages of ECOCUBE and dispelling any misconceptions regarding its pricing.



Source: Prepared by FISCO based on Real Estate Information Network for East Japan data

(2) Solutions Business Field

In the Solutions Business Field, there was an increase in net sales, gross profit, and operating profit YoY. Specifically, net sales increased by 5.0% YoY to ¥8,736mn, gross profit increased by 9.8% to ¥1,984mn, and operating profit rose 7.8% to ¥906mn. A closer look at the sales reveals that property sales decreased by 1.2% to ¥6,999mn, rental income increased by 1.2% to ¥1,013mn, and other income, which primarily stems from the hotel and accommodations business, increased 200.7% to ¥722mn.

Solutions Business Field results

(¥mn)

	Net sales			Gross profit			Gross profit margin	
	FY5/22	FY5/23	YoY	FY5/22	FY5/23	YoY	FY5/22	FY5/23
Property sales	7,080	6,999	-1.2%	1,307	1,248	-4.5%	18.5%	17.8%
Rents	1,002	1,013	1.2%	533	530	-0.5%	53.2%	52.4%
Other income	240	722	200.7%	-33	204	-	-14.0%	28.4%
Total	8,323	8,736	5.0%	1,807	1,984	9.8%	21.7%	22.7%

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

Property sales were largely unchanged YoY. The Company sold off income property buildings and completed sales of Asset Sharing Sapporo, a small-lot real estate product (amount offered: ¥480mn), but postponed planned securitization* of the Leaseback Business, which contributed to net sales in FY5/22. In other income, net sales were aided by a recovery of hotel occupancy rates, which had slumped amid the COVID-19 pandemic, from 2H onward due to the relaxing of entry restrictions into Japan (sales of the hotel business increased 1.7 times). As of FY5/23, occupancy rates were around 90% at LANDABOUT (Taito-ku, Tokyo) and in the 70% range at montan HAKATA (Fukuoka City, Fukuoka Prefecture), helping the hotel business to turn profitable. The Company currently owns these hotel facilities, but after earnings have stabilized, it will consider selling them as Asset Sharing properties.

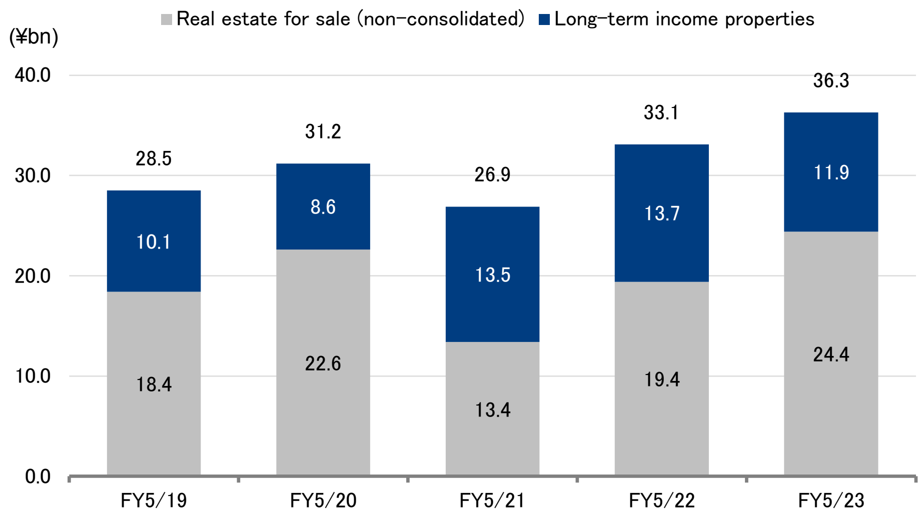
* In August 2021, the Company transferred 88 leaseback properties to LLC Ambai LB No. 2 for ¥1,843mn, and in March 2022, it transferred 173 leaseback properties to LLC Ambai LB No. 3 for ¥2,594mn.

