Q2 2013 Earnings Call

Company Participants

- Hiroshi Asai, Executive Managing Director
- Satoshi Hironaka, General Manager, Accounting & Finance Department

Presentation

Satoshi Hironaka {BIO 19453339 <GO>}

This is Satoshi Hironaka, General Manager in charge of Accounting and Finance. I will explain using the presentation. Please turn to page two. I will go over the highlights of the consolidated income summary.

For the Second Quarter revenue from operations was JPY615.7b, an increase of JPY42.2b. Below that is the operating income of JPY61.1b, up JPY14.1b. Jumping to ordinary income, it was JPY47b, up JPY11.1 billion and net income was JPY26.8b, up JPY10.2b.

Although we do not show it here, the impact of SPC consolidation was minus JPY1.3 billion in revenue, plus JPY5.4 billion in operating income and plus JPY3.6 billion in ordinary income. Among the various segments, the Leasing segment incurred the biggest impact.

Let me explain about the non-operating income and expenses. Please see the middle column describing the year-on-year change.

The equity in net income of affiliates is down by JPY1.2b. This is the rebound of the completion and sale of an office building we were developing in Washington DC last year. For net interest expenses there was an increase in the interest cost etc. This is due to the increase in interest paid resulting from the SPC consolidation.

For extraordinary gains and losses we booked extraordinary losses of JPY2.6b. The breakdown is JPY1.4 billion from the loss of disposal on fixed assets and JPY1.1 billion from the loss on valuation of investment securities. Interim dividends are JPY11 per share, as announced at the beginning of this fiscal year, which is the same as last year's first half.

As for the progress against the forecast, please see the column on the far right. The progress is 42% for revenue, 45% for operating income and for net income, at the bottom, 48%. And we are making no change to our full-year forecast.

Let's look at each segment. Page three, please. We show the changes in operating income in the middle column.

I explained that the operating income increased by JPY14.1b. Here we show the breakdown by segment. To give you a summary, Leasing was up JPY5.5b; Property Sales was up JPY7.5b; Management was up JPY3.3b; Mitsui Home was down JPY3.9b. The Other business was up JPY700 million and the total change was JPY14.1b.

As for the progress in revenue against our forecast, Property Sales was 30%; Mitsui Home was 35%. As you may be aware, bookings tend to be concentrated in the second half, especially in the Fourth Quarter. This is why the progress is only around 30%. Overall, we are making steady progress.

Let's look at each segment in more detail. On page four is the Leasing segment.

In the wording following the bullet point we explain about Mitsui Outlet Park Kisarazu and DiverCity Tokyo coming on-stream and contributing. We also had the full-year contribution of the Nagoya Mitsui Building New Building and the Mitsui Outlet Park Kurashiki, which were both completed last year. As a result revenue was up JPY10.4b, operating income was up JPY5.5b. This includes the positive impact on income resulting from the SPC consolidation.

If you look at the year-on-year change revenue from Offices were basically flat, but Retail Facilities increased JPY10.1b. Together with Kisarazu and DiverCity there was also the full-term contribution of Kurashiki and the Ginza Komatsu building, leading to the large increase.

On page five is the vacancy for Metro Tokyo on a consolidated basis, which we usually disclose. As shown here, the Office Leasing market saw an improvement in vacancy and the vacancy in our Offices in the Tokyo Metro area was 5.0%, which was a slight decline from 5.3% as of June.

During the fiscal year we expect the vacancy to fluctuate depending on the signing and cancellation of lease contracts. We expect it to be around 4% as of March 2013. We have made no changes in our outlook since the beginning of the fiscal year.

Next, the Property Sales segment. We have two sub-segments. For Property Sales to Individuals both revenue and income grew due to an interest in the number of units booked, as well as an improvement in margins. For Property Sales to Investors revenues grew, while operating income saw only a slight increase. In total revenue grew JPY27.4b. Operating income grew JPY7.5b.

