

TAKARA LEBEN (8897 JP)

COVID-DRIVEN WEAK ECONOMY MAY BE A RISK BUT TIGHT SUPPLY OF CODOMINIUM WILL LIKELY SUSTAIN THE PRICE LEVEL

FY19 EARNINGS RESULT

Takara Leben (8897 JP) reported FY19 results with OP of ¥11,901mil (+18.5% YoY) on sales of ¥168,493mil (+27.6% YoY). Sales hit a historical record thanks mainly to a record sales of condominiums in term of both in value and volume.

While sales overshoot company guidance by 5.3%, OP fell short by 8.5% due to revaluation losses of ¥1,008mil for two hotel projects. Net profit attributed to the parent's shareholders was ¥5,361mil (-16.6% YoY), falling short of guidance by 33%. Therefore, extraordinary losses incurred to reflect the impairment losses on the four hotel properties totalling ¥2,071mil, in addition to the aforementioned revaluation losses. The properties in question were aparthotel-type guest houses - 5 in Kyoto and 1 in Osaka - mainly targeting inbound tourists. The guest house market in the region became competitive and both utilisation rate and price per guest had been trending down.

However, while profits fell short of guidance, the dividend payment remained unchanged from the estimated ¥19/share. Management views the shortfall in earnings due the revaluation loss and impairment charges incurred from the hotel projects to be more of a one-off.

FY19 was the 2nd year of the medium-term management plan. Key performance indicators (KPIs) under the plan are as follows:

- 30% shareholder equity ratio (by the end of FY20)
- Less than 60% loan-to-value (LTV) at the end of each year
- Less than 3x D/E ratio at the end of each year
- ROE 15% each year

Three out of four KPIs were largely achieved. However, ROE dropped to 10.9% from 14.3% in FY18 but this is because of aforementioned one-off costs which gave impact to profits. If there were not such a cost, ROE could have reached 17.2%.

EXECUTIVE SUMMARY

- Takara Leben's (8897 JP) FY19 results saw OP hit ¥11,901mil (+18.5% YoY) on sales of ¥168,493mil (+27.6% YoY). Due to revaluation losses associated with two hotel projects in the Liquidation business, OP fell short of company guidance.
- FY19 was the 2nd year of the Medium-term plan. All but one of its KPI's were achieved.
- The core New Built-for-Sale Condominiums segment saw record sales thanks to wider geographical coverage and stable pricing due to tighter supply-demand conditions.
- The impact of COVID-19 will likely affect FY20 as viewings by potential condominium buyers was suspended during the peak months of April / May.
- Until visibility improves, the firm will refrain from releasing its FY20 targets. As of March 20, 1,026 contracts in its core Condominium division have been signed and are due to be delivered during FY20.
- Risks to the Liquidation business due to COVID-19 will likely be offset by a switch to leasing instead of properties sales if the returns fall below targets.
- The Electric Power Generation business is least sensitive to macroeconomic trends. The firm expects stable earnings flow from this business in FY20.
- FY20 is the final year of the 3-year Medium-term Management Plan. The sales target was almost achieved in FY19 while the OP target of ¥14,500mil (+21.8% YoY /+12.3% YoY if there were not any one-off cost in FY19) may prove to be a challenge.

KPIs under the medium-term management plan (FY18~20)

	FY18	FY19	Target
Shareholder equity ratio (%)	25.6	25.9	30% (by the end of FY20)
LTV (%)	60.5	58.3	less than 60% (end of each year)
D/E Ratio (%)	2.3	2.2	less than 3x (end of each year)
ROE (%)	14.3	10.9	15% (each year)

Source: Takara Leben's FY19 earnings presentation

Earnings summary					
(¥mil / March-year end)	FY18	FY19			
	FY	FY	YoY (%)	CE	vs. CE (%)
Total sales	132,005	168,493	27.6	160,000	5.3
Real estate sales	104,823	129,649	23.7	120,720	7.4
Real estate rental	5,829	5,965	2.3	6,000	-0.6
Real estate management	4,512	5,046	11.9	5,200	-2.9
Power generation	10,794	20,982	94.4	21,100	-0.6
Sale of facilities	6,100	15,983	162.0	17,000	-6.0
Revenue from selling energy	4,694	4,999	6.5	4,100	21.9
Others	6,045	6,850	13.3	6,980	-1.9
GP	26,886	30,516	13.5	31,500	-3.1
GPM (%)	20.4	18.1	-2.3pp	19.7	-1.6pp
OP	10,046	11,901	18.5	13,000	-8.5
OPM (%)	7.6	7.1	-0.5pp	8.1	-1.0pp
RP	9,027	11,201	24.1	11,800	-5.1
RPM (%)	6.8	6.6	-0.2pp	7.4	-0.8pp
NP attributed to the parent	6,426	5,361	-16.6	8,000	-33.0
NPM (%)	4.9	3.2	-1.7pp	5.0	-1.8pp

Source: Takara Leben's FY18 & 19 earnings results

SEGMENTS

Real Estate Sales Business

The Real Estate Sales Business segment reported FY19 Gross Profit [GP] of ¥22,619mil (+7.4% YoY) on sales of ¥129,649 (+23.7%YoY). The two main divisions in the segment are 1) New Built-for-Sale Condominiums and 2) Liquidation.

