Samty Co., Ltd.

3244

Tokyo Stock Exchange First Section

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Index

Summary

Sales and profits down sharply in 1H FY11/20 though largely due to skewing of property sales to 2H, mainstay leasing condominium business remains healthy despite the coronavirus disease (COVID-19) outbreak but delayed establishment of a hotel REIT until at least FY11/21

1. Company profile

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

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

While the Company postponed establishment (and listing) of a hotel REIT that had been planned in 2020 to at least FY11/21 because of the COVID-19 outbreak, the leasing condominium business less affected by the impact of fluctuations in economic activity remains healthy and the Company is steadily moving forward with its investment plan (land procurement and acquisition of income properties) for future business.

2. Business result for FY11/20 1H

In FY11/20 1H, the Company reported sharply lower sales and profits with net sales at ¥27,322mn (down 42.9% YoY) and operating income at ¥5,368mn (down 61.5%). Net sales fell substantially year-on-year in the Real Estate Business, though largely because of heavy sales in FY11/19 1H and skewing of FY11/20 sales to 2H. The Company's mainstay leasing condominiums have not been affected by the COVID-19 outbreak and continue to attract strong interest from domestic and overseas institutional investors with support from ongoing low interest rates globally. Additionally, the Property Leasing Business secured higher sales thanks to firm trends in occupancy rates and rent levels at leasing condominiums directly held by the Company, and an increase in owned properties. In Other Business, meanwhile, even though sales fell on a decline in hotel occupancy rates with the COVID-19 outbreak situation, the impact on the Company's overall results is limited and occupancy rates are currently recovering. Profit dropped on lower sales and the operating income margin also decreased. Nevertheless, the margin setback reflects the impact of high-margin property sales in FY11/19, and FISCO believes that the Company is sustaining a high profit margin from the standpoint of the past trend.

3. FY11/20 forecast

For the results forecast for FY11/20, the Company revised initial forecast targets to a range format, taking into account the delay in establishment of the hotel REIT and other factors. Updated targets are ¥88,000mn (up 2.9% YoY) to ¥105,000mn (up 22.7%) in net sales and ¥14,600mn (down 5.2%) to ¥16,900mn (up 9.8%) in operating income. Revisions to initial forecast targets mainly reflect postponement of hotel REIT establishment and related hotel sales until at least FY11/21. Meanwhile, even though the Company plans to shift properties planned for sale to income properties (leasing condominiums, etc.) that are relatively protected from the impact of economic fluctuation with the aim of offsetting this portion, it decided to change the results forecast to a range format based on multiple scenarios due to difficulty of precisely forecasting results at this point. In net sales, the Company expects to secure an increase even at the low end. In profits, however, the Company sees a possibility of profit decline at the low end because of the impact of reassigning properties planned for sale and other factors.

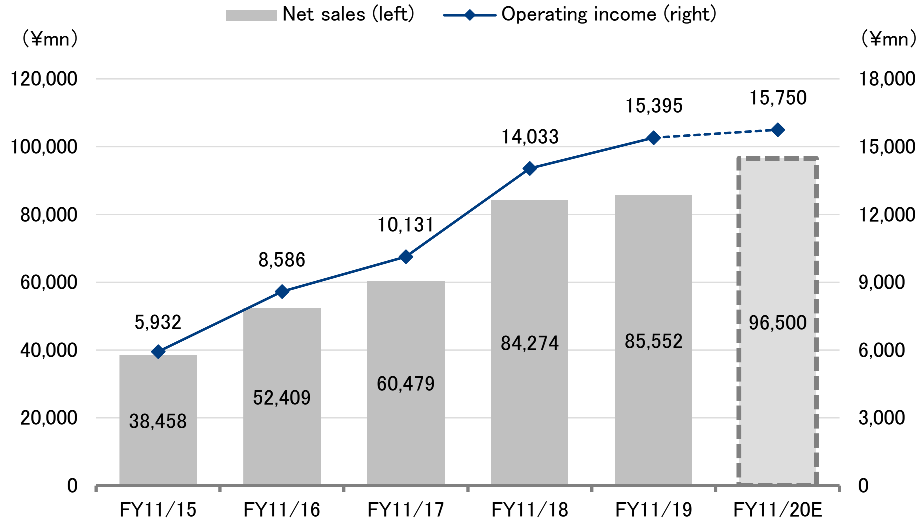
4. Growth strategy

The Company is advancing its medium-term management plan that covers the three-year period from FY11/19 to FY11/21. 1) Developing a business model centered on SRR (strengthening the fee income business); 2) Strategically investing in regional metropolitan areas (expanding business area); and 3) Promoting the hotel development and office building development businesses (develop new growth engines). Also, the Company is placing more of a focus on managing the balance sheet to prepare for a future correction phase. The Company is aiming for operating income around the ¥20.0bn level, ROE around the 15.0% level, and ROA around the 7.0% level, while maintaining an equity ratio of at least 30%.

Key Points

- Sales and profits down sharply in FY11/20 1H though largely due to skewing of property sales to 2H
- Mainstay leasing condominium business remains healthy despite the COVID-19 outbreak but the Company delayed establishment of a hotel REIT until at least FY11/21
- Revised FY11/20 results forecast to a range format accompanying delay in establishment of the hotel REIT, also expects higher net sales at the low end due to selling income property
- Medium-term management plan through FY11/21 seeks sustainable profit growth by raising productivity and capital efficiency while putting emphasis on the balance sheet

