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, 2015. 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, 2015.

(1) Analysis of operating results

During the three months ended February 28, 2015, the Japanese economy experienced a modest recovery, as corporate earnings and the employment situation improved due to the effects of economic measures by the government and bold monetary easing by the Bank of Japan, as well as a fall in crude oil prices.

In the real estate industry where Tosei Group operates, real estate transactions increased amid expectations of rises in land prices and low interest rates. In addition, the total acquisition amount of properties acquired by listed companies and others in 2014 was approximately ¥5.05 trillion, an increase of 16% compared with the previous fiscal year due to a rise in real estate acquisitions by foreign companies, investment funds and others, backed by a weakening yen (according to a survey by a private research institution).

In the Tokyo metropolitan area condominium market, although prices showed an upward trend reflecting rising building costs, the market was stable due to a postponement of a planned consumption tax increase. The number of condominium units sold in 2015 is expected to be approximately 45,000 units, up 5.9% year on year, amid a mounting tendency to return to the city center. The contract rate hovered around 70%, which is viewed as indicating favorable conditions, and the contract rate in January 2015, the latest data available, was 74.9%, a drop of 3.7 percentage points compared with the same month of the previous fiscal year (according to a survey by a private research institution).

In the Tokyo metropolitan area build-for-sale detached house market, housing starts in 2014 totaled 58,000 units, which was down 7.3% compared with the previous fiscal year, due to a prolonged decline reflecting backlash from the consumption tax hike. Although it is necessary to continue monitoring the trend in supply and demand, housing starts are expected to recover and increase in 2015 on the back of market revitalization policies such as the eco-point program for houses (according to the Ministry of Land, Infrastructure, Transport and Tourism data).

At the same time, in the office leasing market of Tokyo’s five business wards, demand was strong due to active expansion or relocation of offices by corporates, and the vacancy rate in January 2015 declined to 5.4%. The average asking rent was in the ¥17,000 range, which was the highest level in three years (¥17,109/tsubo, an increase of ¥867 or 5.3% compared with the same month of the previous fiscal year), showing a modest upward trend for 13 consecutive months (according to a survey by a private research institution).

In the real estate securitization market, as of the end of December 2014, the balance of assets under management at private placement funds was ¥15.1 trillion, down 6.2% from previous year, due to disposals of properties by many funds in the favorable real estate market. At the same time, as of the end of December 2014, assets under management at J-REITs expanded to ¥12.6 trillion, up 12.9% from the previous fiscal year, as the financing environment remained favorable. For example, total market capitalization of J-REIT investment units exceeded ¥10 trillion for the first time since the establishment of the market. Despite the booming conditions in the J-REIT market, the pace of new property acquisitions by J-REITs slowed down due to an intensification in competition for acquisitions, and the total acquisition amount of properties during 2014 was ¥1.5 trillion, down 29.4% compared with previous fiscal year

(according to a survey by a private research institution). Amid this operating environment, in the Revitalization Business, the Tosei Group made steady progress on the sale of assets such as income-generating office buildings and apartment buildings, and also the Group pushed ahead with sales of detached houses and others in the Development Business. 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, 2015 totaled ¥11,525 million (up 1.6% year on year), operating profit was ¥2,365 million (up 47.8%), profit before tax was ¥2,190 million (up 53.5%), and profit for the period was ¥1,390 million (up 59.4%).

Performance by business segment is shown below:

Revitalization Business

During the three months ended February 28, 2015, the segment sold nine properties it had renovated, including Ogawamachi Tosei Building (Chiyoda-ku, Tokyo), Shibuya 4-chome Building (Shibuya-ku, Tokyo) and Kannai Tosei Building (Yokohama-shi, Kanagawa). In addition, the segment sold 16 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). In the three months ended February 28, 2015, it also acquired a total of four income-generating office buildings and apartments and two land lots for renovation and sales purposes.

As a result, revenue in this segment was ¥7,207 million (up 4.6% year on year) and the segment profit was ¥1,849 million (up 114.0%).