- New Built-for-Sale Condominiums:

FY19 GP was ¥15,650mil (+30.7% YoY) on sales of ¥77,171mil (34.9% YoY). The total number of units sold was 1,955 units (+299 units YoY) – slightly above the company estimate of 1,950 units. Both sales units and sales value hit a historical record.

According to the Real Estate Economic Institute Co., Ltd, the supply-demand balance of new condominiums in the Tokyo Metropolitan area in FY19 remained healthy thanks to a 22.0% YoY decline in supply to 28,563 units/annum. FY19 average condominium prices in the Tokyo Metropolitan area remained high at ¥65.55mil/unit (+2.2% YoY). For Takara Leben, the average price range/condominium remains unchanged at ¥39~40mil, which is slightly on the high side given the firm's main target buyers are young families with children.

Some 42.7% of Takara Leben's condominiums were sold in the three major cities (Tokyo Metropolitan area, Chubu and Kinki) and the remaining 57.3% were sold in regional cities. The firm has expanded its regional coverage to 33 prefectures from 31 last year. Condominium demand in regional cities has remained steady thanks to 1) the development of "compact cities" and 2) demand from the elderly who want to move closer to city centres for convenience.

The COVID-19 impact was not apparent in FY19. Based on the estimates in the medium-term management plan, Takara Leben plans to deliver 2,200 condominiums in FY20. Since the announcement of State of Emergency on April 7 and through to the restrictions being lifted on 25 May, all show homes were closed. To respond to this new environment, the firm introduced online marketing and virtual reality systems, however, while they proved to be effective in setting up a first meeting, they were not enough to lead to contracts being exchanged.

So far in June, customer traffic to show homes has recovered to the usual level. The most crucial timing for marketing is during the Golden Week (the beginning of May), and during the summer holiday season to the beginning of Autumn because buyers usually want to move in February and March to meet the start of the academic year.

Since the firm's usual May marketing efforts were disrupted, condominium sales expected in FY20 might be pushed back to FY21. However, nearly 50% (1,062 units) of the planned 2,200 condominiums expected to be sold in FY20 had already been contracted, so were logged in the order backlog as of the end of FY19. Therefore, Takara Leben thinks it is possible that the backlog units are likely to be sold in FY20.

Moreover, Takara Leben remains confident that condominium price will not slip excessively because the supply remains tight. Furthermore, the order backlog of condominium projects at mid-sized construction companies has apparently not seen much of an increase. This provides an opportunity for Takara Leben to negotiate on the construction costs to improve its GPM in the condominium development business in FY20.

The firm has already secured enough of a land bank to develop a total of 6,747 units nationwide, of which 52% of will be designated for the three major cities.

- **Liquidation:**

In the Liquidation division, Takara Leben invested ¥30,200mil (-11.6% YoY) in FY19, of which 45% was for residential properties and 46% was for office buildings. Despite the lower level of investment, sales were ¥37,854mil (+13.0% YoY) – 26.2% above the company's estimate. As well as releasing properties to Takara Leben Real Estate Investment Corporation (3492 JP), the firm diversified its liquidation routes to include private funds and bridge funds, of which 58% of the properties sold were residential and 27% were hotels in FY19. However, the segment's GPM dropped to 12.8% (-8.8ppt YoY) due to the aforementioned hotel-related revaluation losses. Excluding these, the GPM would have been 15.4% (-6.2ppt YoY).

The risk to segment earnings from COVID-19 is that the development and sale of profit-generating properties might fall short of its targets. To mitigate the risk, the firm will look to leasing those properties if the expected return cannot be secured. Takara Leben will continue to proactively investment in new projects as long as they are confident of a decent return.

Real Estate Leasing / Real Estate Management

The Real Estate Leasing business reported a GPM of 26.7% on sales of ¥5,965mil (+2.3% YoY), thanks to a decline in the cost of acquiring new lease properties. The Leasing business is linked to the aforementioned Liquidation business in that properties leased will eventually be liquidated through the firm's Liquidation business.

The Real Estate Management business enjoyed a boost in the number of managed condominium units. In FY19, the units under management rose to 59,747units (+10.6% YoY, 5,711 units). Each condominium property has a management agent chosen by the residents' association. In the past, property management was conducted by property management agencies that were subsidiaries of developers. However, in recent years, residents have start to choose services they want, including voting to change the property management agents. Currently, 49.5% of units under management by Takara Leben were condominiums developed by other developers. The firm prides itself on its low churn rate (0.2%) and reckons that property management mandates can also lead to large-scale repair work of condominiums – typically every 12 years.