Results trends



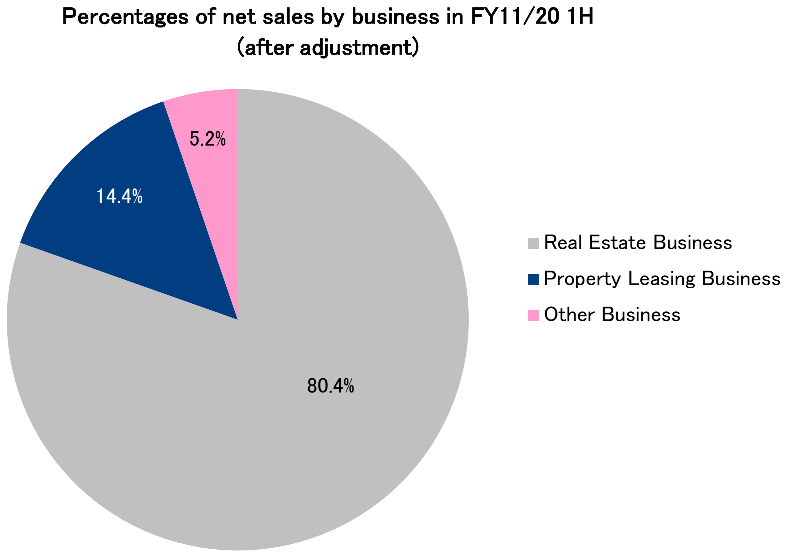
Note: FY11/20 (E) indicates the median value from the outlook range
Source: Prepared by FISCO from the Company's financial results

Company profile

Balanced business portfolio based on Real Estate Business and Property Leasing Business. Leasing condominium business a mainstay largely unaffected by economic fluctuations

1. Business overview

The Company has three business segments: The Real Estate Business, the Property Leasing Business, and the Other Business. The Real Estate Business trended favorably, contributing 80.4% of net sales (after adjustment) in FY11/20 1H. However, it is necessary to be aware that in contrast to the steady growth of the Property Leasing Business, results in the Real Estate Business tend to increase and decrease greatly due to various factors, including the business environment. Since its foundation, the Company's strength has been its leasing capabilities in its area of expertise of residential properties (condominiums, etc.) that can be expected to stably maintain high occupancy rates. Recently the Company has been promoting hotel development business through an alliance with Daiwa Securities Group Inc. <8601>.



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

Also, in March 2015 it established SRR, which was listed on the TSE J-REIT market in June of the same year. The Samty Group plays the role of sponsor of SRR (supplying it with properties) and is responsible for the subsequent asset management and other operations. SRR continues to steadily expand and currently owns 128 properties with combined value of ¥118.6bn (as of August 3, 2020). The Company is also moving ahead with formation of a hotel development fund and plans to list a hotel REIT in FY11/21 or later.

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

* Owns the Shinjuku and Yokohama sales offices.

The Samty Group is comprised of the Company and 13 consolidated subsidiaries, including eight special purpose companies (SPC) and general incorporated associations established and receiving investment in the processes of carrying out for the Real Estate Business and Property Leasing Business in relation to schemes to acquire, own, and develop land, properties, and trust beneficiary rights. The main consolidated subsidiaries include Samty Asset Management Co., Ltd. (asset management, etc.), Samty Hotel Management Co., Ltd. (hotel management, etc.) and Samty Property Management Co., Ltd. (property management, etc.).

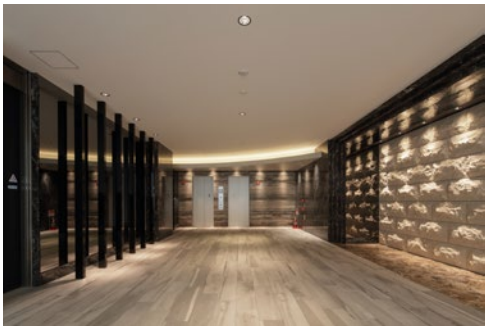
Overviews of each business are as follows.

(1) Real Estate Business

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

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

S-RESIDENCE series



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

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

* Properties acquired to incorporate into REIT

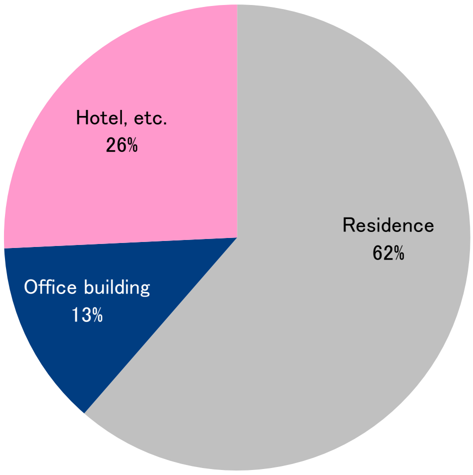
"Investment unit sales in lots" involves the planning and development of studio-type condominiums for investment, mainly to individual investors. A feature of the Company is that it does not have an in-house sales team, and it conducts wholesales (selling units or entire buildings) to sales companies.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

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

(2) Property Leasing Business

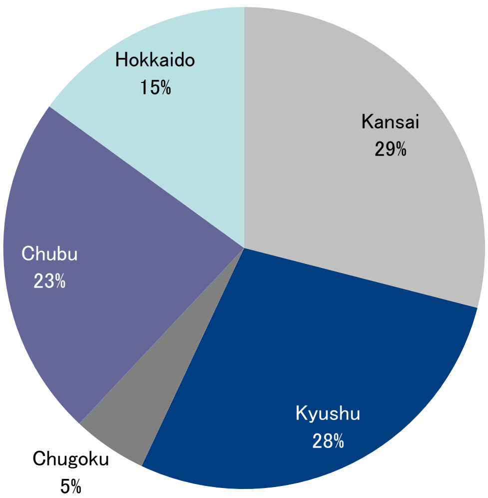
This business is the foundation that ensures stability, and the segment profit margins are also maintaining high levels. It owns around 66 properties nationwide (non-current assets only), centered on the Kansai region, Tokyo metropolitan area and government ordinance designated cities such as Fukuoka, Sapporo, and Nagoya. It also conducts diversified investment in a variety of assets, including condominiums, office buildings, and commercial facilities. In particular, the Company has a high percentage of condominiums that are largely unaffected by economic fluctuations and utilizes its leasing expertise to realize high occupancy rates above 90% when averaged over the year. While the scale of the real estate it owns amounts to around ¥152.0bn (book value), this is divided into ¥77.0bn of inventory assets that it intends to eventually sell (real estate for sale), and ¥75.0bn of non-current assets that it intends to continue to own (all results are as of the end of May 2020).

