

LIFULL Co., Ltd. (2120)
Edited Transcript
Earnings Briefing for the Three-month Period Ended December 31, 2017

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Corporate Participants:

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Presentation

Kazuhiko Abe, *Managing Officer*

We thought that the overall results had reached an acceptable level. Revenue was ¥8,128 million (+14.4% year on year). In relation to this rate of increase, SG&A expenses were ¥5,862 million (+8.1%), which shows that the appropriate control was performed. EBITDA (operating profit before amortization) was ¥1,408 million (+60.3%). The ratio of EBITDA was 17.3%, improving 5.0 percentage points.

With respect to the specifics of SG&A expenses, advertising expenses were ¥2,426 million (+13.1%) as estimated. Personal expenses were ¥1,962 million (+8.3%), operating expenses were ¥236 million (-16.3%), and other SG&A was ¥1,236 million (+4.5%). These expenses were controlled appropriately. In terms of expenses-to-sales ratios, the ratios of cost of sales and other SG&A were 28.7% (-3.3 percentage points), the ratio of advertising expenses was 29.9% (-0.3 percentage points), and the ratio of personnel expenses was 24.1% (-1.3 percentage points).

In sales by segment, HOME'S Services Business recorded ¥6,742 million (+13.2%). The Overseas Business achieved sales of ¥883 million (+17.7%). The Other Business achieved sales of ¥502 million (+25.3%). In all the segments, revenue increased. The Other Business includes subsidiaries and new businesses, and shows strong performance as compared to the same period of the previous year.

In segment income and loss, HOME'S Services Business recorded ¥943 million (+85.0%), and the Overseas Business achieved ¥130 million (+1238.2%). The Other Business recorded a slight decrease of ¥33 million because of advance investment from a medium- to long-term perspective made by subsidiaries, etc. However, we consider that such progress falls within the typical level.

With respect to assets, there were no remarkable points as compared to the previous fiscal period. Investment securities increased ¥401 million due to the impact of investment in the furniture maker KAMARQ.

There were also no substantial changes in cash flows. The balance of cash and cash equivalents was ¥5,275 million, a decline of about ¥1 billion from the previous year. The borrowings for the acquisition of Trovit have been repaid at a rate of about ¥1 billion per year, and will be paid in full in the coming July.

As stated on page 11 of the earnings presentation, the progress of each item is approaching around 20% of the full-year target. Generally, the results for Q1 were satisfactory. The rate of progress for EBITDA is 23.4%, almost reaching one fourth (1/4).

The medium- to long-term plan sets forth the targets of revenue of ¥50 billion level and an EBITDA margin of around 20% in 2020. We have made efforts to achieve these targets.

Takashi Yamada, *Director*

Page 14 of the earnings presentation shows the mid-to-long term strategy roadmap for the real estate field, which is our main business area. The process we have in mind consists of the following four steps: transforming the real-estate industry, stimulating the real-estate markets, expanding the real-estate markets, and building the global platform.

In the first step of transforming the real-estate industry, under the leadership of LIFULL HOME'S Business Department, activities to secure the greater transparency of information about real estate, increase and improve property information, expand the network of real estate companies and increase and strengthen the capabilities of the media were conducted to resolve the problem of asymmetric information.

In the second step of stimulating the real-estate markets, we plan to stimulate the markets by proceeding with the business of the so-called "Akiya Bank," the list of vacant homes that the Ministry of Land, Infrastructure, Transport

and Tourism approved as the model business, the business of the so-called “Minpaku,” the private residence taking lodgers temporarily, which is conducted together with Rakuten, Inc., and other utilizations of vacant homes.

In financing for the development of uses of vacant homes, we will increase the financial inflow mainly by crowdfunding to collect funds from investors who will contribute a small amount of money and thereby expand the real estate markets. After performing the steps described above properly, we will enter the last step of building the global platform.

In securing the transparency of the information about real estate, the volume thereof that we maintain continues to be overwhelming. All the information provided covers as many as 7,790,000 properties. In our efforts to increase the amount of information, the focus is placed on increasing the accuracy and enhancing the quality of information according to the fair competition code for real-estate advertisements. The results that appear to show no improvement are caused by the current emphasis on quality rather than the amount.

In the expansion of the network of real estate companies, the number of customers continued to increase, reaching 27,155. However, average revenue per agent (ARPA) was ¥81,471, a slight decrease from the previous year.

In securing the greater transparency of information other than the specifications of properties, a new function to provide the visual information of the price range for the properties around the station nearest to the target property and the rate of change in prices over the years was added to the service called “Real Estate Price Visualization”. Based on the algorithm for the “Price Map,” the information will be provided to owners who are considering selling properties. We consider that such actions will lead to the stimulation of the distribution of existing houses.

In stimulating the distribution of existing houses, we released “LIFULL HOME’S House Appraisal” last year for the visualization of the information of building performance evaluation. Although only a small number of properties are covered at present, we plan to involve real estate companies in cooperation with the building lots and buildings transaction business associations all over Japan and stimulate understanding among users through the website and encourage spread. Upon a revision to the Building Lots and Buildings Transaction Business Act, the duty to provide an explanation that the inspection has been performed will be imposed from April. Following this movement, we will encourage the spread of this initiative.

