

LIFULL Co., Ltd. (TSE 2120)

Edit Transcript

Earnings Briefing for the Nine-Month Period Ended June 30, 2019(October 1, 2018 to June 30, 2019)

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Venue: LIFULL headquarters

Corporate Participants:

Takashi Inoue, *President and CEO, General Manager of LIFULL HOME'S Business Department*

Takashi Yamada, *Director, Deputy General Manager of LIFULL HOME'S Business Department*

Kazuhiko Abe, *Managing Officer, General Manager of Group Company Business Development Department*

Keizo Tsutsui, *Managing Officer, Manager of President's Office*

Yuji Ito, *Managing Officer, Deputy General Manager of LIFULL HOME'S Business Department*

Yukihiro Hada, *Managing Officer, General Manager of Human Resources Department*

Kohei Kawasaki, *Managing Officer, General Manager of Creative Department*

Presentation / Takashi Inoue, President and CEO

Key Points

1. FY2019/9 Q3 Revenue: JPY 29.3 billion, accelerated growth of +12.8% YoY
EBITDA: JPY 4.2 billion, steadily progressing toward the FY targets at 4.1% YoY
2. Proactive investments for future growth
 - Investment to strengthen LIFULL HOME'S media presence
 - LIFULL HOME'S Basic Membership Fees and prices for listings in rental and sale properties will be raised from October 2019
 - Acquisition of Mitula
 - Anticipatory investment in Rural Revitalization Business
3. Acceleration of Overseas Business
 - Consolidation of Mitula from January, 2019
 - Smooth progress in integration of management of Trovit and Mitula

Consolidated Financial Results for FY2019/9 Q3

[Highlights]

In the mid-term plan, we have set ourselves the targets of JPY 50 billion in revenue and EBITDA of approximately 20% in the fiscal year ending September 30, 2020. This fiscal year ending September 30, 2019 is positioned as a time for investment to reach the goals of the mid-term plan. We have made steady progress in planned revenue of JPY 29,352 million (+12.8%) year on year (all following values will also be year on year) and EBITDA JPY 4,256 million (-4.1%).

To reach the goals of the plan, the improvement of ARPA (*ARPA= Average Revenue Per Agent, revenue per clients) and increasing the number of customers will be the main KPIs in the HOME'S Services Business. In particular, we will focus on measures to improve ARPA, enhancing our media presence and working intensively on SEO. Overseas, we initiated the consolidation of Mitula in January, 2019, and are currently preparing for the integration of the management

of Trovit and Mitula.

[Condensed statements of income and loss (IFRS)]

Revenue was JPY 3,342 million (+16.3%) while expenses such as for the representative service for administration support services for realtors increased.

In SG&A, advertising expenses were JPY 10,020 million (+17.7%) from the branding of LIFULL HOME'S, and web marketing for the consolidation of Mitula increased. Other expenses amounted to JPY 4,925 million (+27.6%) primarily due to the temporary increased spending for the acquisition of Mitula.

Other income and expenses were JPY 101 million (+5.9%) from the profit on the sale of shares of LHL, insurance and advertising agency. However, an impairment loss was posted for LIFULL Social Funding, crowdfunding subsidiary, due to revisions of the business plan, from the delay in the acquisition of the financial business license by LIFULL Social Funding, a crowdfunding operator subsidiary.

The breakdown of the temporary expenses (accumulated total to the 3rd quarter) is as described on page 9 of the Earnings Presentation.

[Sales by segment, segment income and loss (IFRS)]

Revenue generated by the HOME'S Services Business declined 15.4% due to aggressive promotion during the peak season. Revenues increased 3.2% because losses associated with the unprofitable renovation site and the withdrawal of LIFULL Remodel, an original remodel contractor, were more than offset by the increase in the number of inquiries following the initiatives such as SEO. In the Overseas Business, revenues increased 96.7% due to increased revenues from Trovit and the start of the consolidation of Mitula. Despite the M&A costs for Mitula, income increased 145.6%. In the Others Business, revenues decreased 3.9% due to the selling of LHL.

For reference, the transition of quarterly consolidated statements of income and loss and the growth and the composition ratio of each business are shown on pages 12 and 13. Consolidated revenues for the 3rd quarter grew steadily by 16.9% year on year, in which the ratio of revenues from overseas business including MA increased significantly to 22.1% of the total.

