HEIWA REAL ESTATE CO.,LTD.

8803 Tokyo Stock Exchange First Section

7-Jul.-15

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Leading leaser of office and commercial buildings now redeveloping Tokyo's securities business center of Nihonbashi Kabutocho

Heiwa Real Estate Co., Ltd. (8803) started by developing office buildings in Japan's main cities and leasing these buildings to stock exchanges, including those in Tokyo, Osaka, and Nagoya. It now develops office buildings primarily, but also commercial buildings and residential buildings, in Japan's major cities, and leases, sells, manages and operates these buildings. In the fiscal year ended March 2015, FY3/15, it derived 56.4% of its total consolidated operating revenue from leasing and 36.9% from real estate solutions.

The company owns many buildings in Japan's larger cities, primarily in financial districts, and many of these buildings are entirely leased. Therefore, the vacancy rates of its leased buildings are lower than the vacancy rates for leased buildings in general, excluding buildings that the company has stopped leasing for redevelopment purposes, and its leasing fees are on par with market rates. The real estate solutions business is conducted by the Heiwa Real Estate group and Heiwa Real Estate REIT, Inc. (8966) and generates stable management fees.

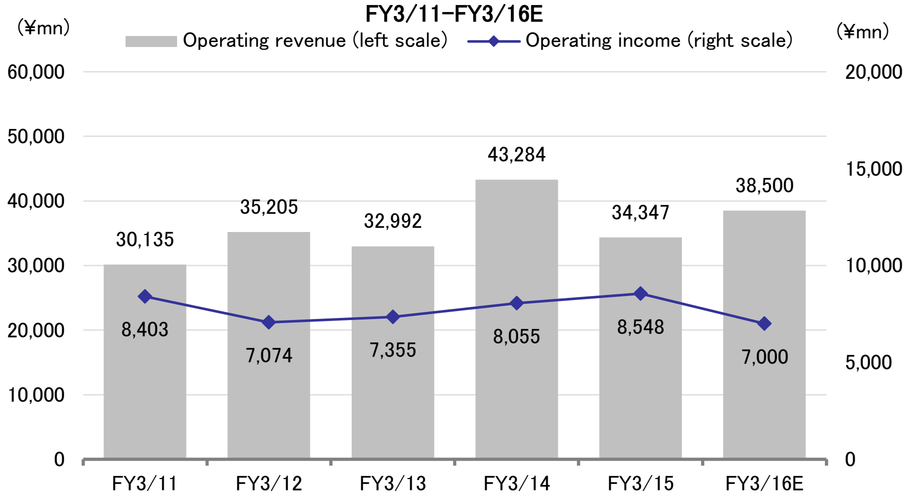
There were some positive and some negative developments at the company during FY3/15. On the plus side, consolidated operating income increased YoY, reflecting factors such as an increase in the price of buildings sold in the real estate solutions business, and the company's financial position improved. On the minus side, the company's net income fell YoY, due to a net extraordinary loss stemming from the disposals for redevelopment. The company's forecasts for FY3/16 also contain positive and negative elements.

The Nihonbashi Kabutocho Revitalization Project is the centerpiece of the company's growth strategy. This project was launched in earnest in 2011, and the company has been acquiring properties in the area, and liaising with the Council on Urban Development for Investment and Economic Growth, and government officials to promote it. On June 15, 2015, part of the area that the company is redeveloping was designated as an urban redevelopment project within a National Strategic Economic Growth Area in Greater Tokyo. Phase I of the company's project is scheduled for completion in 2019, so we look forward to the company's announcement of a detailed plan for redevelopment.

Check Point

- Office leasing conditions are improving in Japan, but the company's business performance in FY3/15 contained positive and negative elements, as do its forecasts for FY3/16
- The company's financial position is improving, and the unrealized gains on its assets are growing notably
- Investor interest focuses on the company's announcement of a plan to redevelop the Nihonbashi Kabutocho district of Tokyo

Consolidated Operating Revenue and Operating Income, FY3/11–FY3/16E



Company Outline

Originated as a real estate developer and leaser to Japan's securities industry

(1) History

Heiwa Real Estate was established in 1947 to develop and lease buildings to securities exchanges and securities companies. That year, Japan's previous 11 securities exchanges forming the Japan Securities Exchange, which was partly private and partly public, was dissolved and replaced with new exchanges that used the old exchanges' assets as in-kind investments. 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 six consolidated subsidiaries.