Working to strengthen financial condition by improving turnover of its income properties, which increases funding efficiency

3. Financial Conditions and Management Indicators

At the end of FY5/23, total assets increased by ¥4,697mn from the end of FY5/22 to ¥45,629mn. The increase was primarily due to a ¥537mn increase in cash and deposits in current assets and a ¥5,981mn increase in real estate for sale. On a non-consolidated basis, it is evident that this category can be further divided into two components: A ¥5.2bn increase in regular properties to ¥17.7bn, and a ¥200mn decrease in rental properties, resulting in a total of ¥6.7bn. Within non-current assets, long-term income properties decreased by ¥1.8bn, totaling ¥11.9bn. However, the overall sum of income properties increased by ¥3.2bn to ¥36.3bn, marking the highest levels recorded since 2010. As previously mentioned, this surge in income properties is attributed to the Company's aggressive property acquisitions through 1H which coincided with rising real estate prices. Subsequently, in 2H sales slowed down, resulting in an accumulation of properties unsold for an extended period.

FY-end balance of income properties



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

Total liabilities increased by ¥4,901mn from the end of FY5/22 to ¥33,855mn. This growth was primarily driven by a ¥4,723mn increase in interest-bearing debt, which was used to finance the acquisition of income properties and upfront investment in new businesses such as ECOCUBE and FLIE. This figure includes sustainability-linked loans (SLL)*, syndicated loans designed to support the achievement of the UN's Sustainable Development Goals (SDGs), and syndicated loans aimed at promoting decarbonization. These loans reflect the Company's SDGs-related initiatives, such as energy-efficient renovations and the promotion of digital transformation within the real estate market. Total net assets decreased by ¥204mn, settling at ¥11,774mn. This decrease is primarily a result of the ¥100mn profit attributable to owners of the parent being offset by dividend payments amounting to ¥191mn and share buyback totaling ¥199mn.

* Sustainability-linked loans (SLL) are a type of loan that encourages borrowers to achieve certain targets that support sustainable economic activity. The terms of the loan change based on extent to which the borrower achieves its Sustainability Performance Targets (SPTs) in its SDGs/ESG strategy. In the most recent SLL, the Company has chosen the number of ECOCUBE specification Renovated Condominiums sold as KPI and set its SPTs as increasing the number of units sold.

An analysis of indicators shows that the Company's capital ratio fell from 29.2% at the end of FY5/22 to 25.8%. This decrease can be attributed primarily to the increase in interest-bearing debt. Additionally, the interest-bearing debt ratio increased from 220.4% to 264.4%. Consequently, the Company's financial standing exhibited some deterioration, and key profitability indicators such as ROA, and ROE, and operating margin have seen consecutive declines over the past two years. To address this trend and improve its financial standing and profitability, the Company has formulated a strategy to increase the turnover of its income properties. This approach aims to efficiently utilize funds to improve its financial standing and profitability.

Consolidated balance sheet and management indicators

(¥mn)

	FY5/20	FY5/21	FY5/22	FY5/23	Change
Current Assets	28,327	20,559	25,101	31,633	6,531
(Cash and Deposits)	4,947	6,215	4,428	4,965	537
(Real estate for sale)	22,918	13,642	19,769	25,751	5,981
Non-current Assets	10,269	15,736	15,831	13,996	-1,834
Total Assets	38,596	36,296	40,932	45,629	4,697
Current Liabilities	17,698	15,610	18,775	23,371	4,595
Non-current Liabilities	10,262	9,098	10,178	10,484	306
Total Liabilities	27,961	24,709	28,953	33,855	4,901
(Interest-bearing Debt)	24,924	20,750	26,363	31,086	4,723
Total Net Assets	10,635	11,586	11,978	11,774	-204
(Security)					
Capital Ratio	27.5%	31.9%	29.2%	25.8%	-3.4pt
Interest-bearing Debt Ratio	234.7%	179.1%	220.4%	264.4%	44.0pt
(Profitability)					
ROA (Return on Assets)	2.0%	5.1%	2.7%	0.6%	-2.1pt
ROE (Return on Equity)	4.9%	10.2%	5.5%	0.8%	-4.6pt
Operating Margin	2.9%	5.3%	3.8%	1.7%	-2.1pt