Development Business

During the three months ended February 28, 2015, the segment focused on the sale of detached houses, which were in firm demand. The segment sold 19 detached houses at such properties as THE Palms Court Kashiwa Hatsuishi (Kashiwa-shi, Chiba),THE Palms Court Bunkyo Honkomagome (Bunkyo-ku, Tokyo) and THE Palms Court Kawasaki Daishi (Kawasaki-shi, Kanagawa). In addition, the segment sold Palms Nishidai, which is a newly-built apartment, and two land lots.

As a result, revenue in this segment was ¥2,324 million (down 7.9% year on year) and the segment profit was ¥409 million (up 20.9%).

Rental Business

During the three months ended February 28, 2015, while the segment sold six buildings of its inventory assets held for leasing purposes, it newly acquired a total of five properties including income-generating office buildings and apartments. 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 ¥833 million (up 8.0% year on year) and the segment profit was ¥348 million (down 26.0%).

Fund and Consulting Business

During the three months ended February 28, 2015, while the balance of assets under management decreased by ¥3,171 million, due mainly to property dispositions by funds, the balance increased by ¥219,868 million, due mainly to new asset management contracts of large projects the segment obtained. The acquisition of such large project contracts increased asset management fees and contributed to sales.

As a result, revenue in this segment was ¥256 million (down 12.0% year on year) and the segment profit was ¥50 million (down 57.0%).

The lower year-on-year revenue and profit results are primarily attributable to the segment having posted disposition fees income pertaining to sales involving large projects in the same period of the previous year.

As of February 28, 2015, the balance of assets under management (Note) totaled ¥517,304 million.

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

Property Management Business

As of February 28, 2015, the number of properties managed by the segment including office buildings, parking lots and schools was 348, which was unchanged from February 28, 2014, while the number of condominiums and apartments under management decreased by 13 to 192, making the total number of properties under management 540, a decrease of 13 from February 28, 2014.

As a result, revenue in this segment was ¥698 million (down 11.2% year on year) and segment profit was ¥26 million (down 73.1%).

Alternative Investment Business

During the three months ended February 28, 2015, the segment focused on leasing activities for properties acquired by a substitute performance. Membership fees from running a sports club also contributed to income in this segment.

As a result, revenue in this segment was ¥204 million (up 172.4% year on year) and the segment profit was ¥45 million (up 7.0%).

(2) Analysis of financial position

As of February 28, 2015, total assets were ¥84,324 million, an increase of ¥3,466 million compared with November 30, 2014, while total liabilities were ¥50,679 million, an increase of ¥2,549 million.
This was primarily due to an increase in inventories resulting from purchase of properties exceeding sales of properties in the Revitalization Business and Development Business, and an increase in borrowings from financial institutions.

Total equity increased by ¥917 million to ¥33,645 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, 2015 totaled ¥17,851 million, an increase of ¥1,750 million compared with November 30, 2014.

The cash flows for the three months ended February 28, 2015 and factors contributing to those amounts are as follows:

Cash Flows from Operating Activities

Net cash used in operating activities totaled ¥757 million (down 76.1% year on year). This is mainly due to profit for the period before tax of ¥2,190 million, as well as an increase in inventories of ¥1,748 million, which was a result of property acquisitions in the Revitalization Business and Development Business, and income taxes paid of ¥1,368 million.

Cash Flows from Investing Activities

Net cash used in investing activities totaled ¥238 million (down 79.0% year on year). This is primarily due to purchases of investment properties totaling ¥665 million and proceeds from sales of available-for-sale financial assets totaling ¥444 million.

Cash Flows from Financing Activities

Net cash provided by financing activities totaled ¥2,757 million (down 36.6% year on year). This mainly reflects ¥6,567 million in the repayments of non-current borrowings and ¥534 million in cash dividends paid, despite ¥10,106 million in proceeds from non-current borrowings.

(4) Operational and financial issues to be addressed

During the three months ended February 28, 2015, 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 six 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 new 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 six 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 new 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 (five members) from outside the company, and has notified all of

the above seven 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.