Core leasing business and real estate solutions business coordinating with REIT form two main businesses

(2) Business overview

Two main businesses, leasing and real estate solutions, provided 93.3% of total operating revenue and almost all operating income in FY3/15

The leasing business owns about ¥218.7bn 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 56.4% of its total operating revenue and 89.1% of its total operating income before eliminations in FY3/15.

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The real estate solutions business has four sub-divisions or sources of revenue and income: a) management fees, b) revenue and income from developed real estate, c) brokerage commissions, and d) 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 listed on the Tokyo Stock Exchange in 2005. Management fee income increases as the amount of assets under management expands. Revenue and income from developed real estate stems mainly from the sales of real estate to Heiwa Real Estate REIT, Inc. 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 all real estate transactions conducted by the company. The housing development business constructs condominium buildings and sells the units of these buildings. This business has a short operating cycle. In FY3/15, the real estate solutions business provided 36.9% of the company's total operating revenue and 21.0% of its total operating income before eliminations.

Business Breakdown in FY3/15

Business segment	Segment breakdown	Share of operating revenue		Share of operating income	
Leasing business	Office buildings	53.5%	56.4%	85.1%	89.1%
	Residential buildings	2.9%		4.0%	
Real estate solutions business	Management fees	3.6%	36.9%	19.4%	21.0%
	Revenue and income from real estate development, etc.	23.0%			
	Brokerage commissions	1.9%			
	Housing development	8.3%		1.6%	
Other businesses	Building management and contract construction		6.7%		2.6%
Eliminations	-		-		-12.7%
Total	-		100%		100%

Source: Company materials

Leasing market is improving, company develops prominent business areas

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

Japan's 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) fell from 9.2% in March 2011 to 4.7% in March 2015, while the average leasing fee in these wards climbed from ¥16,325 per tsubo (3.3 square meters) in March 2014 to ¥17,195 per tsubo in March 2015. The average vacancy rate of office buildings leased in Greater Tokyo by Heiwa Real Estate was 4.4% in March 2015 but, excluding buildings the company had stopped leasing to redevelop, this vacancy rate was only 1.4%, far below the market average vacancy rate. This low vacancy rate is due to the company's practice of leasing many of its buildings as a unit. The company's average leasing fee for its buildings in Greater Tokyo is about the same as the average leasing fee in the five central business wards of Tokyo.

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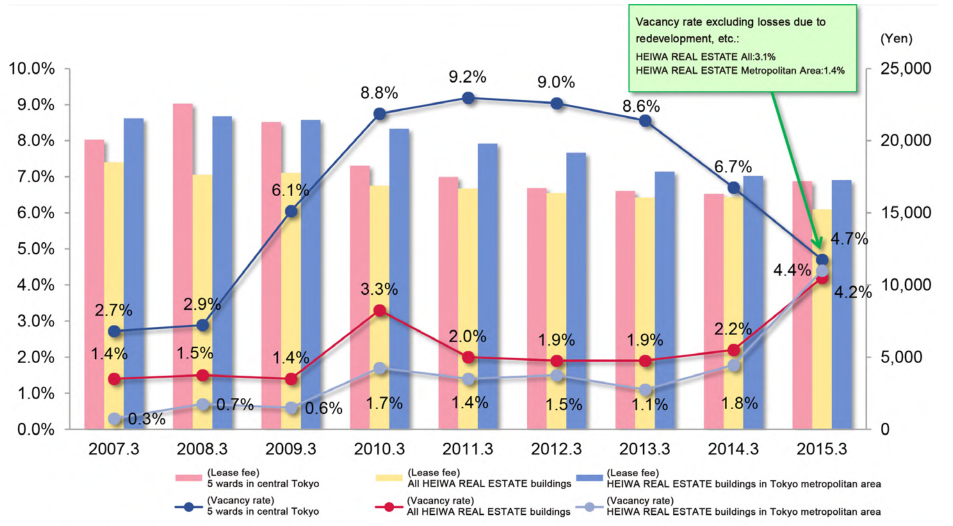
Changes in Vacancy Rates and Unit Lease Fees



*1 The Company's building leasing business is covered (excl. assets for the Real Estate Solutions Business)
*2 Market Vacancy Rates and Unit Lease Fees (Source: Office Data by Miki Shoji Co., Ltd.)
*3 HEIWA REAL ESTATE's unit lease fees (excl. large-scale commercial complex buildings): Computed by dividing lease fee revenue in the last month of FY by leased floor area in the last month of FY