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

Outlook

In FY5/24, to complete inventory adjustment in 1H and target profit recovery in 2H

1. FY5/24 Results Outlook

The Company's outlook for FY5/24 consolidated results calls for increases of 17.7% YoY in net sales to ¥48,543mn, 8.4% in operating profit to ¥769mn, 52.3% in ordinary profit to ¥364mn, and ¥145.5% in profit attributable to owners of parent to ¥247mn. On a half-yearly basis, the Company forecasts an operating profit of ¥65mn in 1H. This projection is based on the assumption that the gross profit margin of the Renovation Business Field will decrease during 1H due to the normalization of Renovated Condominium inventory. However, in 2H, the Company expects the gross profit margin to recover to levels seen in 1H FY5/23, resulting in a projected operating profit recovery to ¥704mn. Furthermore, the Company forecasts an improvement in non-operating profit/loss, with an expected increase of ¥66mn. This improvement is tied to a more favorable financial balance resulting from the more efficient utilization of funds facilitated by a shorter project period for Renovated Condominiums. Additionally, reduced origination costs related to financing secured in FY5/23 contribute to this improvement.

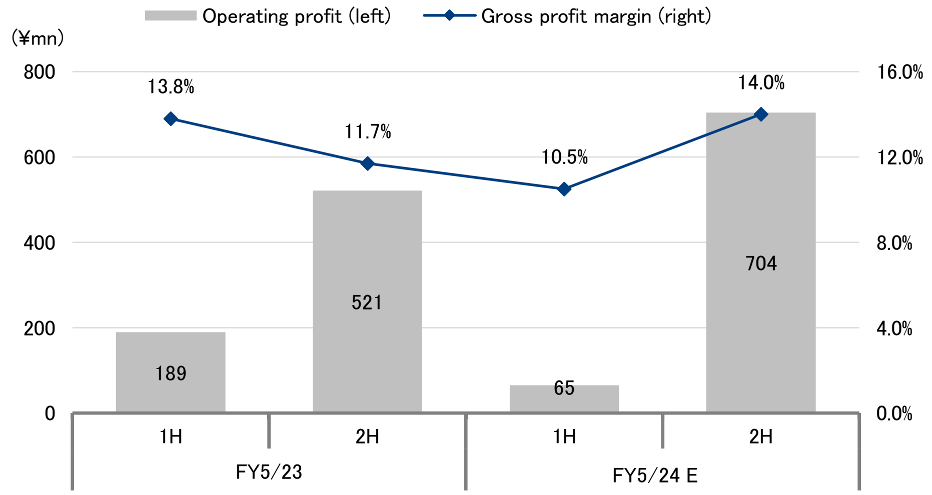
Outlook for FY5/24 results

(¥mn)

	FY5/23		FY5/24 (forecast)				
	Full fiscal year	% of sales	1H	2H	Full fiscal year	% of sales	YoY
Net Sales	41,236	-	24,355	24,187	48,543	-	17.7%
Gross profit	6,112	14.8%	2,821	3,461	6,283	12.9%	2.8%
SG&A expenses	5,402	13.1%	2,756	2,757	5,514	11.4%	2.1%
Operating profit	710	1.7%	65	704	769	1.6%	8.4%
Ordinary profit	239	0.6%	-143	508	364	0.8%	52.3%
Profit attributable to owners of parent	100	0.2%	-115	363	247	0.5%	145.5%
Earnings per share (EPS) (¥)	11.65	-	-13.84	43.38	29.54	-	-
Renovated Condominium							
No. of sales (units)	1,152	-			1,250	-	8.5%
Average sales amount (¥1,000)	26,298	-			27,480	-	4.5%

