

Mitsui Fudosan Co., Ltd. 2Q FY2017

Analyst Meeting Q&A Summary

Q. I feel the US real estate market is already at high levels. How do you view the environment for overseas investments?

A. Generally, when acquiring existing properties, near-term real estate market conditions do have a significant impact. However, our focus is on development projects. Although there is a certain level of risk at the outset for development projects, we have been able to achieve better-than-expected profitability because we have a firm grasp of market trends and leasing conditions in neighboring areas, which allows us to make decisions quickly. For example, leasing at 55 Hudson Yards is already over 80% and the contracted rent levels are higher than we had initially anticipated. We attribute our success in securing the 50 Hudson Yards project at relatively attractive terms to the fact that we were able to act swiftly. The ability to make a quick decision was based on our assessment that the risk was relatively low, given the strong leasing situation at 55 Hudson Yards and the fact that 30% of the property had already been spoken for.

As our overseas business expands, we recognize that we will need to consider acquisitions of existing properties. However, we believe that it is prudent to exercise caution in transacting when market prices are high based on near-term market conditions.

Q. Please discuss your shareholder returns policy.

A. Our appetite for investments is likely to remain strong, given the numerous large-scale domestic and overseas projects already in the pipeline. We also are continuously looking for new investment opportunities that will drive future growth.

As such, under our current medium-term business plan, our policy is to aim to pay 25% of consolidated net profit as a dividend. We view our shareholder returns policy as equally important as our group growth strategy. We are currently discussing our next medium-term business plan.

Q. Please discuss the outlook for investments and cost recovery in both the domestic and overseas businesses.

A. Given the abundance of projects, both domestic and overseas, in our existing pipeline, we expect investment levels to remain high. However, in our overseas business, we also expect to make progress on cost recovery, on the back of the condominium sales that are a part of the Television Centre redevelopment project (UK). We also assume we will sell some of our rental residential properties in the US.

Q. One of your core strategies is 'Full implementation of Group management'. How do you view Mitsui Home in this context?

A. We continue to believe that Mitsui Home has an important role to play within the Group as we focus on providing one-stop services in the residential business. In April of this year, we established the Homes and Lifestyle Promotion Division. We are implementing initiatives that will deepen the collaboration between each of our residential group companies, starting with Mitsui Home.

Q. On the back of the proposed introduction of a 5-day work week for construction sites, there have been increasing concerns that construction costs may rise further. What is your view of the outlook for construction costs?

A. Near-term construction costs have remained stable at elevated levels. We believe that success in addressing this challenge will reflect the capabilities of individual developers. Any progress that the construction industry makes in reforming working styles is predicated on the cooperation of the contractee. We believe it will be important to work with construction companies to reduce costs further through the adoption of labor-saving equipment and efficient construction methods, and ensuring that both parties agree to an appropriate construction period.

Q. The J-REIT market remains weak. If these lackluster conditions persist, would you be concerned about the impact on your Property Sales to Investors business?

A. Our management strategy is based on a model for joint value creation with investors, in which we aim to grow together with the J-REITs. As such, our policy of selling properties into the J-REITs is unchanged, provided we are selling at appropriate prices. Currently, we are seeing strong appetite from non-J-REIT players, such as private funds and corporates. Given this, we have no concerns about selling property.

Q. Related to the faulty installation of foundation piles at a Yokohama condominium, can you tell me how much Mitsui Fudosan Residential has incurred in related temporary payments? Also, when should we assume there will be clarity on how these expenses will be covered?

A. We do not disclose the specific amount of advance payments but as stated in our quarterly financial summary of accounts, we estimate that the combined total costs for reconstruction and temporary housing for residents during construction will come to around ¥39 billion. Discussions with the 3 companies involved in the installation of the foundation piles, Sumitomo Mitsui Construction, Asahi Kasei Construction Material and Hitachi High-Technologies, are ongoing. We maintain our stance which is to seek full restitution from these three companies. We will provide status updates when there has been significant progress which would warrant disclosure.

Q. You have indicated that you expect investment levels to remain high going forward. Given this, how do you think about financial balance?

A. Although it will depend upon our future investment plans, we believe it will be possible to control a rise in the D/E ratio from the current 1.2x to a level of around 1.5x. We recognize that financial balance is an important issue that management must monitor on an ongoing basis. Based on current profit levels, we do not anticipate a significant deterioration in financial soundness.

Q. Could you talk about the profitability of your overseas business, such as the Hudson Yards project?

A. We aim for a NOI yield of between 4.5 - 5% on domestic urban redevelopment projects. We set our hurdle rate for overseas projects higher than for domestic projects to take into account differences such as risks and interest rate levels. We have secured NOI yields of 7 - 8% on already completed projects in the UK. For the 55 Hudson Yards project currently underway, we expect to achieve better returns than initially expected, given that we are signing tenants at rent levels above our initial assumptions.

In the planning phase for 50 Hudson Yards we have set a higher hurdle rate than we would apply to a domestic project. However we expect to ultimately generate better returns than initially expected, similar to what our experience has been with existing projects to date. Please note that we do not disclose the profitability of individual projects.

Q. Compared to your typical office properties, what percentage of the floor space for your mixed-use urban projects would be office space?

A. Typically, the leasable floor area of an office property, relative to total floor area is around 70%. However, for our mixed-use projects it tends to be around 50 - 60%. There have been some projects where it has been below 50%.

Q. You opened an EC mall '& mall' on November 1, which is positioned to co-exist with your real retail facilities. Are you expecting synergies between '& mall' and your logistics facilities business?

A. We think there are many areas for synergies between '& mall' and our logistics facilities business. In September, we opened an ICT Lab on site at MFLP Funabashi I to provide solutions to tenants of our logistics facilities. We could provide '& mall' tenants who will need to manage inventory with the logistics robots and other solutions that we showcase at the ICT lab.

Q. For the residential property sales business, can you indicate how many condominium units you expect to report in FY2018 and the expected level of profits?

A. The number of reported condominium units for FY2018 is likely to be around the mid-3,000 level. However, the profitability of the residential business will include a number of high margin projects in central urban locations. Additionally, from our overseas business, there will be a profit contribution from the Television Centre redevelopment project in the UK. For the Property Sales to Investors sub-segment, barring a dramatic change in the operating environment, we should be able to match the absolute level of profits we expect to generate in the current fiscal year. These are the factors that will contribute to Property Sales segment profits in FY2018.

Q. With investment expected to remain at high levels, the D/E ratio is likely to rise. How do you think about the balance between continued investments and rating agencies' assessments?

A. Our strategy is to undertake investments that will drive future growth while maintaining a certain level of leverage. It is possible that the D/E ratio could rise temporarily from current levels but we believe any increase can be judiciously controlled. We will work closely with the rating agencies to ensure that we are evaluated appropriately.

Q. There has been some discussion of rebuilding the Metropolitan Expressway underground. What impact might this have on your plans for redeveloping the Nihonbashi area?

A. In November, the Ministry of Land, Infrastructure and Transport, the Government of the Metropolis of Tokyo and the Metropolitan Expressway Company convened an initial exploratory meeting on this issue. The local neighborhood has long sought to restore a clear view of the skies in Nihonbashi. We view this as a positive first step to the realization of this aim.

Going forward, we understand that there will be a need for wide-ranging discussions on issues such as structuring traffic access, environmental concerns, construction methods and the period of time required for construction. We will formulate our response at a later stage, when progress has been made on these issues. However, although there may be some changes in the relative mix of applications, we will continue focusing on mixed-use redevelopment.