Source: Company materials

Heiwa Real Estate owns buildings leased to securities exchanges in Tokyo, Osaka, Nagoya, Fukuoka and other main cities of Japan, as well as office buildings in the same areas as the exchanges. The company manages its building portfolio by purchasing new buildings and replacing some older buildings, but in general, it has increased the size of its portfolio. At the end of FY3/15, fixed assets in its leasing business amounted to ¥215.5bn. Furthermore, the prices of leasing assets have been rising. Thus, the unrealized gains on its real estate holdings grew to ¥41.7bn at the end of March 2015 from ¥26.4bn at the end of March 2014.

Main Buildings Leased at the End of FY3/15

Area	Building name	Type	Floor area (square meters)
Tokyo	The Tokyo Stock Exchange Bldg.	Securities exchange	49,627
	Kabutocho Heiwa Bldg. No. 1	Office building	13,842
	Mita Heiwa Bldg.	Office building	25,223
	Uchisaiwaicho Heiwa Bldg.	Office and commercial building	17,868
Yokohama	Yokohama Heiwa Bldg.	Office building	10,836
Sendai	Ichibancho Heiwa Bldg.	Office and commercial building	11,079
Osaka	The Osaka Securities Exchange Bldg.	Exchange, office and commercial building	53,932
	Ito-Yokado Higashiosaka SC	Commercial building	62,691
Kyoto	Kyoto Shoken Bldg.	Office building	10,463
Nagoya	CentRise Sakae	Office and commercial building	15,662
	Nagoya Marunouchi Heiwa Bldg.	Office building	11,412
Fukuoka	Fukuoka Shoken Bldg.	Exchange and office building	10,056
	Fukuoka Heiwa Bldg.	Office building	13,148
Sapporo	Dogin Bldg.	Office building	28,793
	Park East Sapporo	Office building	11,122

Source: Company materials   Note: Buildings with 10,000m[2] or more of floor area

In developing buildings for lease, Heiwa Real Estate considers an entire area, not a single building. Because its buildings are concentrated in the financial districts of leading cities, it excels at developing prominent business areas. For example, in the Sakae area of Nagoya, where it owns the Nagoya Stock Exchange Bldg., the company redeveloped buildings near the exchange over the 10 years from 2004, thereby enhancing the cityscape and increasing the floor area of all buildings leased in the area from 11,300m2 to 39,700m2. Its leasing revenue from the area grew accordingly. Hereafter, the company plans to redevelop the Nihonbashi Kabutocho district of Tokyo and other urban areas.

Two Main Stock Exchange Buildings Owned by the Company

The Tokyo Stock Exchange Bldg.

The Osaka Securities Exchange Bldg.

Source: Company materials

Value chain strategy includes the group's real estate investment trust company

(4) Business model for real estate solutions

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. (listed on the Tokyo Stock Exchange in 2005). As a sponsor of Heiwa Real Estate REIT, Inc., Heiwa Real Estate buys buildings, raises their value, by lowering their vacancy rates, for example, then sells the buildings to Heiwa Real Estate REIT, Inc. This real estate investment trust company then transfers most of its assets to Heiwa Real Estate Asset Management to manage. As its supply of high-quality buildings increases, the asset management company, a consolidated subsidiary, earns increasing management fees, completing a cycle of organic growth for Heiwa Real Estate. Heiwa Real Estate REIT, Inc. concentrates its investment on office and residential buildings in the wards of Tokyo, and its business has been growing in recent years, but its results are not included in Heiwa Real Estate's consolidated results.

■ Business Trends

FY3/15 operating income grew 6.1% YoY, ordinary income rose 16.4%, both exceeding company forecasts

(1) FY3/15 Results

In FY3/15, consolidated operating revenue fell 20.6% YoY to ¥34,347mn, but operating income increased 6.1% to ¥8,548mn, and ordinary income grew 16.4% to ¥6,568mn, while net income dropped 14.0% to ¥2,495mn. Total operating revenue was only 4.6% less than the company had forecast and its decline was due mainly to a large drop in revenue in the real estate solutions business, primarily reflecting a drop in the number of properties sold. Operating and ordinary incomes surpassed the company's forecasts, mainly because the prices of properties sold by the real estate solutions business increased more than the company had projected. The YoY decline in net income was due mainly to two extraordinary losses, one on the sale of properties being redeveloped for the Nihonbashi Kabutocho project, the other a valuation loss on the company's investment in a special purpose corporation.