In terms of the number of units booked, shown in the red box, it was 2,165 units, which was up 310 units. Condos were the main driver for this increase, with 1,835 units booked, up by 405 units year on year. As a result revenue for Property Sales to Individuals was JPY113.9b, up JPY27.1b. If you just look at Condos revenue was up JPY30.5 billion year on year.

Operating income for Property Sales to Investors was JPY5.2 billion (sic; see presentation "JPY1.5b") and the OP margin was 4.6%. Last year the number of units booked was not as large while fixed costs were high, and our operating income was minus JPY2.4b, with an OP margin of minus 2.8%. Compared to that there was a big improvement in margins for Property Sales to Individuals.

On the right hand we show an image of Park Court Roppongi Hilltop. We also booked revenues from Nakano Twin Mark Tower, Park Homes Meguro, The Residence etc.

On page seven we show our progress in achieving contracts. You will notice the strong sales trends, with progress of 76% out of the 4,900 units to be booked this year. In the red box, the second grey line from the top, is the contracts during the year. It was 2,748 units for Condos, similar to the figure of 2,793 units last year.

The second grey line from the bottom is inventories at the end of the year; 466 units as of September end, out of which Condos were 431, Detached Housing 35. Although we do not show it here, the same figure for March end was 404 units, out of which Condos was 380, Detached Housing 24. Inventories went up only a little, even though there was the completion of a large-scale property, reflecting the strong sales trends.

On page eight, the Management segment. Again, there are two sub-segments.

For Property Management which is the Repark Car Park Leasing business, both revenue and income grew thanks to the increase in the number of units managed, as well as the number of consigned units of retail facilities. For brokerage, Asset Management etc. both revenue and income grew due to an increase in the number of properties handled in the Mitsui Rehouse business, the Brokerage business for individuals.

For the overall segment revenue grew JPY6.4b, operating income grew JPY3.3b. We feel that the fundamental earning capability of the business is steadily improving.

In the reference section, the number of units managed in the Repark business has increased by 8,400 year on year. The number of Brokerage transactions also increased by more than 1,400, to reach 18,000, a record level. The segment is doing well.

Next on page nine is the Mitsui Home segment. Mitsui Home has already announced its result on October 30, so I'll be brief.

Both revenue and income declined. This is mainly due to the order backlog under construction at the beginning of the year being smaller than that of last year in the New Construction business. As for the breakdown of orders for New Construction, highlighted in the red box, it was JPY75.2b, up JPY1.9 billion year on year. We do not show the order backlog as of the end of the first half, which increased JPY6.8 billion year on year for New Construction.

On page 10, the Other segment.

For Facility Operations revenue increased due to strong trends in the Hotel Operation business. As a result total revenue grew by JPY2.2 billion and operating income grew by JPY700m. The Hotel Operation business did well due to the impact of the earthquake subsiding, as well as success in our sales strategy of pursuing higher ADR. For the Mitsui Garden Hotels business earnings have improved even compared to two years ago, which was before the earthquake.

Let me move on to the balance sheet. Page 11 shows a summary of the balance sheet.

The left side represents assets. Total assets was JPY4.3 trillion, an increase of JPY446b. This was largely impacted by the SPC consolidation I mentioned earlier. The interest-bearing debt, shown in the grey line on the right, also increased by JPY457 billion to become JPY2.2 trillion. This was also impacted significantly by the SPC consolidation, as we'll discuss in further detail later.

Below that, total net assets was JPY1.14 trillion, up JPY41.3b. The D/E ratio, one of the major financial benchmarks, was 2.01 times as of September end, as highlighted in the red box. The D/E ratio was 1.68 times if you exclude the domestic SPC that were consolidated. The same figure was 1.77 times a year ago, which shows that the D/E ratio declined if you exclude the SPCs. This is due to the increase in the shareholders' equity and total net assets.

Let me explain about some of the major items on page 12 onwards. This is real property for sales including advances paid for purchases.

In the red box, in the middle, the total is JPY882.7 billion on a consolidated basis, up by JPY239.9b. We show the breakdown by company. Mitsui Fudosan Residential was JPY405.6b. The total for SPCs and Mitsui Fudosan's Property Sales to Investors business was JPY477.1b, as shown in the bar chart at the bottom.