[Condensed statements of financial position and goodwill (IFRS)]

Assets totaled JPY 43,550 million (+49.2%) and liabilities totaled JPY 10,307 million (+43.4%).

Non-current assets increased by JPY 11,938 million, mainly due to the increase of goodwill through the acquisition of Mitula and RESEM, a real estate portal operator in Central and South America. About JPY 3.2 billion of the total short-term borrowing of JPY 3.4 billion was for the acquisition of the shares of the Mitula Group.

Of the total equity of JPY 33,243 million (+ 51.1%), JPY 5,716 million was from the issuance of new shares for making Mitula a subsidiary, and capital surplus increased JPY 5,690 million.

[Condensed statements of cash flow (IFRS)]

As a result of the above, cash and cash equivalents increased by JPY 1,341 million to JPY 8,912 million.

Business Update

[HOME'S Services Business]

Despite the negative impact of the termination of the renovation business in September 2018, revenues grew steadily

by 4.2% when excluding this impact.

Looking at the key indicators, ARPA increased steadily to JPY 91,474, and the number of clients grew to 27,111. We proactively implemented measures to enhance the LIFULL HOME'S media presence including a campaign with a drawing for Tsubasa Honda alarm clocks and branding that encourages home seekers to look for a place to live on the basis of the lifestyle that they want, as well as improved UI/UX design. We focused on SEO measures from the beginning of the term, and as a result, we received an increased number of responses along with growing revenue. In addition, automation has increased the efficiency of paid online marketing.

Traffic returned to a steady growth track of +38.0% year on year (October-June), and the segment revenue ratio in the 3rd quarter was improved substantially to 17.9%.

Revisions to the LIFULL HOME'S pricing structure for rental and sale properties will be implemented from October 1, 2019.

Up until now, we have created contracts with various options on an individual basis for clients, but after the change the main optional services will all be included in client contracts. This means that clients will reduce the effort required in selecting optional services and enhance their appeal to users through listings with more extensive information. It is expected that LIFULL will lighten the workload of sales staff and make new proposals leading to growth in client numbers as well as improved SEO thanks to more extensive listing information. Users will gain a clearer understanding of each listing from the rich variety of information present and be able to find the right property. We think that these revisions will be beneficial to all three parties.

The details of the revisions are described on page 22. The basic membership fee will be revised from JPY 10,000 to JPY 15,000. The rate of pay by inquiry will be revised from 4.0%-5.5% to 9.5% without exception for rental properties and from 0.03%-0.05% to 0.05% without exception for sale properties. Fees for basic optional services will be included in the basic membership fee, and fees for panoramic photos and staff comments to gain inquiries will be included in the inquiry rate.

[Overseas Business]

After initiating the consolidation of Mitula in January 2019, the business scale has increased substantially with revenues +96.7% and segment income +145.6%. Supposing that Mitula and RESEM had been consolidated from the beginning of the term, the raw value of revenue would be +140.9% and that of the segment income +363.1% (excluding acquisition-related costs). Looking at the transition of quarterly results, revenues also grew steadily to EUR 17,881 thousand, and excluding the temporary M&A cost of JPY 581 million, income as high as JPY 500 million will be generated each quarter.

Our future growth strategy is to further expand traffic from the combined total of about 200 million users per month from both companies which will lead to income growth as well as accelerate profitability by integrating the organizations of Trovit and Mitula. The number of markets increased from 39 countries, when Trovit was acquired, to 63. We will first increase the number of markets with aggregation sites, and considering the situation in each country, develop into portals. The areas are described on page 30. We will focus on growth in countries with advanced and emerging markets.

[Other Businesses]

LHL, the LIFULL FinTech subsidiary in insurance marketing, was sold to Nippon Life Insurance Company in December 2018. Excluding the impact from this sale, the business scale has continued to see steady growth. The existing businesses

continue to be steady in the quarterly segment income/loss. Although the Rural Revitalization Business is still in the investment phase, specific moves have begun to be made.

Through the LIFULL HOME'S Akiya Bank, service contracted by the Ministry of Land, Infrastructure, Transport and Tourism, we have formed an alliance with more than 560 municipalities across Japan. We provide training programs that foster producers and other experts who will work actively in rural areas. In a training program for Akiya consultation providers, 1.5-2 times as many applicants as the number of places continue to apply for the program. Those who are fostered in this program will be placed in local municipalities as part of a regional development corps in the future. For the utilization of Akiya (vacant houses), we are promoting their use as vacation rentals through Rakuten LIFULL STAY, a joint venture with Rakuten.