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Consolidated Results in FY3/15

	FY3/14		FY3/15				
	Result (¥mn)	% of sales	Company forecast (¥mn)	Result (¥mn)	% of sales	YoY	Result/ forecast
Operating revenue	43,284	100.0	36,000	34,347	100.0	-20.6	-4.6
Cost of sales	31,513	72.8		21,721	63.2	-31.1	
Gross profit	11,770	27.2		12,625	36.8	7.3	
SG&A	3,714	8.6		4,076	11.9	9.7	
Operating income	8,055	18.6	8,000	8,548	24.9	6.1	6.9
Ordinary income	5,644	13.0	6,000	6,568	19.1	16.4	9.5
Net income	2,901	6.7	2,000	2,495	7.3	-14.0	24.8

Source: Company materials

Business Segment Results

(Unit: ¥mn)

	FY3/14	FY3/15		
	Result	Result	Absolute change YoY	% change YoY
Total operating revenue				
Leasing	19,721	19,365	-356	-1.8%
Real estate solutions	20,998	12,668	-8,330	-39.7%
Other businesses	2,563	2,313	-250	-9.8%
Total	43,284	34,347	-8,936	-20.6%
Operating income				
Leasing	7,596	7,616	20	0.3
Real estate solutions	1,134	1,795	660	58.2
Other businesses	260	222	-38	-14.7
Eliminations	-936	-1,085	-148	-
Total	8,055	8,548	493	6.1

Source: Company materials

Net income projected to rise even as the company expedites the formation of a growth base

(2) Company Forecasts for FY3/16

For FY3/16, the company forecasts a 12.1% YoY rise in consolidated operating revenue to ¥38.5bn, an 18.1% drop in operating income to ¥7.0bn, a 23.9% fall in ordinary income to ¥5.0bn, but an 8.2% increase in net income to ¥2.7bn. The company foresees an increase in operating revenue in the real estate solutions business stemming from an upturn in the number of properties sold. This is the main factor it expects to lift overall operating revenue. However, the overall operating revenue forecast is low, considering the historical trend of this revenue. From FY3/16, the company's revenue from leasing the Tokyo Stock Exchange Bldg. is scheduled to decrease by about ¥1.2bn per year, and this decrease is the main reason that the company projects declines in its operating and ordinary incomes. However, the company does not foresee extraordinary losses in FY3/16 comparable to those in FY3/15, so it anticipates a rise in net income. The company's focus in FY3/16 will be expediting the formation of a foundation for growth over the medium-to-long term.

Strengthening its financial base

(3) Financial Position

The company's financial position improved in FY3/15. Its current assets decreased by ¥14,292mn to ¥31,534mn at the end of the fiscal year, mainly because the company reduced its balance of marketable securities by ¥9,554mn and its cash and deposits by ¥2,106mn to purchase more assets for lease and to reduce its interest-bearing debt and strengthen the company's financial base. Fixed assets grew by ¥15,078mn to ¥265,767mn, primarily because tangible fixed assets increased by ¥9,211mn, reflecting purchases of land and buildings.

Total liabilities decreased by ¥5,406mn to ¥205,438mn, the result of a ¥9,066mn fall in current liabilities, and a ¥3,660mn rise in fixed liabilities, resulting from efforts to strengthen the company's financial base.

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Measures of financial stability and profitability were basically unchanged YoY in FY3/15. Since the collapse of Lehman Brothers in September 2008, the company has been reducing its interest-bearing debt and lowering its ratio of gross debt to equity as part of its efforts to improve its financial condition.