In increasing and strengthening the media capabilities, a range of actions for smartphones have been undertaken. The number of applications downloaded for either Android or iOS has exceeded five million. In addition, the Android version won the Google Play “Best of 2017” award for two consecutive years. The iOS version was renewed with its design refreshed and its search function improved, resulting in an increase in popularity.

In the business of online real estate transactions, the online delivery of the disclosure statements of important conditions for rent has been permitted since October 2017. Following this movement, we established a system for the complete online process from previewing and consulting about properties to the delivery of the disclosure statements of important conditions and the execution of the agreement.

In particular, the number of properties that can be previewed and consulted about online exceeded 1.4 million, despite the short preparation period for the service. There is a button for making reservations for online previews on the website, and the focus of the promotional campaigns has been changed to online previewing and consulting. We plan to emphasize convenience for users and encourage the use of the service, and ultimately make it a new typical means of relocation.

In the initiatives for stimulating the real estate markets, the core theme is regional revitalization. The use of vacant homes, financing and private residences taking lodgers temporarily will be linked and combined.

For the so-called “Akiya Bank,” the list of vacant homes that the Ministry of Land, Infrastructure, Transport and Tourism approved as the model business, the website was launched at the end of September 2017. More than 300 municipalities have already joined this initiative, and the number of properties whose information is provided exceeded 1,000, which shows high expectations.

In crowdfunding for real estate utilizing investments and loans, while we are waiting for a review for the issue of a license by the Financial Services Agency, we have already started sourcing properties with the intention of concurrently creating records of actual activities for this initiative, albeit on a small scale.

With respect to the so-called “Minpaku,” the private residence taking lodgers temporarily, the new law (the act for residence accommodation business) will be enforced on June 15 this year. Rakuten LIFULL STAY has begun to accept properties ahead of its enforcement.

In the expansion of the real estate markets, we entered into a business alliance with one of China’s largest brokers, Lianjia (Homelink), which has an extremely extensive brokerage function of 8,000 agencies and 150,000 agents in China. We expect that the provision of information on the properties in Japan to Chinese investors through Homelink should lead to the stimulation of investment in real estate in Japan.

The Overseas Business, which constitutes the foundation of the global platform, has expanded into four countries with LIFULL HOME’S portal model and 57 countries with Trovit. The actions to be taken for the current fiscal period vary somewhat from country to country and according to the services. It is planned to gather traffic and establish fee-

charging services.

In proceeding with the Overseas Business, our goal is the ultimate ideal global platform that fully covers both real estate in Japan, which will be pitched to customers both in Japan and abroad, and real estate abroad, which will be pitched to customers both in Japan and abroad. Currently, LIFULL HOME'S provides information on real estate in Japan to customers in Japan. To provide information on real estate in Japan to overseas customers, we recently entered into an alliance with Lianjia (Homelink). Trovit assumes the operations for overseas real estate for overseas customers.

The new business is conducted for the following three objectives: making every "LIFE" "FULL," the development and training of managers, and the expansion of the business fields.

In a new initiative, LIFULL Fab was opened at the head office on February 1. It is a workshop that introduces a laser cutter, a 3D printer and other machine tools. These tools are loaned to people who undertake manufacturing and engineering work. We intend to create and launch additional new businesses in the form of open business, involving business people who are LIFULL HUB users and other persons either inside or outside the Company.

Questions and Answers

Q1. The acceptance of vacation rentals will start in one month. Please provide information on any further progress. At the press conference last year, it was said that "of 40,000 properties whose information was provided on Airbnb, the Company would be able to secure the largest share with some percentage of the vacant homes of LIFULL HOME'S." Later, the upper limit of the business days and the regions not appropriate for vacation rental were referred to. Is there any information, not limited to that for March, regarding the quantity of properties to be covered and the possible candidates for such use?

A1. (Kazuhiko Abe) I cannot provide specific figures, but they were satisfactory. Airbnb currently provides information on a large number of properties; however it was inspected by the Japan Fair Trade Commission, and it is rumored on the Internet that a lot of illegal agencies are involved in it. Upon the enforcement of the new act in June, the illegal ones will be clamped down on and penalties will be imposed, which will result in a decrease in the number of properties handled. Rakuten LIFULL STAY has steadily increased the number of properties, so information on a considerable number of properties will be available by June. The vacation rental business is going well.

Q2. The policy for disclosure has changed. Previously, the sales of rentals and the sales of sales under the HOME'S business used to be indicated separately, and it was reported that in the segment of sales, the market for used condominiums would grow in the medium to long term. The REINS statistics and other information announced yesterday reported that the number of used condominiums sold did not increase. How about the situation of your company? I think that the reasons for this lack of increase include the fact that some business operators purchase the properties for renovation directly using their brokerage subsidiaries, and other business entities purchase properties through the website, which are not included in the statistical data; namely, a substantial volume of sales were made outside the markets. I would like some information about your company's situation.