Sales by property type for FY11/20 1H (Property Leasing Business)



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

Distribution of properties owned by area for FY11/20 1H (based on total floor space)



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

(3) Other Business

This business mainly involves the ownership and management of hotels, the condominium management business, and the construction and renovation business. The hotels business operates and manages 10 hotels nationwide, including four hotels developed in-house. Other than conducting the hotel business, the subsidiary Samty Property Management also conducts condominium management (including external properties, mainly the Company's condominiums), construction and renovation, and other work.

Hotels in which the Company participates

Hotel name	Location	No. of rooms
Center Hotel Tokyo	Chuo-ku, Tokyo	108
Amano Hashidate Hotel	Miyazu-shi, Kyoto	86
GOZAN	Higashiyama-ku, Kyoto	21
S-PERIA HOTEL Nagasaki	Nagasaki-shi, Nagasaki	155
Hotel Sunshine Utsunomiya	Utsunomiya-shi, Tochigi	160
S-PERIA HOTEL Hakata (developed in-house)	Hakata-ku, Fukuoka-shi	287
S-PERIA INN Nihombashihakozaki (developed in-house)	Chuo-ku, Tokyo	114
S-PERIA INN Osaka Hommachi (developed in-house)	Nishi-ku, Osaka	125
S-PERIA HOTEL Kyoto (developed in-house)	Shimogyo-ku, Kyoto	165
NEST HOTEL Hiroshima Hatchobori	Naka-ku, Hiroshima-shi	126
Total		1,347

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

2. Features

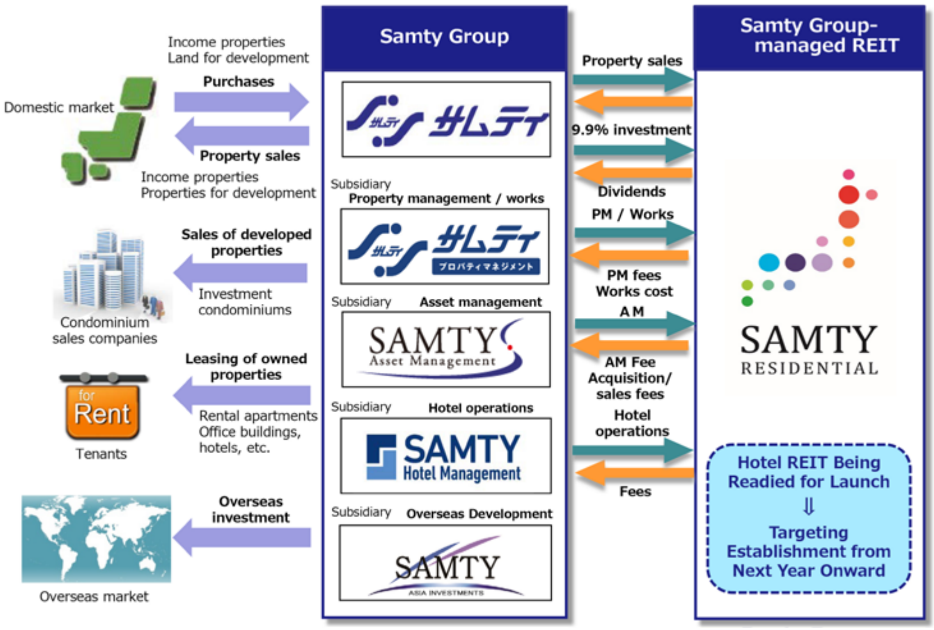
A feature of the Company is that it handles all aspects of the property business with its business model combining two businesses, the Real Estate Business and the Property Leasing Business. This forms its strength in terms of the superiority of its business and revenue structure.

(1) A superior business model

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

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

Business model overview



Source: The Company's results briefing materials

(2) The profit structure as a strength

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

3. History

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

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

Next, to further expand its business and disperse it over different regions, it opened branch offices in Tokyo in February 2011, in Fukuoka in June 2012, in Sapporo in May 2015, in Nagoya in March 2016, and in Hiroshima in December 2019, and it steadily expanded the regions in which it does business.

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

Results trends

Sales and profits down sharply in FY11/20 1H though largely due to skewing of property sales to 2H

1. Overview of FY11/20 1H results

In FY11/20 1H, the Company reported sharply lower sales and profits with net sales at ¥27,322mn (down 42.9% YoY), operating income at ¥5,368mn (down 61.5%), ordinary income at ¥4,301mn (down 66.4%), and profit attributable to owners of parent at ¥2,939mn (down 67.5%). However, even though the COVID-19 outbreak had some impact, the primary decline factor is skewing of property sales to 2H and the 1H results were not much weaker than planned.

Net sales fell substantially year-on-year in the Real Estate Business, though largely because of heavy sales in FY11/19 1H and skewing of FY11/20 sales to 2H. The Company's mainstay leasing condominiums have not been affected by the COVID-19 outbreak and economic trends and continue to attract strong interest from domestic and overseas institutional investors with support from ongoing low interest rates globally. Additionally, the Property Leasing Business secured higher sales thanks to firm trends in occupancy rates and rent levels at leasing condominiums directly held by the Company and increase in owned properties. In Other Business, meanwhile, although sales fell on a decline in hotel occupancy rates (including temporary closures) with the COVID-19 outbreak situation, the impact on the Company's overall results is limited and occupancy rates are currently recovering.

Profit dropped on lower sales and also a decline in operating income margin to 19.7% (vs. 29.2% a year ago). Nevertheless, the margin setback reflects the impact of high-margin property sales in FY11/19, and FISCO believes that the Company is sustaining a high profit margin from the standpoint of the past trend*. Regarding losses accompanying the COVID-19 outbreak, ¥482mn in fixed costs at hotels with reduced operating rates pressured earnings, though the Company booked ¥101mn in fixed costs from hotels that temporarily suspended operations as extraordinary losses.

* Operating income margins (1H basis) in past years were 15.9% in FY11/16 1H, 18.4% in FY11/17 1H, 19.7% in FY11/18 1H, and 29.2% in FY11/19 1H.

Furthermore, while "continuous stable profit" (total value in the various businesses*1) emphasized by the Company modestly declined to ¥6,015mn (down 3.9% YoY) because of lower hotel guest room income and a drop in construction income*2 (temporary suspension, etc.) related to the COVID-19 situation, it has been recovering in 2H.