As public private partnerships, we have established regional revitalization agreements with municipalities. To date, there are six such alliances with municipalities, with utilization projects for vacant houses underway in Kamaishi and Sabae.

In addition, we plan to create multipurpose facilities across Japan called Living Anywhere Commons. These facilities will be outfitted with work and residential spaces including kitchens, showers and bedrooms for long-term stays. The recreational facilities were opened in Aizu-Bandai and Izu Shimada. Through these initiatives, we want to create a perspective of the world that enables people to work where and how they want.

One year has passed since the new Residential Accommodation Business Act came into effect in June 2018. The number of licensed facilities has increased from 2,200 to 17,000, and the gross numbers of lodgers has jumped from 220,000 to 930,000.

In Rakuten LIFULL STAY's Vacation Stay, more than 12,000 residences have already been registered, and collaborations with companies with overseas networks including HomeAway, trivago, and Booking.com are running smoothly.

While working on these, the LIFULL Group is currently expanding its scope and steadily working towards its goal of creating the world's best life database and solution company in Japan and overseas.

Questions and Answers

Q1) What impact will the change of the pricing structure revisions in the mainstay rental & sale businesses have on your company's revenues? Also, the ratio seems to have nearly doubled for clients. I believe that it is reasonable if the rate of closing also increases, but what is the advantage for clients in accepting the revisions?

A1: Inoue) You can expect a positive effect, because the pricing structure revisions are aimed at increasing revenues. In terms of the target of revenues of JPY 50 billion for the next term, we consider that the pricing structure revisions will have a major impact in our core HOME'S Services Business. At the same time, we believe that the cost can be utilized to generate further added value by reducing sales resources. Therefore, we expect both an increase in revenues and cost reductions.

We began notifying clients of the revisions in June, and clients have agreed to them for the most part.

We will not be sure about the rate of closing until after we actually initiated the revisions, but we expect that providing richer content will make it easier for users to choose and this will lead to increased rates of closing.

A1: Ito) The individual plans of optional services based on clients' needs that we have created until now have become

increasingly more difficult to understand. For this reason, we would like to start the positive cycle of making plans easier to understand, improve usability, increase the amount of information, and thereby strengthen the website itself. With respect to the PL impact, we presently have a certain amount of revenue from the current optional services, which are to be merged with inquiry fees, so we cannot be sure about the actual results before the implementation in October. We are aware that in IR communications, growth of 15% or more is expected in the LIFULL HOME'S Services Business, and this is the target we hope to achieve.

Q1 Supplement) In the real estate business, realtors' incomes are usually equivalent to about one month's property rent. If a property can be rented out after one round of advertising, when two rounds were necessary in the past, it is beneficial for realtors. Also, other than revenues, less time and effort are required for realtors than at present. All in all, is it correct to assume that you have obtained approval from clients?

A1 Supplement: Inoue) That is correct. For example, for a property with a rent of JPY 100,000, we would charge an inquiry fee of roughly 5,000 yen per inquiry. However, this was only for inquiries. On top of that, we would charge additional fees for optional services such as panorama listings, sales staff comments, and company information. Likewise, under the revisions to 9.5%, the inquiry fees would be 9,500 yen per inquiry. However, we will offer unmetered optional services and focus on the establishment of an inquiry and the improvement of the rate of closing, so we and the realtors can produce win-win results. When we explain this, most of our clients find it better, because they can save time and effort.

Q2) Traffic has increased by 38%, but excluding the withdrawal from the renovation business, the HOME'S Services Business' revenues grew +4.2%, which is a strong deviation from 38%. I would like an explanation of this and would also like to know about both the current situation and the future regarding whether these pricing structure revisions will shrink this deviation and whether revenues will increase in accordance with traffic.

A2: Inoue) With respect to customers to whom inquiry fees apply in the rental and secondary markets, the increase in traffic has led to an increase in inquiries, resulting in a linear increase in revenues. However, some clients are not on inquiry-based plans. In addition, since a listing-based pricing model is employed for condos and detached houses, negotiations on listing-based prices will begin after traffic increases, which is why the increase in revenues is delayed for three to six months. We are currently working on it to increase the revenues for the next term.