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

Operating profit and gross profit margin of Renovation Business Field



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

The Company expects that the adjustment phrase in the broader pre-owned condominium market will persist for an extended period. This adjustment is driven by a combination of factors, including a growing inventory of available properties and increasing sales prices, which have somewhat dampened buyer motivation. In light of these market conditions, the Company will focus on completing the optimization of its inventory. It will also concentrate on acquiring high-quality properties that align with its objectives. Additionally, the Company plans to foster sales and profit growth within the Renovation Business Field by diversifying its products offering. This diversification includes income property buildings, securitization of leaseback properties, and the Asset Sharing series. The Company has set specific sales targets for its main businesses, which are as follows: ¥34.3bn (up 16.2% YoY) for Renovated Condominiums (1,250 units, up 8.5% YoY; average price per unit up 4.5% to ¥27.48mn), ¥4.0bn for income property buildings, ¥1.9bn for securitization of leaseback properties, ¥2.0bn for the Asset Sharing series, ¥2.0bn for the Renovation and Decoration Business, and ¥700mn for the hotel business.

Ambidextrous management that combines rebuilding existing core businesses and expanding upfront investment business

2. Priority measures

Amid a persistently uncertain market environment, in FY5/24, the Company unveiled a strategy to establish a more streamlined management foundation. This is to be achieved by promoting an ambidextrous management approach that rebuilds existing core businesses and enhances upfront investment activities with the objective of improving efficiency and profitability. The upfront investment business includes two key components: ECOCUBE (an energy-efficient renovated condominium product) and FLIE (a real estate sale and purchase platform aimed at digital transformation real estate transactions).

(1) Rebuilding existing core businesses

In the Renovation Business Field, the Company is committed to strengthening its earnings base through a series of strategic measures anchored in three principal themes: elevating inventory turnover by accelerating the sales of current properties, strengthening the end-to-end process from property acquisition to commercialization and sales by leveraging factor analysis of internal and external marketing data, and promoting construction period reductions.

a) In April 2023, the Company reorganized its Renovated Condominium business. This restructuring included the implementation of an East/West area system to ensure a more detailed supervision and execution process. Additionally, a new evaluation system based on project duration was introduced to promote sales activities with a heightened focus on project timelines. While sales activities primarily emphasized property acquisitions, the Company now aims to improve the quality of properties and reduce the number of properties that had remained unsold for an extended period by approaching property acquisitions with awareness on the entire process. Particularly the property sale phase.

b) In June 2023, the Marketing Department, previously a part of the Corporate Communication Division, was transformed into an independent organization called the Sales Planning Department. This strategic move was made to further strengthen the procurement and sales of Renovated Condominiums further. The core responsibilities of the Sales Planning Department include analyzing supply and demand in each geographical area, a crucial element in expediting project timelines from acquisition to sales. Furthermore, the department is tasked with planning property specifications and design. Simultaneously, the Company established a new Renovation Design Department within its design and construction subsidiary INTELLEX Space Plan Co., Ltd. Previously, the Company had implemented advanced interior design for all properties, resulting in varying costs for different properties, not appealing to all potential buyers. However, by tailoring interior design to factors such as price range and location, the Company expects to achieve cost savings in interior construction. This strategic shift aims to reduce project timelines and overall expenses while also paving the way for a development of a new appraisal system based on accumulating substantial data.