*1 Comprised of rent income, asset management fees, hotel guest room income, and others.
*2 Samty Property Management, which handles management operations, focuses on the construction and renovation business and property brokerage business in addition to condominium management, leasing property management, and building management as part of its total support.

Meanwhile, the Company was very successful concerning purchases that will lead to future growth. The Company acquired 33 development sites (acquisition price of ¥12.5bn), and 39 income properties (acquisition price of ¥24.6bn), making healthy progress.

For the Company's financial condition, the Company effectively utilized funds procured through property sales and borrowings to proactively acquire land for development and income properties. Gross assets expanded to ¥252,522mn, an increase of 15.4% from the end of the previous fiscal year. Shareholders' equity, meanwhile, fell slightly to ¥70,659mn (down 0.5%), despite a rise in retained earnings, because of the acquisition of treasury shares (¥892mn) and other factors. The Company's equity ratio dropped to 28.0% (vs. 32.5% at the end of the previous fiscal year). Also, interest-bearing debt was up 23.4% from the end of the previous fiscal year to ¥173,952mn, but the ratio of long-term debt was approximately 77% and net D/E ratio* was kept down to a level of 1.94 times, so it can be said that the Company is maintaining stable financial ratios while expanding assets.

* (interest-bearing debt - cash and deposits) ÷ shareholders' equity

FY11/20 1H results

(¥mn)

	FY11/19 1H		FY11/20 1H		Change	
	Results	% of net sales	Results	% of net sales		% of change
Net sales	47,827		27,322		-20,505	-42.9%
Real Estate Business	42,743	89.4%	22,125	80.9%	-20,617	-48.2%
Property Leasing Business	3,203	6.7%	3,949	14.5%	745	23.3%
Other Business	2,106	4.4%	1,439	5.3%	-666	-31.7%
Adjustment	-226	-	-192	-	33	-
Cost of sales	29,586	61.9%	16,635	60.9%	-12,951	-43.8%
SG&A expenses	4,288	9.0%	5,317	19.5%	1,028	24.0%
Operating income	13,952	29.2%	5,368	19.7%	-8,584	-61.5%
Real Estate Business	14,855	34.8%	6,669	30.1%	-8,186	-55.1%
Property Leasing Business	1,174	36.7%	1,671	42.3%	497	42.3%
Other Business	5	0.2%	-285	-	-290	-
Adjustment	-2,083	-	-2,686	-	-603	-
Ordinary income	12,803	26.8%	4,301	15.7%	-8,502	-66.4%
Extraordinary income	259	-	117	-	-141	-
Extraordinary loss	0	-	108	-	108	-
Profit attributable to owners of parent	9,044	18.9%	2,939	10.8%	-6,104	-67.5%
Breakdown of net sales in the Real Estate Business (after adjustment)						
Development securitization	32,142		14,628		-17,514	-54.5%
Renovation securitization	8,934		5,378		-3,556	-39.8%
Investment unit sales in lots	1,258		1,497		239	19.0%
Asset management	389		591		202	51.9%
Continuous stable profit	6,259		6,015		-244	-3.9%
Dividends, rent income	3,272		3,829		557	17.0%
Asset management fees (acquisition), brokerage, construction	648		315		-333	-51.4%
Asset management fees (during the period), hotel income, property management	2,339		1,871		-468	-20.0%

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

Financial position at the end of May 2020

(¥mn)

	End of November 2019	End of May 2020	Change	
				% of change
Current assets	122,428	160,384	37,955	31.0%
Cash and deposits	44,918	36,548	-8,369	-18.6%
Real estate for sale	28,637	77,027	48,390	169.0%
Real estate for sale under construction	46,339	44,073	-2,266	-4.9%
Non-current assets	96,374	92,138	-4,236	-4.4%
Property and equipment	78,420	74,973	-3,446	-4.4%
Intangible assets	172	157	-14	-8.7%
Investments and other assets	17,781	17,007	-774	-4.4%
Total assets	218,803	252,522	33,718	15.4%
Current liabilities	22,581	34,214	11,632	51.5%
Short-term borrowings	2,315	7,961	5,645	243.9%
Current portion of long-term debt	16,387	21,320	4,933	30.1%
Non-current liabilities	124,593	147,036	22,442	18.0%
Long-term debt	112,224	134,670	22,446	20.0%
Net assets	71,627	71,271	-356	-0.5%
Total liabilities and net assets	218,803	252,522	33,718	15.4%
Interest-bearing debt	140,927	173,952	33,025	23.4%
Shareholders' equity	71,027	70,659	-368	-
Equity ratio	32.5%	28.0%	-4.5pt	-

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

The results according to each business are as follows.

(1) Real Estate Business

Net sales decreased 48.2% YoY to ¥22,125mn, and segment profit declined 55.1% to ¥6,669mn. Both sales and profits weakened. Main setbacks in net sales were 1) decline in sales of buildings from the S-RESIDENCE series to three properties (vs. 10 properties in the previous fiscal year) and period delay in selling Mercure Kyoto Station (developed in-house; though the sale was already completed in June) in development securitization and 2) decline in sales of buildings to five properties (vs. eight properties in the previous fiscal year) in renovation securitization. As already explained, however, this largely happened because of heavy sales in FY11/19 1H and skewing of FY11/20 sales to 2H. Meanwhile, 3) the decline in sales of condominiums for investment to 49 units (vs. 93 units) was within the anticipated range. 4) Asset management business delivered higher sales thanks to operational and management fee increases accompanying growth in SRR's asset management balance. Profit fell on lower sales, and segment profit margin dropped as well to 30.1% (vs. 34.8% in the previous fiscal year). Nevertheless, the margin moved lower due to the impact of high-margin property sales in the previous fiscal year, and FISCO believes the assertion that profit margin remains at a high level is reasonable.

(2) Property Leasing Business

Net sales rose 23.3% YoY to ¥3,949mn, and segment profit expanded at a healthy pace with a 42.3% increase to ¥1,671mn. Rent income strengthened due to sustaining high occupancy in owned leasing condominiums and proactive acquisitions of income properties. The Company owned 66 buildings (only fixed assets) at the end of 1H. Profits benefited from a boost driven by higher sales and also significant improvement in segment profit margin to 42.3% (vs. 36.7% in the previous fiscal year).

