# II. Review of operations

## 1. Business and other risks

There were no business and other risks that newly arose during the three months ended February 28, 2017. In addition, there were no significant changes in “Business and other risks” described in the annual securities report for the previous fiscal year.

## 2. Important operational contracts, etc.

No important operational contracts, etc. were determined or entered into during the first quarter of the fiscal year under review.

## 3. Analysis of financial position, operating results and cash flows

Any forward-looking statements included in the following descriptions are based on the best estimates or judgment of the Tosei Group as of February 28, 2017.

### (1) Analysis of operating results

During the three months ended February 28, 2017, the Japanese economy remained on a moderate recovery track. There was firm personal consumption supported by an improving employment and income environment in Japan, and signs of recovery in exports against a backdrop of improving overseas economies. Although it is necessary to keep in mind the impact of the uncertainty surrounding overseas economies and volatility in financial and capital markets, the moderate recovery is expected to continue going forward.

In the real estate industry where Tosei Group operates, domestic real estate transactions by listed companies and other such entities from January 2016 to December 2016 decreased 7.4% year on year to ¥4.0131 trillion, against a backdrop of investors’ reluctance to invest due to the decline in the number of properties circulating in the market and the surge in real estate prices. However, transactions are expected to increase going forward as investors’ desire to acquire property remains strong due to a favorable financing environment (according to a survey by a private research institution).

In the Tokyo metropolitan area condominium market, the number of units sold in 2016 fell 11.6% year on year to just over 35,000, falling below 40,000 for the first time in seven years. Although the average sales price decreased 0.5% year on year to ¥54.9 million per unit, the price per m2 for private areas increased 1.8% year on year to ¥793,000 following the impact of persistently high building costs and the surge in land acquisition prices. In projections by a private research institution, the number of units sold in 2017 is forecast to increase 6.2% year on year to 38,000.

In the Tokyo metropolitan area build-for-sale detached house market, housing starts for 2016 rose 6.9% year on year to 60,712. There is strong demand for detached housing, which is relatively inexpensive compared to condominium prices, and housing starts recovered to the 60,000 unit level for the first time in three years (according to the Ministry of Land, Infrastructure, Transport and Tourism data).

In the office leasing market of Tokyo’s five business wards, there is strong office expansion and relocation demand backed by an improvement in corporate earnings, and the vacancy rate remains below 4% while there is an ongoing trend of gradually increasing rents. The vacancy rate in January 2017 declined 0.27 percentage points year on year to 3.74%, and the average asking rent was ¥18,582 per tsubo (1 tsubo = 3.3m2), a 4.5% increase of ¥792 year on year (according to a survey by a private research institution).

In the real estate securitization market, even amidst a trend of declining real estate transactions in Japan, properties were proactively acquired through J-REITs and J-REIT acquisitions in 2016 increased 10.8% year on year to ¥1.7692 trillion, the third-highest level ever. As of January 31, 2017, the total value of assets under management in the J-REIT market (acquisition cost base) increased 11.2% year on year to ¥15.5683 trillion, and the J-REIT market is continuing to expand (according to a survey by a private research institution).

Amid this operating environment, in the Revitalization Business, the Tosei Group made steady progress in selling assets such as income-generating office buildings and apartments, while in the Development Business, the Group pushed ahead with sales of detached houses. In addition, we proactively acquired income-generating properties and land for development as future sources of income.

As a result, consolidated revenue for the three months ended February 28, 2017 totaled ¥14,677 million (up 8.5% year on year), operating profit was ¥3,828 million (down 7.3%), profit before tax was ¥3,658 million (down 6.5%), and profit for the period was ¥2,500 million (down 4.2%).

Performance by business segment is shown below.

**Revitalization Business**

During the three months ended February 28, 2017, the segment sold 25 properties it had renovated, including Onoecho 6-chome Building (Yokohama-shi, Kanagawa), Kishino Building (Toshimaku-ku, Tokyo), NOUER Nakamachidai (Yokohama-shi, Kanagawa) and Demeure Sagamihara (Sagamihara-shi, Kanagawa). In addition, the segment sold 11 units in the Restyling Business, including Hilltop Yokohama Negishi (Yokohama-shi, Kanagawa), Hilltop Yokohama Higashi Terao (Yokohama-shi, Kanagawa) and Renai Kamakura Ueki (Kamakura-shi, Kanagawa).

During the three months ended February 28, 2017, it also acquired a total of four income-generating office buildings and apartments and one land lot for renovation and sales purposes.