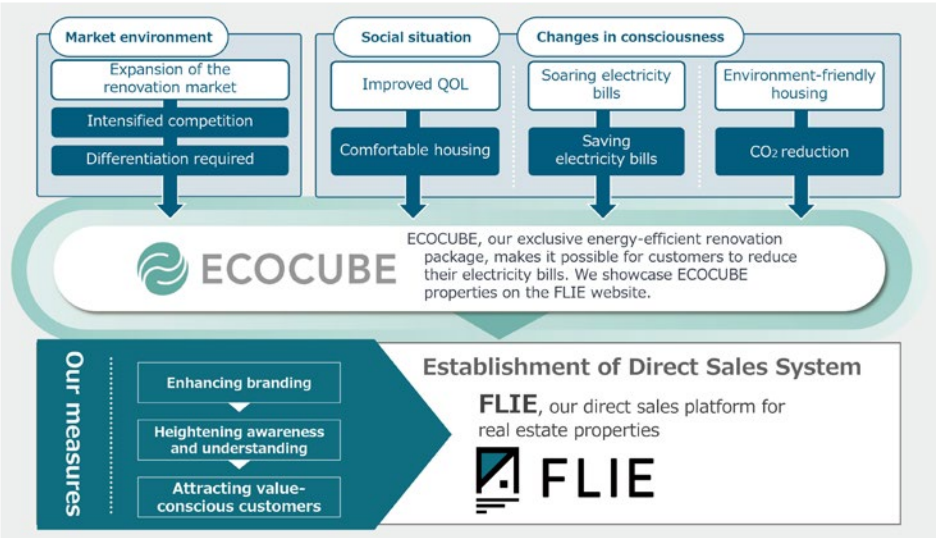
c) As part of an initiative to expedite construction timelines, the Company plans to establish stable partnerships with construction firms that consistently meet its quality standards. Additionally, measures will be taken to address the challenges posed by the skilled labor shortage in the industry. To mitigate the prolonged construction periods attributed to an increasing number of older properties and the ECOCUBE properties, the Company will adopt a more stringent approach to property appraisal, narrowing down the selection of properties for purchase. Furthermore, the Company will introduce a new product, ECOCUBE L, which does not install insulation materials.

In the Solutions Business Field, the Company is focused on achieving sales and profit growth. These strategies include planned securitization of the Leaseback Business to ensure consistent consolidated earnings, the sale of small-lot real estate products (Asset Sharing series) and a focus on maintaining stable and high occupancy rates in the hotel business. To achieve these goals, the Company will continue its aggressive acquisition of leaseback property through its website and by expanding alliances. Notably, in FY5/23, it acquired 133 properties, an increase of 18 compared to FY5/22, with a total value of ¥2.4bn, marking a ¥700mn increase from FY5/22. In 1H FY5/24, the Company plans securitization sales of ¥1.9bn, in addition to selling individual properties. Asset Sharing sales are projected to reach ¥2.0bn, primarily in 2H. The Company is optimistic about the hotel business, anticipating the continuation of high occupancy rates as travel because increases following the pandemic. It remains committed to its policy of aggressive property acquisitions while considering a range of exit strategies.

(2) Expanding upfront investment business

As part of its medium-term growth strategy, the Company aims to expand its market share in the highly competitive pre-owned condominium market. The key to this strategy is the promotion of ECOCUBE (an energy-efficient renovated condominium product that offers enhanced living conditions, cost savings on electricity, and environmental benefits, including CO_2 emissions reduction.) The Company plans to boost sales directly through FLIE website, leveraging the online platform for increased market presence and visibility.

Maintaining action based on medium-term priority policies



Source: The Company's results briefing materials

a) Increasing ECOCUBE Sales

In FY5/23, ECOCUBE sales reached a total of 150 units. However, several challenges were encountered during the year, including prolonged project periods due to additional work, difficulty in passing on property price and construction cost increases to sales prices, and a slow up-take in buyers' appreciation of the product's added value.

For FY5/24, the Company is introducing ECOCUBE L as a new product designed to address these challenges. ECOCUBE L is tailored for properties with a floor area of $50m^2$ or more, constructed according to the new seismic standards. ECOCUBE L units feature improved insulation through the use of inner windows, among other enhancements, based on unit-specific heat calculations. The units achieve additional cost savings by eliminating the need for insulation materials, thereby reducing overall construction time. The Company has set a sales target of 400 units for ECOCUBE L in FY5/24, representing over 30% of the total sales of Renovated Condominium sales.

Starting in April 2024, the Revised Building Energy Efficiency Act mandates the application of the Building-Housing Energy Efficiency Labeling System (BELS) to all newly constructed properties available for sale or rent. This requires the display of energy efficiency performance information. In the pre-owned condominium business, the Company intends to take the lead in energy efficiency labeling to drive the adoption of energy-efficient renovations. ECOCUBE L meets the energy efficiency standards and qualifies for home loan tax reduction as energy-efficient housing *. This means the tax reduction associated with home loans can offset the higher price, making it likely to stimulate increased demand for ECOCUBE L.