The balance as of the beginning of the fiscal year was JPY842.8b. As we explain in the footnote, the balance increased by JPY200b, from JPY642.8 billion as of the end of March 2012.

Please see the table in the middle. New investment was JPY145.8 billion (sic; see presentation "JPY145.4b"); cost recovery was JPY97.1 billion (sic; see presentation "minus JPY97.1b"). The breakdown of new investment of property sales was roughly 60% individuals, 40% investors.

On page 13, tangible and intangible fixed assets. As highlighted in the red box, the total was JPY2.57 trillion, up JPY265.9 trillion -- JPY265.9 billion on a consolidated basis. From the top, Mitsui Fudosan followed by the SPCs. The figure for SPCs was mainly the JPY230 billion for Tokyo Midtown etc., JPY130.1 billion for Mitsui Fudosan America Group, up JPY28.2b. This increase is due to the acquisition of the Homer Building in Washington DC, as we have announced in our press release.

Below that, Mitsui Fudosan UK Group is JPY29.1b, up JPY1.9b. There was a slight increase due to the progress in construction of offices in the West End and the City of London.

In the middle table we break down the changes into CapEx etc. The balance as of the beginning of the fiscal year increased by JPY240.8b, again due to the SPC consolidation. The initial balance was JPY2.55 trillion (sic; see presentation "JPY2.545 trillion") and there was CapEx of JPY35.7 billion and depreciation of JPY29 billion during the first half.

Lastly, the interest-bearing debt on page 14. As explained in the bullet point, the cash-out in our operating activities was JPY33.6b, due to new investments exceeding cost recovery. There was another JPY56.5 billion of cash-out in our investment activities, mainly CapEx. The increase from SPC consolidation was JPY456.8b, making the total JPY2.2 trillion.

The breakdown of the interest-bearing debt is shown in the red box. The balance of non-recourse debt is JPY381.2b. The JPY9 billion of non-recourse debt as of March 2012 was the debt in the US, which was originally consolidated. We consolidated JPY359.5 billion in relation to the domestic SPCs. Together with other increases the balance became JPY2.2 trillion.

That's all from me. Thank you.

Hiroshi Asai {BIO 17334260 <GO>}

This is Hiroshi Asai, Executive Managing Director in charge of Accounting and Finance. Following up on the results highlights by Mr. Hironaka, I would like to explain the business environment of our main business segments, Leasing, Property Sales and Management, and the outlook for achieving our full-year targets.

We continued to watch the domestic and global economy carefully with the issues in Europe, China, as well as trends in the US economy. For the real estate industry we think the first half of this year was positive overall. Our results in the first half were also positive, as Mr. Hironaka explained, and we are confident that we can achieve the full-year targets.

Let me go over each segment, first, the Office Leasing market.

Some of you may have felt changes in the trends of the market. We feel it too. There is very strong demand for office consolidation in Central Tokyo, especially for positive consolidation, not just for cost cutting. As a result of last year's earthquake demand for BCP-compatible, safe, earthquake-resistant offices is also extremely strong, also, offices with good facilities, those with the latest facilities and functions.

We are starting to see more of these types of positive demand. Although Japanese companies in general may be struggling, some are doing well and these companies are starting to ask for additional floor space. Behind this is the fact that rents have declined since the Lehman shock. Partly due to these lowered rents, we feel that demand is quite strong.

As some of you may have confirmed for yourselves, the September vacancy for the central five wards of Tokyo was 8.9%, which is in line with the feel we are getting. Based on this we feel that Tokyo office vacancy has peaked out.

Some people ask us about the secondary vacancy and its impact. As for our office buildings, we are able to lease them up quickly even if they become vacant. We are benefiting from tenants' demand for expansion and consolidation and we do not feel that the secondary vacancy is significantly deteriorating the overall market.