As a result, revenue in this segment was ¥10,939 million (up 363.4% year on year) and the segment profit was ¥3,417 million (up 1,775.3%).

**Development Business**

During the three months ended February 28, 2017, the segment focused on the sale of detached houses, for which there was firm demand. The segment sold 24 detached houses at such properties as THE Palms Court Kashiwa Hatsuishi (Kashiwa-shi, Chiba), THE Palms Court Koshigaya Lake Town (Koshigaya-shi, Saitama), THE Palms Court Machida Turukawa (Machida-shi, Tokyo).

During the three months ended February 28, 2017, it also acquired one land lot for hotel project, one land lot for condominium project and land lot for 11 detached houses.

As a result, revenue in this segment was ¥969million (down 88.9% year on year) and the segment loss was ¥173 million (in comparison with segment profit of ¥3,580 million in the same period of the previous fiscal year ).

During the three months ended February 28, 2017, all the segment revenue came from detached houses sale. On the other hand, in the same period of the previous fiscal year the segment sold two commercial facilities. For this reason, the segment revenue and profit decreased.

**Rental Business**

During the three months ended February 28, 2017, while the segment sold 14 buildings of its inventory assets held for leasing purposes, it newly acquired one apartment. In addition, the segment made efforts to lease vacancies out following acquisitions and also focused on leasing activities for its existing non-current assets and inventory assets.

As a result, revenue in this segment was ¥1,471 million (up 33.7% year on year) and the segment profit was ¥660 million (up 43.1%).

**Fund and Consulting Business**

During the three months ended February 28, 2017, while ¥11,061 million was subtracted from the balance of assets under management (Note), due mainly to property dispositions by funds, ¥29,465 million was added to the balance of Assets under management ¥448,186 for the end of the previous fiscal year, due mainly to new asset management contracts of large projects the segment obtained. The balance of assets under management as of February 28, 2017, was ¥466,589 million. The acquisition of such large project contracts increased asset management fees and contributed to revenue.

As a result, revenue in this segment was ¥468 million (down 16.7% year on year) and the segment profit was ¥159 million (down 24.0%).

Note: The balance of assets under management includes the balance of assets that were subject to consulting contracts, etc.

**Property Management Business**

. During the three months ended February 28, 2017, the number of properties under management increased as a result of efforts to win new contracts and maintain existing contracts. Consequently, the total number of properties under management was 599 as of February 28, 2017, an increase of 18 from February 29, 2016, with the total comprising 378 office buildings, hotels, schools and other such properties, and 221 condominiums and apartments.

As a result, revenue in this segment was ¥828 million (up 29.0% year on year) and segment profit was ¥75 million (up 170.6%).

**Other**

For the three months ended February28, 2017, there were no revenue in this segment (in comparison with segment revenue of ¥136 million in the same period of the previous fiscal year) and the segment profit was ¥0 (in comparison with segment loss of ¥1 million in the same period of the previous fiscal year).

**(2) Analysis of financial position**

As of February 28, 2017, total assets were ¥120,715 million, a decrease of ¥561 million compared with November 30, 2016, while total liabilities were ¥78,227 million, a decrease of ¥2,038 million.

This was primarily due to a decrease in inventories resulting from sale of properties exceeding purchase of properties in the Revitalization Business and Development Business, a decrease in borrowings from financial institutions accompanying such property acquisitions and decreases in accrued income tax.

Total equity increased by ¥1,477 million to ¥42,487 million, mainly due to an increase in retained earnings and payment of cash dividends.

**(3) Analysis of cash flows**

Cash and cash equivalents (hereinafter “cash”) as of February 28, 2017 totaled ¥21,529 million, down ¥110 million compared with November 30, 2016.

The cash flows for the three months ended February 28, 2017 and factors contributing to those amounts are as follows:

**Cash Flows from Operating Activities**

Net cash provided by operating activities totaled ¥1,779 million (net cash used in operating activities totaled ¥3,450 million in the same period of the previous fiscal year). This is mainly due to profit before tax of ¥3,658 million and income taxes paid of ¥2,155 million.

**Cash Flows from Investing Activities**

Net cash provided by investing activities totaled ¥61 million (up 503.3% year on year). This is primarily due to proceeds from withdrawal of time deposits ¥95 million.

**Cash Flows from Financing Activities**

Net cash used in financing activities totaled ¥1,952 million (net cash provided by financing activities totaled ¥4,876 million in the same period of the previous fiscal year )This mainly reflects ¥8,742 million in the repayments of non-current borrowings and ¥1,009 million in cash dividends paid, despite ¥7,981 million in proceeds from non-current borrowings.

