Mitsui Fudosan Co., Ltd.

1H FY2021 Analyst Meeting Q&A Summary

Q. As the U.S. begins tapering, there are concerns that interest rates and cap rates will rise. Is there a possibility that Mitsui Fudosan might accelerate sales of overseas properties going forward? What is your view on the environment for investing in overseas real estate?

A. U.S. interest rate moves are within the range of our assumptions for investment decisions. Against this backdrop, in line with an awareness of turnover in real property for sale, we plan to continue selling properties. The current outstanding balance of real property for sale is high because many properties are still in development. In the East and West Coast areas of the U.S., the pandemic has largely stabilized. We will continue to invest selectively and aim to begin selling properties as they are completed.

Q. You indicated that reservations in the hotel business are picking up near term. Please talk about ADR trends. Also, what is your view on the possibility of the hotel business returning to profitability in FY2022, assuming that COVID-19 comes under control?

A. Currently, our occupancy rates are recovering but the key going forward will be whether there is a recovery in ADRs. For instance, our Kyoto hotels are reporting solid increases in reservations for the autumn colors season. However, in addition to a further improvement in ADRs, a return to profitability will require revenue, which is ADR multiplied by occupancy rate, to exceed the breakeven point.

The hotel business is included in the Other segment, which is currently reporting operating losses, a situation we deplore. We will focus on putting this business into the black in FY2022 by growing revenue and reducing expenses.

Q. Please share your view of Mitsui Fudosan's office business in Japan and the U.S., including a discussion of the outlook for vacancy rates for the domestic office business, domestic tenant trends in optimizing office usage, and the back-to-office moves by tenants in the U.S.

A. On the back of an extended domestic state of emergency, tenants are now taking longer to make decisions on leases. We have reflected this in our outlook for the vacancy rate, which we now expect to be at around 4% at the end of the fiscal year.

On office optimization, many tenants have been consulting us on what work places should look like, including how to think about the diversification of work styles going forward or office strategies, taking into account differences in sectors, business types and corporate cultures. We believe this environment allows us to demonstrate our strength: we are able to provide proposals which accommodate diverse work styles through a combination of fixed location offices, shared offices and working from home. With regard to near term leasing conditions, we have started to see a gradual increase in negotiations for floor space of more than 1,000 tsubo (3.3 sqm) since the beginning of October.

In the U.S., we are hearing that companies are starting to bring employees back to the office although the current situation is mixed. There are some corporates, primarily financial institutions, that have already brought employees back into the office but others planning for a return from January 2022. In terms of the current leasing situation, there hasn't been a huge change from the 75% level achieved with core tenants in place at 50 Hudson Yards. However, we are starting to make progress on leases for relatively smaller floor spaces. We believe office leasing trends changed in the summer; we hope to see further progress going forward.

Q. Please discuss the outlook for Property Sales to Investors going forward, given your aim to enhance ROA and ROE.

A. Currently, the outstanding balance for real property for sale excluding residential properties has grown to ¥1.3 trillion. We continue to aim to reduce this to around ¥1 trillion over the medium- to long-term. Our operating profit target for Property Sales to Investors in the current fiscal year is ¥111 billion, which represents a new record high. Our first priority is to focus on achieving our stated target. In thinking about profit levels for the Property Sales segment going forward, if we take into account the outstanding balance of real property for sale and control of assets on the balance sheet, we believe it should be possible to assume profits of a similar scale to this fiscal year for FY2022.

Q. Within the Property Sales to Investors business, have there been properties that you have been able to sell at higher-than-expected prices? Also, from a longer-term perspective, do you believe it will be possible to significantly increase operating profits further in the Property Sales to Investors business?

A. There are some negotiations in the Property Sales to Investors business where price levels are higher than our initial assumptions. Given that cap rates remain low as well, it continues to be a sellers' market.

The outlook for operating profit in the medium- to long-term will be determined by the balance between business opportunities we acquire and asset disposals. We hope you will continue to hold high expectations for this business going forward.

Q. Please comment on the expected timing of profit contributions for both 50 Hudson Yards and Tokyo Midtown Yaesu, which are completing in FY2022.

A. As a result of the accounting treatment of property depreciation and free rent, the timing of profit contribution for domestic offices typically lags the completion of the property. In particular, with large-scale properties where it takes time for tenants to move in and there is a staggered schedule for tenant moves, it generally takes 2 years to achieve stabilized operation. In contrast, in the U.S., free rent is amortized over the life of the lease, which means that a certain level of profit can be recognized immediately upon completion. As a result, we expect 50 Hudson Yards to make some profit contribution from next fiscal year.