(3) Other Business

Net sales decreased 31.7% YoY to ¥1,439mn, and the segment had a ¥285mn loss. Both sales and profits weakened (including a loss). Hotel guest room income declined due to a substantial drop in hotel occupancy* and temporary closures of some hotels due to the impact of the COVID-19 outbreak. Recently, however, conditions appear to be recovering. In profits, the segment slumped to a loss as fixed costs pressured earnings amid lower sales.

* Occupancy was 10-20% during April to mid-June. In July, it recovered to about 30%.

2. The development plan (pipeline) situation

Development conditions for the S-RESIDENCE series and other businesses are a total of 119 planned buildings (7,997 units) with completions of 11 buildings (636 units) in 2020, 48 buildings (3,073 units) in 2021, 48 buildings (3,230 units) in 2022, and 12 buildings (1,058 units) in 2023. FISCO thinks the Company should be capable of maintaining strong income results with its healthy pipeline build-up even compared to the end of FY11/19 (total of 79 buildings with 5,267 units). For hotel and office building development, four properties are scheduled to open for business in FY2020, four properties in FY2021, and one property in FY2022 (the details are given below).

Topics

Delayed establishment of the hotel REIT due to the COVID-19 outbreak, though making steady progress in the investment plan mainly for residences in various areas nationwide

1. Measures to halt the COVID-19 outbreak

With the aim of ensuring the health and well-being of employees and their families and business partners, the Group has taken various steps - 1) adopting work from home, online meetings, and online communication tools, 2) recommending staggered working hour and commuting by car and bicycle, 3) curtailing non-essential business trips, and 4) distributing non-woven masks and sterilization products. In particular, it introduced telework early and has focused on cultivating a safe and convenient work environment. Management intends to continue pursuit of new working styles suited to the “With Corona” and “After Corona” eras.

2. Investment made

As previously mentioned, the Company acquired 33 development sites (acquisition amount: ¥12.5bn) and 39 income properties (acquisition amount: ¥24.6bn). Furthermore, including properties with planned settlements, the Company has secured 64 development sites (acquisition amount: ¥24.9bn) and 54 income properties (acquisition amount: ¥43.1bn). Of the 64 development sites (all residences), there are 6 in Hokkaido, 16 in the Tokyo metropolitan area, 19 in Chubu, nine in Kansai, 11 in Chugoku, and three in Kyushu. Also, of the 54 income properties (52 residences, one hotel/office, one other), there are 5 in Hokkaido, 1 in Tohoku, 11 in the Tokyo metropolitan area, 1 in Koshinetsu, 8 in Chubu, 13 in Kansai, 2 in Chugoku, and 13 in Kyushu. The Company is developing properties nationwide and has been able to achieve results for investments in regional urban areas as set out in the medium-term management plan. In addition, it is planning investment of a total amount (including construction expenses) of approximately ¥300.0bn for the three years (FY11/19 to FY11/21), and as of end-May 2020, the midway point, it is making steady progress toward this goal at ¥214.1bn (71.4% progress rate).

3. Expansion of the hotel and office business

In hotel development, the Company is currently in the process of developing seven hotels with scheduled openings of two hotels in 2020, four hotels in 2021, and one hotel in 2022. In addition to hotels, the Company has plans to develop office buildings, centered on major cities throughout Japan, and is developing two such properties. Regarding future investments, however, considering current market conditions and other factors, management intends to focus on residence development and income properties that are relatively unaffected by economic trends and the COVID-19 outbreak.

Hotel and office building development plans

Opening fiscal year	Property type	Project name (provisional)	Location	No. of rooms	Comment
2020	Hotel	Mercure Kyoto Station	Shimogyo-ku, Kyoto	225	Already sold
	Hotel	Ibis Styles Nagoya	Nakamura-ku, Nagoya	284	Land already sold
	Office	S-BUILDING Shin-Osaka	Yodogawa-ku, Osaka	-	Already completed purchase reception
	Office	S-BUILDING Sapporo Odori	Chuo-ku, Sapporo	-	Currently in sale discussions
2021	Hotel	Agora Kyoto Shijo Karasuma North Tower (provisional)	Shimogyo-ku, Kyoto	80	
	Hotel	Agora Kyoto Shijo Karasuma South Tower (provisional)	Shimogyo-ku, Kyoto	140	
	Hotel	Fukuoka HOTEL PJ	Fukuoka	87	
	Hotel	Kyoto Oike HOTEL PJ	Chuo-ku, Kyoto	120	
2022	Hotel	Haneda HOTEL PJ	Ota-ku, Tokyo	362	Pending

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

4. Movement toward establishment of a hotel REIT

The Company postponed establishment of the hotel REIT that it planned to launch in 2020 to at least FY11/21 due to the impact of the COVID-19 outbreak. However, it has already secured properties to be included in the portfolio upon establishment (approximately ¥55.0bn), and has already been acquired for properties to be included in portfolio in the future (approximately ¥55.0bn).

Earnings outlook

Revised FY11/20 results forecast to a range format accompanying delay in establishment of the hotel REIT

1. FY11/20 forecast

For the FY11/20 results forecast, the Company revised initial forecast targets to a range format, taking into account the delay in establishment of the hotel REIT and other factors. Updated targets are ¥88,000mn (up 2.9% YoY) to ¥105,000mn (up 22.7%) in net sales, ¥14,600mn (down 5.2%) to ¥16,900mn (up 9.8%) in operating income, ¥12,200mn (down 7.5%) to ¥14,600mn (up 10.7%) in ordinary income, and ¥8,500mn (down 12.7%) to ¥10,100mn (up 3.7%) in profit attributable to owners of parent.