## (4) Operational and financial issues to be addressed

During the three months ended February 28, 2017, there was no significant change in issues to be addressed by the Tosei Group.

The Company has set the basic policy regarding the persons who control the decision-making on the financial and business policies of the Company. The contents of basic policy (matters set forth in Article 118, item 3 of the Ordinance for Enforcement of the Companies Act) are as follows:

a. Contents of basic policy

The Company believes that the persons who control decisions on the Company's financial and business policies need to be persons who fully understand the details of the Company's financial and business affairs and the source of the Company's corporate value and who will make it possible to continually and persistently ensure and enhance the Company's corporate value and, in turn, the common interests of its shareholders.

The Company believes that ultimately its shareholders as a whole must make the decision on any proposed acquisition that would involve a change of control of the Company. Also, the Company will not reject a large-scale acquisition of the shares in the Company if it will contribute to the corporate value of the Company and, in turn, the common interests of its shareholders.

Nonetheless, there are some forms of large-scale acquisition of shares that benefit neither the corporate value of the target company nor the common interests of its shareholders including those with a purpose that would obviously harm the corporate value of the target company and the common interests of its shareholders, those with the potential to substantially coerce shareholders into selling their shares; those that do not provide sufficient time or information for the target company's board of directors and shareholders to consider the details of the large-scale acquisition, or for the target company's board of directors to make an alternative proposal and those that require the target company to discuss or negotiate with the acquirer in order to procure more favorable terms for shareholders than those presented by the acquirer.

It is particularly necessary and essential for the persons who make decisions on the Company's financial and business policies to (i) maintain the system under which the Company internally covers the five business fields that allow the "integration of real estate and finance," which leads to maximization of the potential of the Company group, (ii) maintain employees who support that system with knowledge and experience specializing in real estate and finance, (iii) maintain the Company's trust in the real estate industry that has been built up over a long period of time based on the establishment of the ability and information networks supporting various value creation technologies, and (iv) master knowhow that enables comprehensive business. Unless the acquirer of a proposed large-scale acquisition of the shares in the Company understands the source of the corporate value of the Company as well as the details of financial and business affairs of the Company and would ensure and enhance these elements over the medium-to-long term, the corporate value of the Company and, in turn, the common interests of its shareholders would be harmed.

The Company believes that persons who would make a large-scale acquisition of the shares in the Company in a manner that does not contribute to the corporate value of the Company or the common interests of its shareholders would be inappropriate as persons that control decisions on the Company's financial and business policies. The Company believes that it is necessary to ensure the corporate value of the Company and, in turn, the common interests of its shareholders by taking necessary and reasonable countermeasures against a large-scale acquisition by such persons.

b. Overview of special measures to realize the basic policy

Under the medium-term management plan called "Advancing Together 2017" (the targeted period of the plan is three years from December 2014 to November 2017), the Company group aims to further strengthen the business infrastructure by expanding and developing of the existing five business areas

and considering its advance to peripheral areas of business, to build optimum corporate governance for expansion of the Company group and increase of the employees which are entailed in expansion of the business, and to establish efficient organization management structure. Further, the Company group will emphasize the cultivation of the most valuable asset of the Company group, i.e. the human resources to increase satisfaction of the employees of the Company group. As the Basic Policy in the medium-term management plan for the further growth of the Company group, the Company group is determined to establish the original and distinctive "Tosei brand" by providing products ensuring high customer satisfaction and high-quality services. Based on these policies, the Company group is dedicated to redefine existing ideas with the spirit of challenge and advance as the risk-taking group of companies, to aim "creation of new values and sensation as the truly globally-minded and promising professionals".

The Company group has previously appointed multiple outside directors (two members), invited all Audit & Supervisory Board Members (four members) from outside the company, and has notified all of the above six outside directors and Audit & Supervisory Board Members as "independent directors and/or Audit & Supervisory Board Members" in accordance with the "Principles of Corporate Governance for Listed Companies" of the Tokyo Stock Exchange. Also, the Company group has reinforced the business execution function by the introduction of the executive officer system, and the establishment of the corporate governance board, and will continue to endeavor to further strengthen corporate governance. Specifically, the Company group will focus on putting into practice actions based on a high-level awareness of compliance through raising awareness from the level of "role model" to that of "ideal" in accordance with the Compliance Principles of the Company, thorough implementation of risk management by correctly understanding and analyzing risks involved in corporate activities, continuous performance of accountability to various stakeholders including investors by promptly publicly disclosing correct corporate information under the spirit of fair disclosure, and other efforts for strengthening corporate governance.

c. Overview of measures to prevent decisions on the Company's financial and business policies from being controlled by persons deemed inappropriate according to the basic policy

The plan is a measure to prevent decisions on the Company's financial and business policies from being controlled by persons deemed inappropriate under the above basic policy, and its objective is to ensure and enhance the Company's corporate value and, in turn, the common interests of its shareholders.