Q. Is there a possibility that you might incur impairment losses as a result of the pandemic in the hotel or other businesses going forward?

A. In our hotels and resorts business, epitomized by the Mitsui Garden Hotel brand, many of the properties are operated under master leases; as such, the hotels and resorts business accounts for a very small part of total assets on the balance sheet. In addition, our independent auditors conduct impairment checks every fiscal year. At this point, they have not flagged up the possibility of impairments on any properties.

Q. Please discuss current conditions in your China and Southeast Asia businesses.

A. With the lifting of restrictions on movement, we have seen a recovery in GMV trends for our retail facilities in Taiwan, Southeast Asia and China.

With regard to the residential business, there are some projects in China where we have a minor share, but the outstanding balance of investments compared to the overall balance sheet is very small, amounting to less than 1% of total assets. That said, we believe that it is necessary to closely monitor the residential market going forward for indications of a possible change in sentiment by prospective buyers. The residential business in Taiwan continues to do well, but in Thailand, it appears there are some properties where progress has been slower than initially expected.

Compared to the scale of our U.S. investments, our combined investments in China and Southeast Asia are relatively small, so we would expect any impact on our overall earnings to be limited.

Q. Uniqlo has apparently indicated its intention to participate in your e-commerce mall '&mall'. Please comment on the current conditions at '&mall'.

A. Conceptually, '&mall' is an EC mall that co-exists with real retail facilities and has an important role to play in realizing our omni channel strategy. Our customers typically engage with both real stores and the EC mall. As an example, a consumer might search for an item on '&mall', and then come to a LaLaport to check the item and try it on, or exchange sizes before ultimately making a purchase. Since establishing '&mall' in 2017, we have seen solid growth. Currently, around 400 stores participate on '&mall' and registered users have grown to around 4.2 million.

On a conventional EC mall, in many cases participating retailers set up their own distribution centers. However, at '&mall', deliveries are made from the Lalaport that is closest to the consumer. This has benefits for retailers in that they do not need to set up dedicated logistics facilities and they can also enjoy lower delivery costs and reduce CO2 emissions given the shorter distances for delivery. In addition, this approach leads to improved inventory turnover in stores, contributing to more efficient store operations.

We understand that Uniqlo's decision to become a participating retailer was a reflection of their recognition of these benefits.

Q. Please talk about the improvements to the profitability of the Repark car park leasing business and the possibility of raising market share.

A. In response to the pandemic, we have been implementing measures to lower the breakeven point to improve profitability for the Repark business. We have been closing unprofitable locations and reviewing rents in order to ensure that the business can generate revenues and profits even at occupancy rates below pre-COVID levels.

With regard to raising market share, the number of units under management is being temporarily depressed by near term measures to close unprofitable locations. However, we are aiming to raise our market share by leveraging the group's network to gather information about new potential locations and making further progress on enhancing the profit structure.

Q. Please comment on the recovery prospects for each business in the next fiscal year.

A. At this stage, we haven't formulated our plan for the next fiscal year but I would expect the comparison to pre-COVID-19 FY2019 earnings will be an important consideration.

If we look at the Leasing segment, the office business was largely unaffected by the pandemic. While we expect a profit contribution from 50 Hudson Yards, which will be completed in FY2022, the expenses related to the first year of operation for Tokyo Midtown Yaesu will also have an impact. For retail facilities, GMV for October has virtually recovered to pre-COVID-19 levels. Given this, we would expect to see a positive impact from new retail facilities which came online after FY2019.

In Property Sales, we would expect to see operating income for the domestic residential business to match or exceed operating profits for this fiscal year. In Property Sales to Investors, we would hope to see a similar level of profits to this fiscal year.

In the Management segment, given that both the Repark car park leasing business and the Rehouse retail brokerage business are running ahead of this fiscal year's plan, we would hope to generate profits at around the midpoint between FY2019 and FY2021 levels in FY2022.

The key businesses in the Other segment are Tokyo Dome and the hotels and resorts business. Relatively speaking, we would expect to see the Tokyo Dome business recover earlier than the hotels and resorts business. The key drag for Tokyo Dome has been the restrictions on spectator numbers. Given strong underlying demand to see baseball games and concerts, it would be easier to create projections for this business if the spectator restrictions are lifted. However, projecting prospects for the hotel and resorts business is very challenging. With the number of inbound travelers to Japan unlikely to recover immediately, the key will be how successful we are at attracting Japanese travelers that had historically chosen to travel abroad but are rethinking domestic travel.

Q. Please discuss the progress you have made on capex, relative to your initial plans.

A. We had initially guided for capex of ¥230 billion. New investments to date were around ¥130 billion, in line with initial plans.