Revisions to initial forecast targets, as already explained above, mainly reflect postponement of hotel REIT establishment and related hotel sales until at least FY11/21 due to the impact of COVID-19. The Company also expects about ¥1,500mn in lost hotel sales (FY11/20) related to the COIVD-19 situation from declines in hotel occupancy and hotel guest room income. Meanwhile, even though the Company plans to shift properties slated for sale to income properties (leasing condominiums, etc.) that are relatively unaffected by the impact of economic fluctuations with the aim of offsetting this portion, it decided to change its results forecast to a range format based on multiple scenarios due to the difficulty of precisely forecasting results at this point. In other words, disparities between high-end and low-end estimates in the forecast reflect a range of 30 properties to 44 properties in anticipated sales for renovation securitization (income properties). The Company does not significantly revise other estimates versus the initial forecast and targets sales of 28 properties in development securitization (including seven condominium buildings for investment). As a result, it still projects an increase in net sales even at the low end.

In profits, however, the Company forecasts an increase in profit at the high end and decrease in profit at the low end based on anticipated declines in the operating income margin in both cases with a range of 16.1% to 16.6% (vs. 18.0% in FY11/19). Margin setbacks are 1) non-recurrence of FY11/19's high-margin property sales and 2) the impact of adjusting properties planned for sale (shifting from high-margin hotel development properties to income properties). Just as in 1H, FISCO thinks the Company is sustaining a high margin from the standpoint of past results*.

* Operating income margins (full-year basis) in past years were 16.4% in FY11/16, 16.8% in FY11/17, 16.7% in FY11/18, and 18.0% in FY11/19.

FISCO favorably assesses the Company's change in policy to sustain high results by shifting properties planned for sale from hotel development properties to income properties (leasing condominiums, etc.), responding dynamically to changes in the external environment, as a rational decision. From a different viewpoint, we think the Company's ability to make this type of adjustment highlights its strength arising from stable leasing condominiums. Furthermore, regarding the hotel business that postponed property sales (the Company directly owns five of the 10 properties that are operating), we believe the ability to respond while staying abreast of recovery in market conditions because it already has financing measures in place to sustain direct ownership for the time being is an advantage, too. We also think the number of income properties targeted for sale assumed in the forecast is at a level that is well within reach considering external factors (such as continuation of low interest rates worldwide) and internal factors (property ownership situation and stable cash flow), and the main point is how close the Company comes to the high-end scenario.

FY11/20 forecast

(¥mn)

		FY11/19		FY11/20				Versus revised forecast	
		Results	% of net sales	Initial forecast	% of net sales	Revised forecast	% of net sales	Change	% of change
Net sales	High end	85,552		100,000		105,000		19,448	22.7%
	Low end					88,000		2,448	2.9%
Operating income	High end	15,395	18.0%	17,500	17.5%	16,900	16.1%	1,505	9.8%
	Low end					14,600	16.6%	-795	-5.2%
Ordinary income	High end	13,193	15.4%	14,600	14.6%	14,600	13.9%	1,407	10.7%
	Low end					12,200	13.9%	-993	-7.5%
Profit attributable to owners of parent	High end	9,740	11.4%	10,100	10.1%	10,100	9.6%	360	3.7%
	Low end					8,500	9.7%	-1,240	-12.7%

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

2. View of FY11/21 results

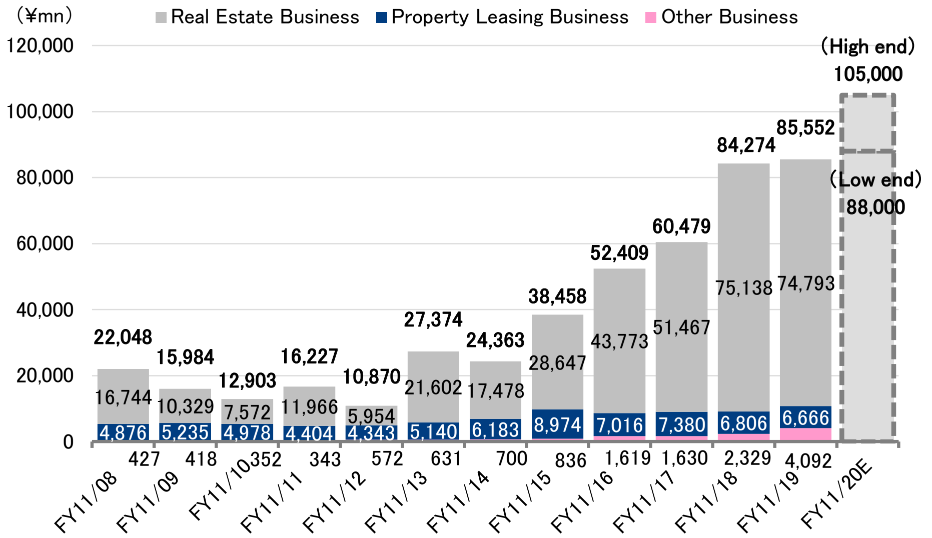
In FY11/21, the final fiscal year of the medium-term management plan, FISCO thinks the Company's success in establishing the hotel REIT will strongly influence the outcome, particularly amid continued heightened uncertainty including the impact of COVID-19. Nevertheless, even if the Company delays establishment of the hotel REIT again, it should be capable of sustaining high results because of the planned completion of 48 buildings in the development securitization business (S-RESIDENCE series and others). We therefore believe that FY11/21 results could rise significantly if the Company achieves the best-case scenario (establishment of the hotel REIT, advances in development securitization business, and other positives).