The plan stipulates procedures that must be followed in any cases of purchase, etc. of share certificates, etc. of the Company ((i) a purchase or other acquisition that would result in the holding ratio of share certificates, etc. *(kabuken tou hoyuu wariai)*of a holder *(hoyuusha)* totaling at least 20% of the share certificates, etc. issued by the company; or (ii)a tender offer *(koukai kaitsuke)* that would result in the party conducting the tender offer's ownership ratio of share certificates, etc. and the ownership ratio of share certificates, etc. of a person having a special relationship totaling at least 20% of the share certificates, etc. issued by the Company; or (iii) any similar action to (i) or (ii) above)

In practical terms, the acquirer must provide the Company a statement of undertaking (acquirer's statement) and an acquisition document that includes essential information, etc. before making the acquisition, etc.

Upon receiving these documents, the independent committee, while obtaining independent expert advice, will conduct its consideration of the acquisition terms; collection of information on materials such as the management plans and business plans of the acquirer and the Company's board of directors and comparison thereof; consideration of any alternative plan presented by the Company's board of directors, and the like; and discussion and negotiation with the acquirer. The Company will disclose information in a timely manner.

When (i) the acquisition is not in compliance with the procedures prescribed in the plan or (ii) it threatens to cause obvious harm to the corporate value of the Company, and, in turn, to the common interests of shareholders, (iii) and it is reasonable to implement the gratis allotment of stock acquisition rights, the independent committee will recommend the implementation the gratis allotment of stock acquisition rights to the Company's board of directors. In addition, when a meeting of shareholders is convened to confirm the intent of the Company's shareholders, the Company's board of directors will respond to the shareholders' intent. These stock acquisition rights will be allotted with an exercise condition that does not allow, as a general rule, the acquirer to exercise the rights and an acquisition provision to the effect that the Company may acquire the stock acquisition rights in exchange for shares in the Company from persons other than the acquirer. The Company's board of directors, in exercising its role under the Companies Act, will pass a resolution relating to the implementation or non-

implementation of the gratis allotment of stock acquisition rights, respecting the recommendation of the Independent Committee to the maximum extent. In addition, when a meeting of shareholders is convened to confirm the intent of the Company's shareholders, the Company's board of directors will respond to the shareholders' intent. If the procedures for the plan have commenced, the acquirer must not effect an acquisition until and unless the Company's board of directors resolves not to trigger the plan. The effective period of the plan expires at the conclusion of the ordinary general meeting of shareholders for the last fiscal year ending within three years after the conclusion of the 65th Ordinary General Meeting of Shareholders. However, if, before the expiration of the effective period, the Company's board of directors resolves to abolish the plan, the plan will be abolished at that time.

d. Decisions by the Company's board of directors regarding specific measures and reasons therefor

Company's board of directors deems that the new medium-term management plan and other measures such as the efforts to enhance the corporate value and the strengthening of corporate governance were established as specific measures to continuously and sustainably enhance the corporate value of the Company and, in turn, the common interests of its shareholders, and that these are truly in accordance with the basic policy, not detrimental to the common interests of the Company's shareholders and not for the purpose of maintaining the positions of the Company's corporate officers.

In addition, the Company's board of directors deems that the plan is not detrimental to the common interests of the Company's shareholders, not for the purpose of maintaining the positions of the Company's corporate officers, and in accordance with the basic policy based on the following reasoning: approval from the general meeting of shareholders must be obtained for its renewal; its effective period is stipulated as a maximum of three years and it can be abolished at any time by the resolution of the Company's board of directors; an independent committee, which is composed of members who are independent from the management of the Company, has been established; in the event that the plan's countermeasures are triggered, the Company must obtain a resolution by the independent committee when making a decision for triggering the countermeasures in the plan, and the plan fully satisfies the three principles set out in the Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests released by the Ministry of Economy, Trade and Industry and the Ministry of Justice on May 27, 2005.

**(5) Research and development activities**

No item to report.