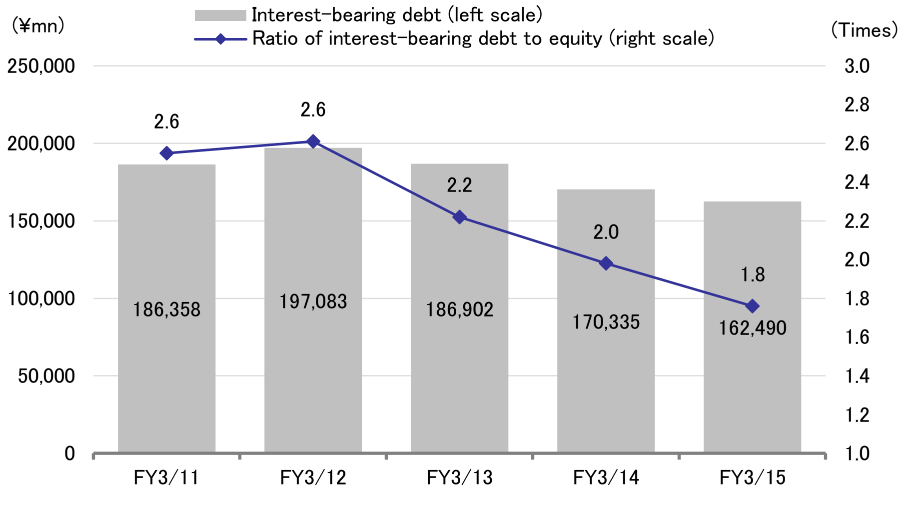
Summary of Consolidated Balance Sheet and Measures of Management Performance

(Unit: ¥mn)

	FY3/14	FY3/15	Absolute change YoY
Current assets	45,826	31,534	-14,292
Cash and deposits	11,152	9,046	-2,106
Marketable securities	11,860	2,306	-9,554
Fixed assets	250,689	265,767	15,078
Tangible fixed assets	209,197	218,408	9,211
Total assets	296,834	297,736	902
Current liabilities	51,681	42,615	-9,066
Fixed liabilities	159,162	162,822	3,660
Total liabilities	210,844	205,438	-5,406
Total net assets	85,990	92,298	6,308
Total liabilities and net assets	296,834	297,736	902
Measures of financial stability			
Current ratio (current assets ÷ current liabilities)	88.7%	74.0%	-
Equity ratio (total equity ÷ total assets)	29.0%	31.0%	-
Measures of profitability			
ROA (ordinary income ÷ total assets)	1.9%	2.2%	-
ROE (net income ÷ total equity)	3.4%	2.8%	-
Operating income margin	18.6%	24.9%	-