* Homeowners who own energy-efficient housing that complies with energy efficiency standards, are eligible for tax reduction on loans. The tax reduction can be as much as ¥40.00mn for homes with move-in date in 2022–2023 or ¥30.00mn for homes with move-in dates in 2024–2025 over a maximum period of 13 years, with 0.7% of the outstanding loan balance at the year-end being deducted from their income tax, partially offsetting the following year's resident tax.

RECOSYS Inc., a subsidiary of the Company, is actively developing a franchise business model to accelerate the growth of ECOCUBE. As of the end of FY5/23, fifteen companies have joined the franchise network. While these franchise companies are gradually establishing a track record in terms of sales, generating royalty revenue from them has proven to be more challenging than initially anticipated. As a result, the Company has adjusted its strategy by focusing on generating revenue from the franchise business through the development of building materials and equipment designed specifically for energy-efficient renovation, to be sold to franchise companies.

b) Expansion of the FLIE Real Estate Direct Sales Platform

The Company's subsidiary FLIE Co., Ltd. operates FLIE, an online platform facilitating secure, direct real estate transactions between sellers (real estate companies) and buyers. One of FLIE's notable features is its elimination of the need for buyers to pay a broker fee, saving them approximately 3% of the property price. By the end of July 2023, the platform had surpassed 2,000 pre-owned condominium listings, comprising both the Company's own listings and those from other sources), compared to 1,518 listings the previous year. This accomplishment positions FLIE as one of the largest direct sales sites in Japan. Additionally, FLIE's listing coverage has expanded beyond the metropolitan Tokyo area to encompass most regions across the country, with plans to expand into the Northern Kantō and Kōshin areas in the future.

In order to increase convenience to users, the Company is developing Smaview, a touchless self-tour reservation system that allows users to view the interiors of properties at any time by making an online reservation with their smartphones. The system is being tested with a limited number of properties and is continuously being improved. Additionally, since 2022, electronic contracts for real estate properties have been allowed. Going forward an electronic contracting function is expected to be added to the site.

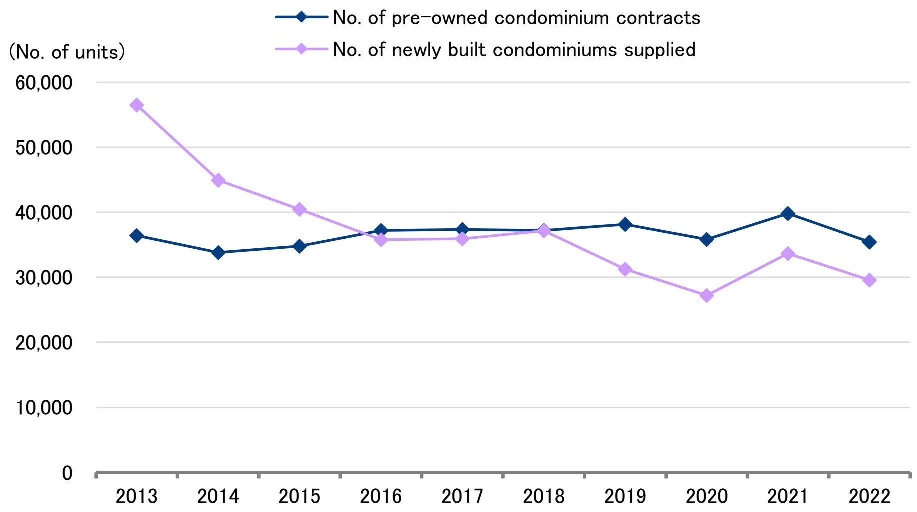
The volume of sales on FLIE is still small, and development investment will take precedence for the time being. However, it is expected that the site will contribute to earnings if listings increase when the site expands nation-wide. Currently, contract commissions are recorded as sales. In the future, the Company is expected to provide various added functions developed for real estate companies that list properties on the site and collect service usage charges.