Results trends

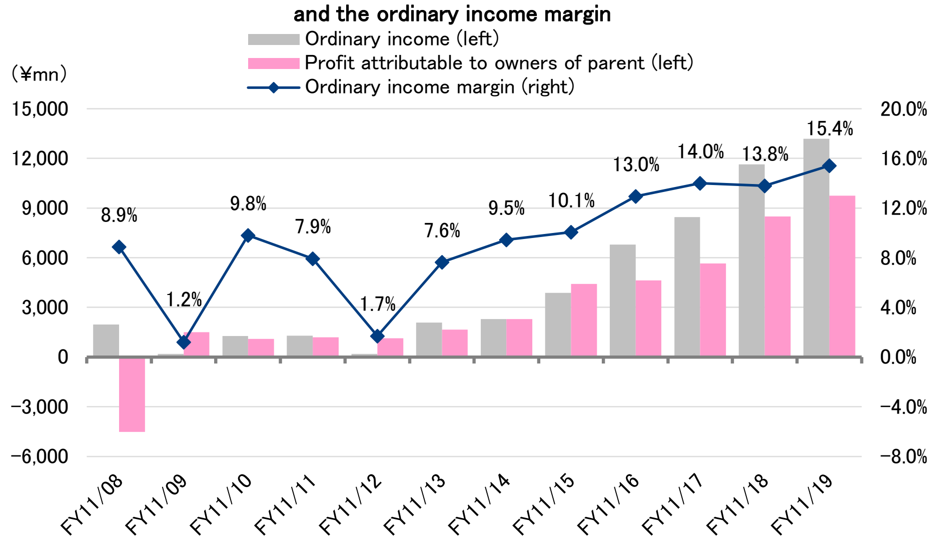
Substantial growth in Real Estate Business amid strong real estate market

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

Since FY11/13, the Real Estate Business has greatly recovered due to the change in financial institutions' attitude toward financing, which has occurred against the backdrop of the recovery of the domestic economy and monetary easing, and the Company's results have entered an expansion phase. In particular, the Company has achieved a significant expansion in business over the past few years, aided by the establishment of a business model centered on SRR which listed on the stock market in October 2015, as well as increased demand from overseas investors. In terms of profit and loss also, the ordinary income margin has been improving year by year thanks to the progress in the highly profitable development securitization, and in FY11/19 it has reached a high ordinary income margin of over 15.0%.



Note: Excluding internal sales
Source: Prepared by FISCO from the Company's financial results and financial results briefing materials



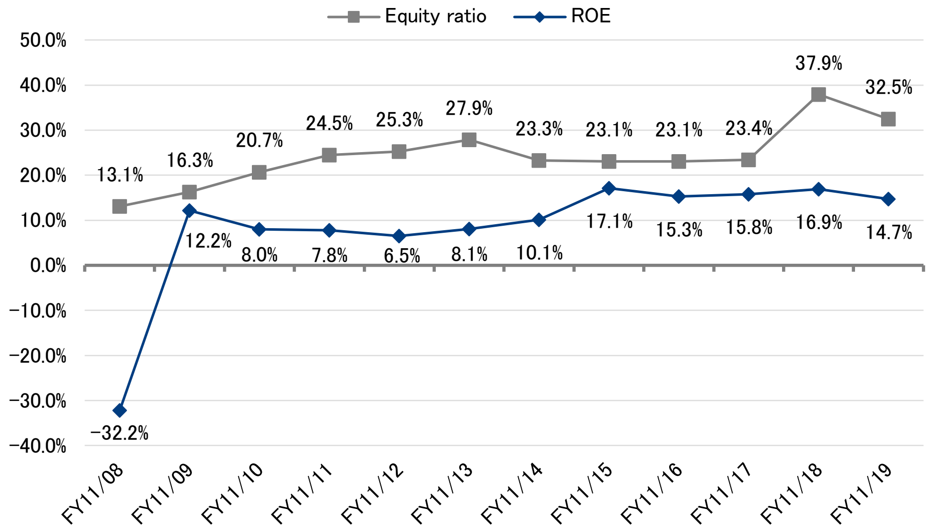
Source: Prepared by FISCO from the Company's financial results

Although the equity ratio increased to 27.9% in FY11/13 following the implementation of a capital increase through a public offering (approximately ¥2.0bn), it has been at a level of around 23% since FY11/14 due to the Company's active accumulation of assets and other factors. However, the Company bolstered its financial base in October 2018 by issuing stock acquisition rights* (approximately ¥15.0bn), and due to the disposition of treasury shares (approximately ¥2.7bn) in conjunction with the capital and business alliance with Daiwa Securities Group in May 2019, the equity ratio as of November 30, 2019, was 32.5%.

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

On the other hand, ROE, which indicates capital efficiency, has trended upward alongside the improvement in the profit margin. In FY11/19, it had reached the high level of 14.7%.

Trends in the equity ratio and ROE



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

Industry environment

Cautious stance toward hotel and commercial facilities due to the impact of the COVID-19 outbreak, though residential and logistic center businesses are firm

The J-REIT market will have a significant impact on the Company's growth strategy in the future. As of the end of June 2020, its market capitalization stood at around ¥13,044.2bn (-14.2% YoY), and there were 63 J-REITs listed (flat YoY). Looking back, although there was a phase in which the market was temporarily sluggish due to the impact of tightening credit and related factors following the 2008 financial crisis, since 2012 it has steadily trended upward thanks to the recovery of the domestic economy and the effects of long-term monetary easing. However, despite the cautious stance toward hotels and commercial facilities amid concerns about overall economic sluggishness, slumping inbound tourism demand, and movement restrictions and activity curtailment due to the COVID-19 situation, demand remains firm in the residential and logistic center businesses that are relatively insulated from the impact of economic fluctuations and these areas help to support the entire market.

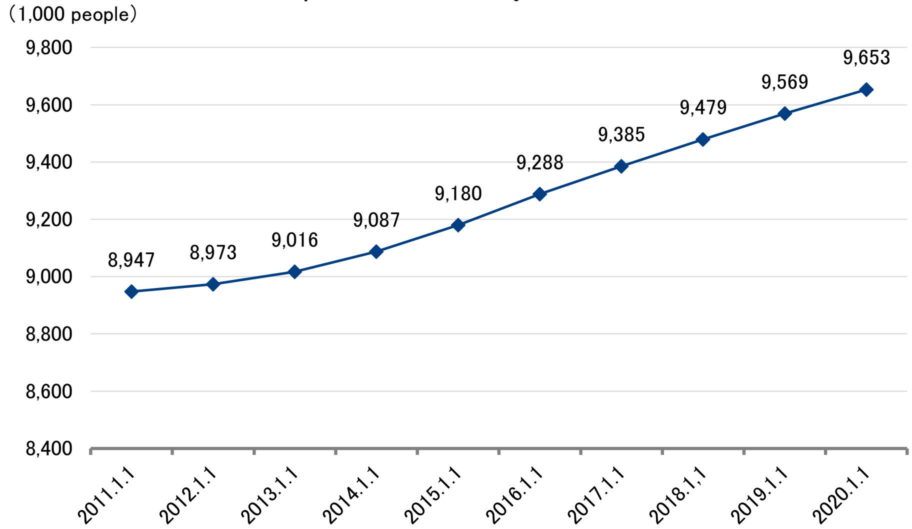
The TSE REIT index trended firmly due to a robust domestic real estate market (rising rents, etc.). In particular, investment appetite for J-REITs from domestic and overseas institutional investors remains vibrant because they generate yield and have relatively stable cash flow against a backdrop of sustained monetary easing policy by the Bank of Japan (BOJ) and healthy office demand up to now. At the same time, J-REITs still lack direction even though they recovered after a temporary large decline in March 2020 in reaction to the COVID-19 outbreak from the start of 2020. Nevertheless, FISCO thinks room for further decline is limited considering expectations for prolonged monetary easing from the BOJ.