Source: Company materials

Interest-bearing Debt and Ratio of Interest-bearing Debt to Equity



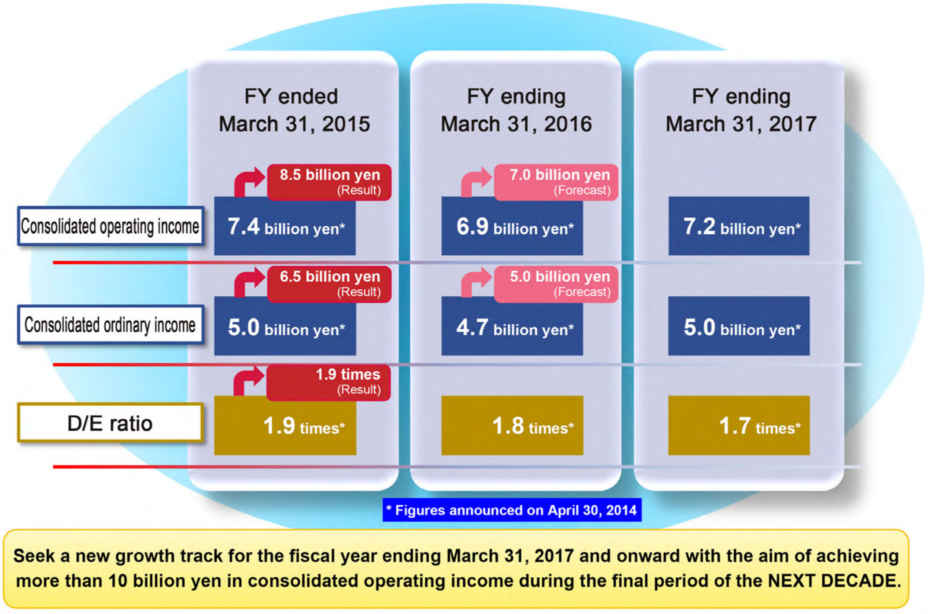
■ Growth Strategy

Building a base in FY3/15–FY3/17 for growth through FY3/24

(1) Medium-to-long-term Management Plan

FY3/15 was the first year of the company's current medium-to-long-term management plan, called "over the NEXT DECADE", which ends in FY3/24. In FY3/15–FY3/17, the company will concentrate on building a foundation for future growth, so it does not foresee strong income growth during those three years. When it announced this plan, on April 30, 2014, it targeted operating income of ¥7.4bn for FY3/15, ¥6.9bn for FY3/16, ¥7.2bn for FY3/17, and at least ¥10.0bn for FY3/24. It did not announce operating revenue targets because this revenue varies substantially depending on sales of properties. In FY3/15, the company surpassed its targets, earning an operating income of ¥8.5bn, against the ¥7.4bn target, an ordinary income of ¥6.5bn, versus the goal of ¥5.0bn, and a gross debt-to-equity ratio of 1.8 times, lower than the objective of 1.9 times. As mentioned above, the company now projects an operating income of ¥7.0bn for FY3/16.

Consolidated Targets for FY3/15–FY3/17



Source: Company materials

The company's main strategy for its leasing business is to promote the Nihonbashi Kabuto-cho Revitalization Project, while its main strategy for its real estate solutions business is to support the growth of Heiwa Real Estate REIT, Inc. and thereby expand its management fee business.

Project is progressing smoothly, and detailed development plan is pending

(2) Nihonbashi Kabuto-cho 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 construct new buildings and thereby expand its leasing assets, revenue and income. It originated the project as part of its corporate vision of contributing to urban revitalization in areas with similar issues.

Nihonbashi Kabutocho 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, there are many old buildings in Nihonbashi Kabutocho now, reflecting several factors. Since the 1990 collapse of Japan's stock market bubble of 1986–1989, Japan's economy has remained weak, its securities industry has consolidated and shrunk, surviving securities companies have relocated, and stock transactions have been totally automated. About 100,000 square meters of Nihonbashi Kabutocho are targeted for redevelopment. In the decade from 2014 to 2023, Heiwa Real Estate plans to redevelop the Kabutocho project and the Kayabacho project, which both front onto Heisei Dori avenue.

In April 2015, the Council on Urban Development for Investment and Economic Growth presented an interim report calling for the redevelopment of Nihonbashi Kabutocho as an area where financiers, mainly asset managers, can thrive. It is to become a neighborhood where financiers, financial venture companies, primarily involved in asset management, and providers of specialized financial services can develop, congregate, and interact with listed companies. The area should encompass hotels, residences, an investor forum hall, and entertainment facilities for practitioners of advanced finance, including non-Japanese personnel. A detailed plan is likely to be produced soon.

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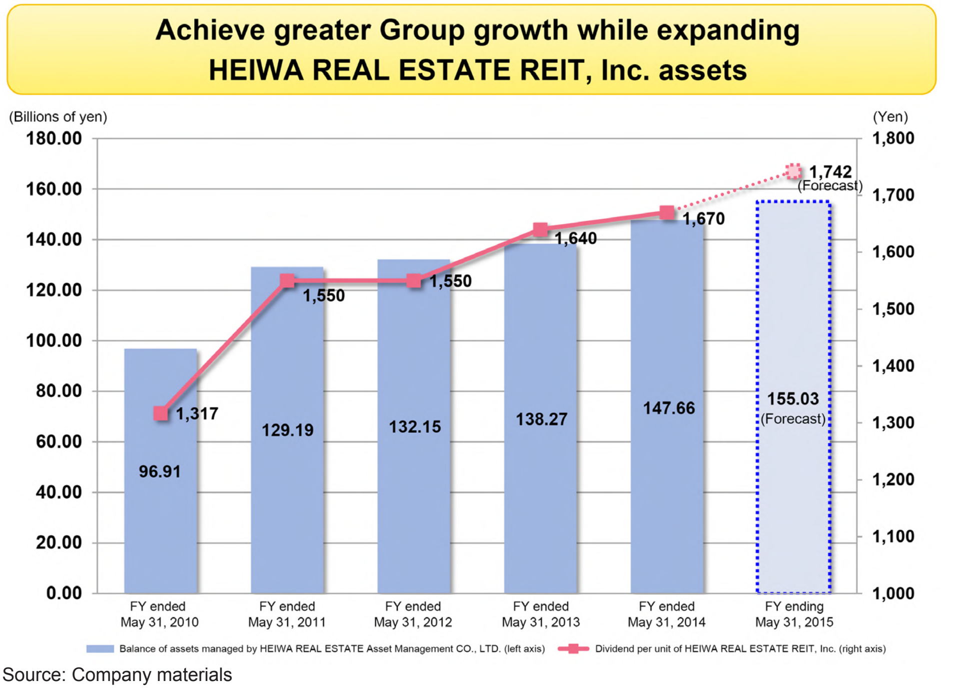
Since 2011, when Heiwa Real Estate launched the Nihonbashi Kabuto-cho Revitalization Project in earnest, the company has been buying old buildings in the area. In May 2015, it bought the Kayabacho Kyodo Building, which is well situated in Kabutocho. The company has also been meeting regularly with the Council on Urban Development for Investment and Economic Growth are Produced and with government representatives. On June 15, 2015, the district commission for National Strategic Economic Growth Area in Greater Tokyo designated as an urban redevelopment project the Nihonbashi Kabutocho and Kayabacho 1-chome area, which is part of the area the company is redeveloping.