A2. (Takashi Yamada) This lack of increase in the distribution of used properties will have a negative impact on the business from the perspective of brokerage distributors. In terms of the advertisement that is run by the brokerage distributors handling used properties, the Company will be affected as the media to a certain extent. However, the business operators who engage in purchase and resale also ultimately sell properties to end users. In that regard, we should be able to provide some support in terms of advertising. Accordingly, we consider that the Company will not be materially affected overall.

Q3. I would like to know the outlook for the ratio of SG&A expenses for Q2. For Q1, the rate of the increase in advertising expenses falls below the rate of the increase in sales and gross profit, which I perceive to mean that the advertising expenses were controlled. For Q2, which is the high season, does the policy according to which the ratios of advertising expenses and other items of SG&A expenses shall be determined in accordance with sales and gross profit remain unchanged? What worries me, despite the fact that the overall increase in advertising expenses does not exceed the level of sales, is the possibility of a significant increase in investments in online advertisements as compared to the previous year because television commercials are not planned for October to December this year, while the investment was focused on television commercials for Q3 of the previous year. Is the viewpoint that distinguishes online advertisements and other (offline) advertisements correct? I would like the policy for advertising expenses and overall SG&A expenses for Q2 to be provided.

A3. (Kazuhiko Abe) We consider that the results for Q1 are at an acceptable level. We intend to apply the same policy during and after Q2. The same rate of increase in SG&A expenses as the rate of the increase in sales will lead

to an increase in profits. We are therefore working on this control. The information about the online advertisements and the other (offline) advertisements is not disclosed, and the expenses for them are controlled as a whole. The same applies to other SG&A. The personal expenses are controlled in consideration of productivity per person. In spending the operating expenses, an agency service and other means are used to reduce costs. The policy according to which SG&A expenses shall also be controlled from an overall perspective will be applied during and after Q2.

Q4. I understand that the guidance for sales of the HOME'S Services Business for the current fiscal period include estimated new sales. What are the estimated organic growth rates of the existing businesses of LIFULL HOME'S and the new businesses, respectively? Are those rates based on the advertisement model or on a lower gross profit ratio? With respect to the timing for posting, are the changes in the first half or the second half? Please also provide your views about the results of revenue for Q1.

A4. (Kazuhiko Abe) We also put the new businesses into an overall perspective. We expect the actual conditions to be the growth of the existing LIFULL HOME'S businesses by about 15% to 20%. Of the new businesses, some may produce good results and others may not. We will proceed with these businesses from an overall perspective.

Q5. With respect to the explanation that LIFULL HOME'S LIVE secured 1.4 million properties in three months, could you please provide information about the response of users and member stores and the possibility of new monetization to secure profits from the model for charging in rentals?

A5. (Takashi Yamada) LIFULL HOME'S LIVE handles over 1.4 million properties; however, only a small number of transactions are conducted, so it is too soon to expect the additional charging to increase earnings yet. First, we need to encourage the use of the service among users and create a new transaction flow. Then we will be able to charge fees for the resulting value provided.

Q6. The result of HOME'S Services Business for Q1 grew 13% from the previous year. How do you view the difference from the forecast annual increase of 24%? Is the result for Q1 as estimated, or does it fall a little below the estimate? If it is as estimated, at what timing in the future is a significant increase expected?

A6. (Takashi Yamada) We consider that the growth for Q1 has reached an acceptable level because the result for Q1 generally tends to fall toward the end of a year. Success will depend on the result for the coming Q2, January to March, which is the high season. We work hard to achieve the targets and meet your expectations every day. The current situation does not allow us an optimistic view because we are forced to compete with competitors during the high season. But we make diligent efforts.

Q7. What is your view regarding the number of customers per year and the assumptions for the growth of ARPA? According to the report, ARPA fell due to the efforts to acquire small- and medium-scale clients for Q1. Will this trend continue for a year? Or is a change expected?

A7. (Takashi Yamada) We plan to raise ARPA by increasing the number of reactions from the media and the reactions based on which fees can be charged. We expect that ARPA will increase for the quarter falling under the high season during which user transfers increase. Annual ARPA is also expected to increase, with more responses resulting from the media growth.

Q8. The annual SG&A expenses are forecast at ¥30.1 billion. Are the budgeted costs necessary in part to carry out the plan for the current fiscal period? And will they be spent throughout the year in different amounts for the respective quarters? Can these expenses be controlled for a greater reduction, taking the situations of Q1 and Q2 into account? Given the significant decrease for Q1, the budget should increase considerably.

A8. (Kazuhiko Abe) While sales increase, the SG&A expenses and the advertising expenses are spent on business. Should sales not grow, these expenses will be controlled and saved. The amount budgeted for personnel expenses is also considerable; however, in reality the circumstances for recruitment are severe and the required employees sometimes cannot be secured. For the past year, the personnel increased about 10% with a sales increase of 15% or more, which means that the appropriate control was in place. The same applies to the operating expenses. To save on costs, agency services are used, and if their use is not possible for any reason, the services will not be used. The advertising expenses are spent on brands and products with the specific figures managed, considering the future business, such as the postponement of expenditure for brands to the following fiscal year. The Company's policy is to exercise control while watching the figures from an overall perspective.