Leading the field in energy-efficient renovated condominiums whose demand is set to grow amid push for a decarbonized society to achieve medium- to long-term growth

3. Medium- to Long-term Outlook for Renovated Condominiums Market

In 2022, the condominium market in the Tokyo metropolitan area experienced a reversal in trends, with both the number of pre-owned condominium contracts and newly built condominiums supplied decreasing for the first time in two years. Specifically, the number of pre-owned condominium contracts decreased by 11.0% YoY to 35,429, while the number of newly built condominiums supplied decreased by 12.1% to 29,569. Factors behind these declines include ongoing delays in procuring construction materials and sales price increases, as well as consumer sentiment that has dipped due to the uncertain economic outlook. Despite these challenges, pre-owned condominiums have held a dominant position in the market for seven consecutive years since 2016, with their position continuing to rise each year. As such, it is expected outstripped that the leading role in the condominium market will shift from newly built units to the pre-owned market.

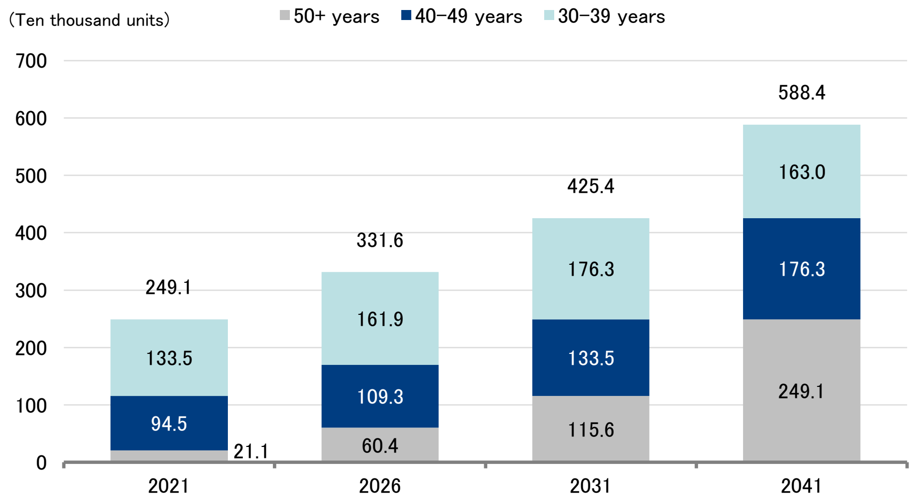
Condominium market trends in metropolitan Tokyo area



Source: Prepared by FISCO based on data from the Real Estate Information Network for East Japan for pre-owned condominiums and the Real Estate Economic Institute Co., Ltd. for newly built condominiums

Looking ahead over the medium to long term, it is expected that the pre-owned condominium market will become more stable due to the accumulation of stock. At the same time, steady growth is expected in the market of renovated condominiums. According to a survey by the Ministry of Land, Infrastructure, Transport and Tourism, the national stock of condominiums in 2021 was 6,859,000 units. Of these, 2,491,000 units, or approximately 36% of the total, were constructed at least 30 years ago and require renovation. By 2041, this number is expected to grow by approximately 2.4 times to 5,884,000 units. While obtaining the consent of residents is necessary for an entire condominium building renovation, projects for single condominiums will support the growth of the renovated condominium market. So far, only 316 condominium buildings have been rebuilt nationwide, including those undergoing reconstruction as of April 2022. For this reason, the trend in the pre-owned condominium market is expected to be renovating and selling individual units. Measures to improve energy efficiency of existing homes will likely continue in the context of the government's policy to realize a decarbonized society. We at FISCO therefore see substantial growth potential for the Company, which had led the way in the business and has a strong track record of interior renovation work.