The asking rents, which, as I said, have been coming down every year since the Lehman shock, finally seems to have hit the bottom. And, although this does not yet apply to all locations and buildings, there are some signs of rents going up, for example, rents being increased at the time of contract renewal.

Going forward we expect a gradual shift to a recovery trend. In any case, the 2012 supply issue, which had been of concern for the past few years, seems to be behind us and future supply will be quite limited, which should improve vacancies.

Asking rents also seems to be showing signs of partial recovery, as I mentioned. I think this sign of improvement in asking rents will become more clear in the first half of FY 2013 onwards.

As explained earlier, our office vacancy for the Tokyo Metropolitan Area is 5%, which should be around 4% in March, and our business results are extremely positive.

We are working on the leasing activities for offices that are expected to be completed in the future, such as buildings in Nihonbashi and Iidabashi. For example, in Nihonbashi we are seeing the results of our development of entire neighborhoods. The specifications and quality of the buildings is highly evaluated by tenants and we are receiving a lot of enquiries. We expect leasing to be successful for the offices under construction and we should be able to lease them up.

We are also working on improving the specifications of the existing buildings, as well as managing the properties for our tenants, for example, BCP-related management. We believe we should be able to accommodate our tenants' needs.

Next, let me talk about the retail facilities. For the overall market there were various events in the first half. There was the typhoon and due to the long-lasting summer the sale of autumn products was a little slow. The summer discount sales by department stores were somewhat dispersed and lacked momentum. The Cool Biz products sold well last year, but not as much this year, same for disaster-prevention items.

Due to all these factors we think the first half of this year was slightly down year on year for the overall retail market. However, for our facilities we were able to achieve roughly the same first-half sales as last year. In terms of competition among facilities, management capabilities in keeping the facilities fresh and attractive is getting more and more important. I think we saw our efforts in these areas bear fruit in the first half.

As I have mentioned repeatedly in newspaper interviews, our new properties are showing strong performance. Outlet Park Kisarazu is doing better than expected and DiverCity Tokyo is also doing extremely well. Both facilities are attracting visitors from a wide area. With a very broad investor base their sales are steadily growing.

In this first half we also worked on renewals in our facilities, which is a major initiative for us. Four large retail facilities were opened six years ago. This year there are many tenants for which the lease contract expires and we are conducting tenant renewals in several facilities. We worked on Lazona Kawasaki and LaLaport Toyosu in the first half and we renewed about half of the tenants.

In some cases we brought in new tenants. In others we conducted refurbishments or relocations and improved the attractiveness of the overall facility for the first time since its opening. The results are extremely positive. We are also expecting major renewals of LaLaport Yokohama and Kashiwanoha, as well Tokyo Midtown, by next spring and we are looking forward to the results.

As I just explained, the Leasing segment for offices and retail is doing very well. The official operating income forecast is JPY98b, but at present we are doing somewhat better than this target.

As explained, we are doing very well now, but we also have major projects in Hibiya, Nihonbashi and Otemachi coming up in the future. We will work on the development step by step and win the competition among neighborhoods. We are currently working on these large-scale developments to create neighborhoods in Hibiya, Nihonbashi, Otemachi etc. Not all of it can be disclosed, but we are making steady progress.

For retail facilities we have been able to win opportunities for regional-type facilities, such as the previous Expoland in Osaka, as well as Izumi, also in Osaka. There also is the Fujimi LaLaport project in Saitama. These are the three projects we have announced and there are also other regional-type retail facilities we are considering. We have built up a lot of expertise in retail and we would like to achieve further steady growth.

Next, the Property Sales side. Let me first talk about the Sales to Individuals business. For the overall market the initial month contract rate was a little below 70% in September, but we believe this was due to exceptional reasons. In general we believe the initial month contract rate for the first half was above the 70% benchmark.

In that sense we believe the fundamental demand for housing is extremely strong. In the background is the very low mortgage loan interest, tax cuts and other policies, such as the expansion of gift tax exemption. Thanks to these factors we feel very strong incentives among the buyers.