Q3) What is your estimate of the change in monthly revenues per affiliated real estate business after the pricing structure revisions? It seems that you estimate an increase, but if that is the case, compared with SUUMO, your competitor, what is your estimate of the unit price for affiliated real estate businesses, the gap in terms of functions, and the advantages following the revisions?

A3: Inoue) I decline to disclose the details of the estimated average unit price per customer in the future after the pricing structure revisions, because it is directly related to the business forecast. There are minor differences from SUUMO in terms of functions and prices, but I believe that these are only slight differences for realtors and users. Since the real estate portals have been around for more than 20 years, we are aware that it has gradually become a commodity. We, therefore, think that it is necessary to offer services that dramatically change the user experience and do not only address the minor differences. More specifically, as I mentioned earlier, services like LIFE LIST, in which users search for a place to live based on their preferred lifestyle. Generally, users search for a place to live by choosing an area, train line and station and select specifications such as rent, size, etc.,. However, it is difficult to find their ideal dwelling based on these options alone. The core of our medium and long-term efforts are to create a UX that allows users to find places to live based on the questions of "What is a FULL LIFE?" and "What kind of lifestyle do I want to have?"

An example of competitors entering the market would be how Google Maps has recently become a common way to search for restaurant information. As a result, restaurant portals and review sites have seen spikes in traffic or losses in revenue. When traveling, it is enough to look up hotel vacancies in the surrounding area on Google Maps. Even with

the entry of a competitor like this, we are thinking seriously about what services/content gets to users' hearts. It's not just about SUUMO. We are seriously considering what users really want and focusing on gaining a competitive advantage in this situation.

Recently we have seen in the news that Amazon has entered the real estate market in the US. In this business model, Amazon is gathering agents in its marketplace, and when users choose an agent and eventually decide on a rental property, Amazon takes a share of the broker's commission. We are following our medium-/long-term strategy while thinking about what moving house market we should create 5 to 10 years from now including questions such as "will the Amazon model work in Japan?".

Q4) In terms of the overseas business: In the next 1Q, the acquisition of Mitula will be equalized and revenues are currently growing. Looking at the next and following terms, what percentage of organic growth in overseas business do you currently expect?

A4: Inoue) With respect to the organic growth of our overseas business, please see the quarterly results that we have disclosed. Cost reductions and the improvement of unit prices due to the positive effect (+ α) of the integration are as we announced earlier, and you can make estimates on the basis of these pieces of information.

Q5) I understand that your forecast for this term is EBITDA of 14.1% and about 20% for the next term, but do you think that you will be able to achieve these targets now?

A5: Inoue) We think that the target for the next term, EBITDA of 20%, is highly achievable on the basis of the pricing structure revisions, growth overseas, and the elimination of temporary costs.

Q6) If the organic media power of LIFULL HOME'S improves, your way of thinking about advertising expenses to revenues may change in the next term and thereafter. With respect to this term, there is a portion that you have boosted, but if the natural flow is increased, do you think that your way of thinking about advertising expenses is likely to change?

A6: Inoue) First, we believe that we control the ratio of advertising expenses at 30% of revenues. Top priority is placed on organic SEO measures. We expect that because of these pricing structure revisions, we will increase the amount of text and image content, which will be evaluated appropriately by search engines.

Second, we think that both branding and paid online marketing are equally important. It is said that in Japan, people change the place where they live four to five times in their lifetime and do not always think about it. We need to continue branding, so that when people think of moving house, they will remember to check LIFULL HOME'S. We think that the stronger the brand power is, the stronger the effect it will generate to boost CVR from inquiries to contracts, which is an effective measure in the medium/long term. We are currently improving the efficiency of paid online marketing by automatically posting several tens of millions of keywords using AI, etc. We expect that, from now on, we will be able to generate a certain performance without significant increases in cost, which is a short-term measure. We want to lower the ratio of advertising expenses to 25% and then further to 20%.

Q7) Recently, services, apps, and websites that seem to focus solely on renovation properties have appeared. I would like to know more about your company's efforts and way of thinking regarding renovation properties.

A7: Inoue) While the population is decreasing, if we build too many new properties, the number of unoccupied houses will increase. Accordingly, considering the social structure, we support the renovation of used houses for long-term use. We take a positive stance on secondary markets and renovations, and although it is not particularly conspicuous in LIFULL HOME'S, there is a renovation website available with a variety of examples and is growing steadily. However, since the market for buying used houses for renovation is still small among Japanese home buyers, we are taking time to raise awareness for the development of the market.