Estimated number of condominium units in stock by building age



Source: Prepared by FISCO from data from the Ministry of Land, Infrastructure, Transport and Tourism

Temporarily withdrawal of Medium-term Management Plan with the goal to formulate new three-year plan starting in FY5/25

4. Revision of the Medium-term Management Plan

The Company has announced its decision to revise its three-year Medium-term Management Plan, originally spanning from FY5/23 to FY5/25. This revision is prompted by recent earnings performance and the prevailing uncertainty in the real estate market and interest rate trends. In FY5/24, the Company intends to manage its progress based on a single-year earnings forecast and will announce a new medium-term plan starting in FY5/25, allowing for a better assessment of market conditions. Despite these changes, the Company remains steadfast in its commitment to the Circular Renovation Model, a fundamental policy aimed at achieving strong growth while contributing to a sustainable society. This policy centers on expanding the nationwide sales of its energy-efficient renovation product ECOCUBE. The objective is twofold: reducing CO_2 emissions and enhancing residents' quality of life (QOL) by providing a comfortable living environment. Furthermore, the Company is actively fostering the FLIE real estate sale and purchase platform, designed for the digital transformation (DX) of real estate transactions. This platform is geared towards fostering fair transactions with increased participation. In FY5/24, the Company intends to minimize upfront investment made in FY5/23, including promotional and development expenses. This strategy aligns with the priority of re-establishing a lean earnings structure.

Additionally, the Company has submitted an application to change its stock market classification from the current Prime Market to the Standard Market. Notably, it had not met two of the listing criteria for the Prime Market (market capitalization of tradable shares and average daily trading value). Initially, the Company had planned to fulfill these criteria by around end-FY5/27 to maintain its Prime Market listing. However, due to a rule change by the Tokyo Stock Exchange, it must now meet these criteria by the end of FY5/26 or risk being designated as Securities Under Supervision. To ensure that existing shareholders and investors can continue to trade its share with confidence, the management team has chosen to change its market classification to the Standard Market, effective October 20, 2023.

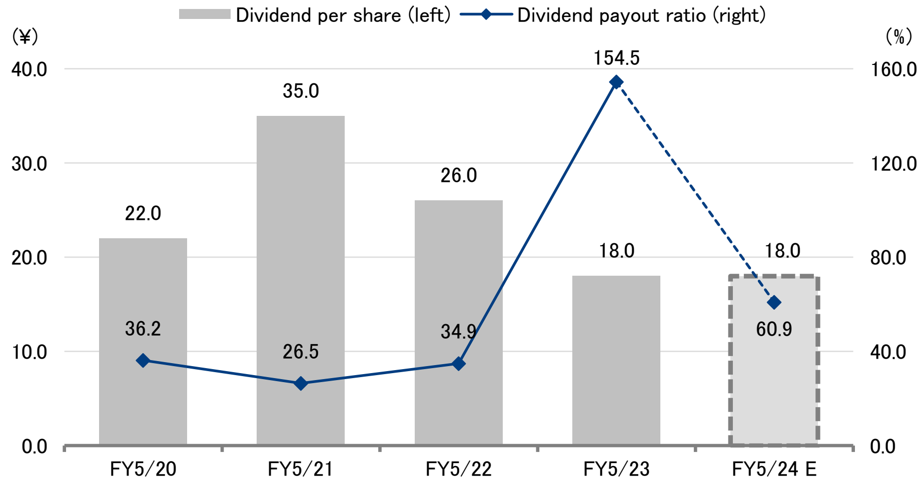
Shareholder Return Policy

Dividend payout ratio Target of at least 30%

The Company has a shareholder return policy of paying dividends to its shareholders. The dividend policy is based on linking dividend to results, strengthening the Company's financial position, and supplementing retained earnings. The Company targets a dividend payout ratio (on a consolidated basis) of at least 30%. It forecasts dividend per share of ¥18.0 (dividend payout ratio of 60.9%) in FY5/24, the same as the previous fiscal year.

The Company conducts share buybacks from time to time as part of a flexible capital policy depending on changes in the business environment. Most recently, it acquired 349,000 shares for ¥199mn from January to May 2023.

Dividend per share and dividend payout ratio



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

Disclaimer

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