For Mitsui Fudosan the number of visitors to our model rooms declined last year due to the earthquake, but this year the number of visitors per project has improved to the pre-earthquake levels. The demand is very strong and we are capturing this strong demand.

For example, Park City Musasashi-Kosugi Grand Wing Tower, this is a high-rise condo in front of Musasashi-Kosugi station and this is receiving a lot of attention from potential buyers. Another example is Park Court Chiyoda-Fujimi The Tower, which is the redevelopment in Iidabashi. This is somewhat in the high-end price zone, but it is very popular.

Park Tower Shinonome, which is a tower condo in the bay area, has made a good start, despite concerns about the bay area following the earthquake. I think this is because we put in a lot of effort to this flagship eco-mansion project in terms of disaster-related measures, earthquake resistance and the environment.

As for this fiscal year's forecast, as Mr. Hironaka explained earlier, we have already achieved 76% progress in Condo contracts and Detached Houses are doing well too. Our guidance for operating income for the Sales to Individuals business is JPY14b, which we are very confident we can achieve.

The only challenge is the OP margin. We expect it to be 5% for the Sales to Individuals business due to some pre-Lehman projects still being on our books and we are not yet satisfied with these margins. We will continue to work on selling these pre-Lehman projects.

We are also making efforts on the cost side, such as joint procurement and bringing down the cost of our orders. When these efforts bear fruit we expect to see a steady improvement in the OP margin.

As for product design and planning, we have set our original standards for smart condos. We have started to apply these standards to all Tokyo Metro condos that we work on from July this year.

Next, the Sales to Investors business. For the overall market the JREI share prices have finally recovered and the Tokyo Stock Exchange REIT Index has exceeded 1,050. There are equity financings and IPOs, which shows the very strong investment appetite among investors. The lenders are also willing to lend to the real estate sector. There is strong appetite for financing both from the equity and debt sides.

As for the real estate transaction market, frankly speaking, there are still only a few opportunities of buying good properties that are generating cash flow, the type which REITs and funds would like to buy. We may have to wait a little longer for these opportunities to increase. Maybe we might have to think of some kind of incentive.

As for acquisitions by Mitsui Fudosan, things started moving a little in the first half. We are not looking for properties already generating cash flow. Instead we acquire properties for development, develop it ourselves, lease it up and then sell it to funds and REITs.

We have been making continuous efforts in relation to CRE, visiting various corporate clients and helping them make use of, or sell, their properties. These efforts are starting to take shape and the acquisitions of offices, retail and residential properties for development has picked up a little in the first half compared to last year.

We announced in April in the new mid to long-term plan that we will work on logistics properties too. Through the CRE sales activities we are making progress in acquiring land for logistic property development.

The guidance for operating income for the Sales to Investors segment is JPY8b. Some of you may worry that the progress in the first half was small, at only JPY1.6b. However, things tend to concentrate in the second half and we would like to continue targeting the JPY8 billion figure for the full year.

Lastly, the Management segment. As Mr. Hironaka explained, the Rehouse business booked record first-half results. The Repark business is also steadily growing units under management. In property management we increased the number of properties under consignment. I think we made steady progress in the first half in fortifying our earnings base.

One of our major management initiatives or targets is to increase the assets under management. There were some property acquisitions in the first half by the listed REITs that we sponsor. The private REIT, managed by Mitsui Fudosan Investment Advisory, is also acquiring properties and making other preparations for future expansion. We believe we can steadily grow our assets under management and we believe we can achieve the full-year targets for this segment too.

Lastly, let me comment on the financing environment. The financing environment continues to be very favorable. Financial institutions are willing to offer long-term, low-interest financing. Being able to raise long-term, low-interest financing is a big tailwind for a company like Mitsui Fudosan, with close to JPY2 trillion of debt. It helps us strengthen the financial base of the Company.

We issued JPY10 billion of 10-year straight bonds in August. The interest was below 1%, at 0.964%. The very favorable conditions are continuing in the direct finance market as well.

Today I talked about the business environment of the major segments and our plans to achieve the full-year guidance. Thank you.