Support for an increase in assets at Heiwa Real Estate REIT, Inc. and an improvement in the quality of these assets

(3) Increase fee businesses, primarily the asset management business
While expanding the assets of Heiwa Real Estate REIT, Inc., the company plans to expedite its strategies to increase the revenue and income of its entire group. In FY3/13, the company supplied ¥6.1bn of properties to Heiwa Real Estate REIT, Inc. This supply rose to ¥9.5bn in FY3/14 and remained high at ¥9.1bn in FY3/15. As a result, the balance of assets under management at Heiwa Real Estate Asset Management has grown steadily, increasing by ¥7.37bn in FY3/15 to ¥155.03bn, and the management fee income of this company has climbed. In FY3/15, management fee income came to ¥1,237mn. Although this was a small portion of total operating revenue, this income is highly profitable, so its contribution to overall income is significant. Accompanying the growth of Heiwa Real Estate REIT, Inc., the dividends per unit paid by this company have risen steadily. For the six-month fiscal period to May 2015, it plans to pay dividends per unit of ¥1,742, which would be ¥72 more than the dividends it paid for the six-month fiscal period to May 2014.



Source: Company materials

The company's price-to-book ratio (PBR) of 0.73 times at the end of FY3/15 is lower than the average PBR of listed Japanese real estate companies. The company foresees little profit growth for the next couple of years, but when it releases a detailed plan for the redevelopment of the Nihonbashi Kabutocho area, its growth potential will become clearer, and its share price may well rise.

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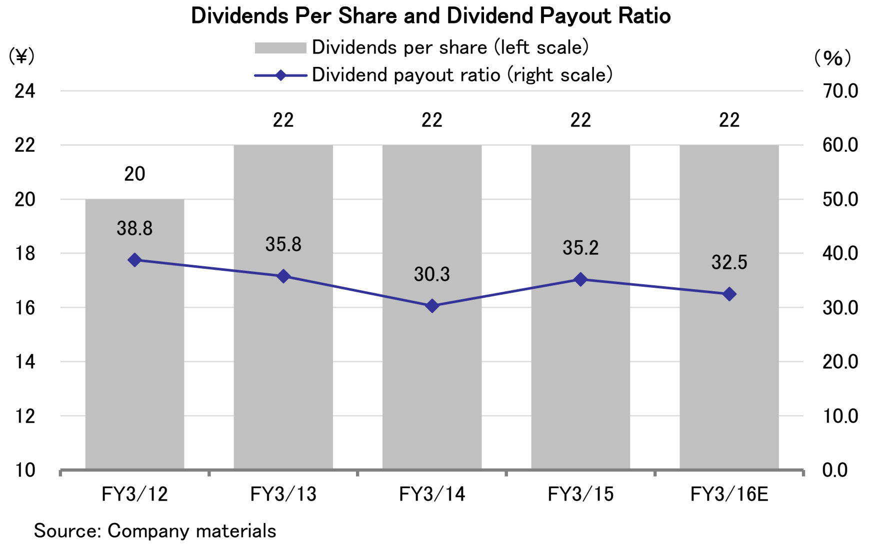
Shareholder Return Policy

Maintaining dividends of ¥22 per share, 30% dividend payout ratio

Although the company needs to retain funds for its Nihonbashi Kabuto-cho Revitalization Project, it intends to maintain a dividend payout ratio of 30%. For FY3/15, it paid interim dividends of ¥11 per share and year-end dividends of ¥11 for full-term dividends of ¥22. For FY3/16, it plans to pay the same dividends.



Source: Company materials

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