Electric Power Generation Business

The Electric Power Generation Business has two revenue sources: 1) facility sales – the sale of mega solar facilities to funds such as Takara leben Infrastructure Fund (9281 JP) and 2) electricity sales.

In FY19, Takara Leben earned sales of ¥15,983mil (+62% YoY) from facilities sales. Seven facilities worth a total ¥13,858mil were sold to Takara Leben Infrastructure Fund. The firm also acquired 10 facilities which have the capacity to generate up to 57MW, including the under-development facilities, at a FIT price above ¥27/KWh. The current

capacity generation is 206MW, of which 77% has a FIT price of ¥36/KWh – well above METI's FY19 FIT guideline of ¥14/KWh – therefore offers an attractive return. FY19 Electricity sales were ¥4,999mil (+6.5% YoY).

The business is relatively resilient against the macroeconomic environment; therefore, Takara Leben will likely continue buying and selling of facilities.

FY20 OUTLOOK AND MEDIUM-TERM MANAGEMENT PLAN

Given the uncertainties of the economic impact due to COVID-19, Takara Leben has not yet announced its FY20 guidance but plans to do so promptly, as soon as visibility improves.

FY20 is the final year of the 3-year Medium-term Management Plan which calls for 3-year CAGR of 15.3% in sales and 4.8% for OP. The final-year sales target of ¥170,000 was almost achieved one year earlier, in FY19. However, the final-year OP target of ¥14,500mil (+21.8% YoY on FY19 OP / +12.3% YoY if the one-off revaluation losses are excluded) may prove to be a challenge due to the COVID-19-driven weak macro environment. However, there is currently no change on the Medium-term Management Plan's targets. The shareholder return policy also remains unchanged with a principle pay out of 25~30% while also aiming to pay a stable dividend.

Medium-term Plan (FY18~20) Summary						
(¥mil)	FY17	FY18	FY19	FY20 Est	YoY (%)	3-yr CAGR (%)
Sales	110,851	132,005	168,493	170,000	0.9	15.3
GP	25,779	26,886	30,516	34,500	13.1	10.2
GPM (%)	23.3	20.4	18.1	20.3	+2.2pp	n/a
OP	12,597	10,046	11,901	14,500	21.8	4.8
OPM (%)	11.4	7.6	7.1	8.5	+1.4pp	n/a
RP	11,792	9,027	11,201	13,000	16.1	3.3
RPM (%)	10.6	6.8	6.6	7.6	+1.0pp	n/a
NP attributed to the parent	7,367	6,426	5,361	9,000	67.9	6.9
NPM (%)	6.6	4.9	3.2	5.3	+2.1pp	n/a

Source: Nippon-IBR based on Takara Leben's Medium-term Management Plan and FY19 earnings presentation

Medium-term Management Plan (FY3/19 - FY3/21) by Business Segment												
(¥mil, March-year end)	Prev Plan		FY18~20 Medium-term management plan									
	FY17		FY18			FY19			FY20 Est			
	Sales	GP	Sales	GP	% Sales	Sales	GP	% Sales	Sales	GP	% Sales	
Real estate sales	79,341	17,086	104,823	21,060	20.1	129,649	22,619	17.4	129,950	25,750	19.8	
New condominiums	60,368	13,313	57,203	11,977	20.9	77,171	15,650	20.3	84,500	18,600	22.0	
New detached houses	6,335	830	8,817	701	8.0	7,808	720	9.2	14,850	1,950	13.1	
Renewal resale	588	78	3,305	537	16.2	3,431	421	12.3	3,400	400	11.8	
Liquidation	9,707	2,322	33,502	7,235	21.6	37,854	4,828	12.8	24,000	4,400	18.3	
Others	2,340	541	1,993	608	30.5	3,382	997	29.5	3,200	400	12.5	
Real estate rental	5,472	1,346	5,829	1,207	20.7	5,965	1,589	26.7	6,300	1,575	25.0	
Real estate management	4,000	504	4,512	633	14.0	5,046	576	11.4	5,400	700	13.0	
Electric power generation	18,239	5,273	10,794	1,422	13.2	20,982	3,137	15.0	21,200	2,910	13.7	
Facilities sales	14,687	5,068	6,100	1,414	23.2	15,983	3,020	18.9	17,000	2,700	15.9	
Electricity sales	3,552	204	4,694	8	0.2	4,999	116	2.3	4,200	210	5.0	
Others	3,797	1,568	6,045	2,561	42.4	6,850	2,593	37.9	7,150	3,565	49.9	
Total	110,851	25,779	132,005	26,886	20.4	168,493	30,516	18.1	170,000	34,500	20.3	
OP	12,597		10,046			7.6	11,901		7.1	14,500		8.5
RP	11,792		9,027			6.8	11,201		6.6	13,000		7.6
NP attributed to the parent	7,367		6,426			4.9	5,361		3.2	9,000		5.3
Dividend (JPY)	16		16			n/a	19		n/a	21		n/a

Source: Nippon-IBR based on Takara Leben's Medium-term Management Plan and FY19 earnings presentation

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