Trends in the TSE REIT index

Source: Prepared by FISCO from various materials

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

Population trend in Tokyo's 23 wards



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

Meanwhile, looking at the hotel development and office building development businesses, hotel occupancy rates have remained high against a backdrop of increased inbound demand. However, even though hotel occupancy has dropped significantly because of the COVID-19 outbreak, FISCO believes it is likely to recover over the longer term due to the Japanese government's tourism promotion strategy and structural supply-demand balance. In office building development as well, despite the need to pay attention to the impact of changes in working style (such as wider use of remote work and satellite offices), regional major urban areas where the Company develops properties face severe office shortages and this suggests that sufficient business opportunities exist.

Growth strategy

The Company will promote its medium-term management plan, the Samty Toughening Plan, and will aim for sustainable profit growth while emphasizing the balance sheet

1. Medium-term management plan

The Company is advancing its medium-term management plan which covers the three-year period from FY11/19 to FY11/21. The Company is looking to succeed and further strengthen the key priority measures and financial strategies of the previous medium-term management plan "Challenge 40" which it achieved two years ahead of schedule in FY11/18. Specifically, the Company will work on the following: 1) Developing a business model centered on SRR (strengthening the fee income business); 2) Strategically investing in regional metropolitan areas (expanding business area); and 3) Expanding the hotel development and office building development businesses (develop new growth engines). Also, the Company is placing more of a focus on managing the balance sheet in order to prepare for a future correction phase, and as a part of this, the Company is putting maximum emphasis on strengthening its financial base, centered on rental cash flow. The Company is looking to realize sustainable growth while maintaining an equity ratio of at least 30%. The Company is aiming for operating income around the ¥20.0bn level, ROE around the 15.0% level, and ROA around the 7.0% level by focusing on productivity and capital efficiency, while purposely not setting a net sales target.

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

	FY11/18 Results	FY/11/19 Results	FY11/21 Targets	
Operating income	¥14,033mn	¥15,395mn	¥20,000mn	level
ROE	16.9%	14.7%	15.0%	level
ROA	8.5%	8.1%	7.0%	level
Equity ratio	37.9%	32.5%	30.0%	or higher

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

2. Key priority measures and direction

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

The Company intends to continue promoting asset build-up at SRR with ongoing robust property supply and pursue expansion of asset management fees. It also plans to focus on the property management operations (managing properties, construction, etc.). In addition to adding hotels and office buildings to the lineup of real estate for development and sale, the Company will launch new management funds*1 in addition to SRR and increase acquisition fees. Furthermore, in addition to creating a mechanism to acquire MC fees by bringing hotel management operations in-house*2, the Company will bolster the fee income business by growing rental income and acquiring overseas income, along with other initiatives.

*1 As explained above, the Company is jointly launching a large-scale hotel development fund with Daiwa Securities Group and aims to establish a hotel REIT in FY11/21 or later (with the Group handling the asset management business).

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

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

The Company plans to invest approximately ¥300.0bn (land + construction expenses) over three years. The Company is making steady progress with accumulation of ¥214.1bn (71.4% progress rate) as of the end of May 2020, the midway point. In particular, residence development, the Company's core business, already reached ¥84.9bn (106.2%), surpassing the goal. The expansion of the sales area has been a success with properties developed in the Tokyo metropolitan area and regional cities nationwide. Income property (this category is also mainly residence properties) totaled ¥97.8bn (72.5%), indicating healthy progress with acquisitions.

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

Investments in hotel and office development, which is positioned as a new growth engine, meanwhile, is lagging at ¥31.2bn (36.8% progress rate). The Company has taken a cautious stance for the time being in light of the impact of the COVID-19 outbreak on market condition trends. For the remaining investment portion, it intends to shift to residence development and income property acquisitions because these categories are less affected by the impact of economic fluctuations.

The direction the Company is focused on is not only a flow type earnings structure from repeated buying and selling, but also converting to a stock-type earnings structure that stably accumulates earnings. At FISCO, we evaluate this strategy to be rational, because it minimizes the impact of the business cycle and enables it to achieve sustainable growth. Furthermore, FISCO thinks the policy change in respect to the COVID-19 outbreak impact is a rational decision. Build-up in residence developments and income properties that attract vibrant demand from domestic and overseas investors is therefore likely to strongly affect future growth. We believe the Company holds advantages precisely due to the highly uncertain industry environment with its knowhow, network cultivated up to now and financial capabilities. The Company's alliance with Daiwa Securities Group deserves notice from a longer-term perspective. We see opportunities in a new era and new business that envisions the next stage, including the hotel REIT trend, overseas initiatives, and crowdfunding.

Returns to shareholders

Plans to raise the dividend for an eighth straight year in FY11/20, still has considerable room for dividend increase in the future from profit growth

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

In FY11/20, the Company plans to raise the dividend by ¥3 year-on-year to ¥82 (with a ¥38 interim dividend and ¥44 year-end dividend). If this level is achieved, it will increase the dividend for the eighth straight year since FY11/12. The Company targets a dividend payout ratio of around 30%, but at FISCO, we think that considerable room remains for the dividend to increase in the future from profit growth.

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

* Center Hotel Tokyo, S-PERIA INN Nihombashihakozaki, and S-PERIA INN Osaka Hommachi

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