II. Review of operations

1. Business and other risks

There were no business and other risks that newly arose during the six months ended May 31, 2017. In addition, there were no significant changes in “Business and other risks” described in the annual securities report for the previous fiscal year.

2. Important operational contracts, etc.

No important operational contracts, etc. were determined or entered into during the second quarter of the current fiscal year.

3. Analysis of financial position, operating results and cash flows

Any forward-looking statements included in the following descriptions are based on the best estimates or judgment of the Tosei Group as of May 31, 2017.

(1) Analysis of operating results

During the six months ended May 31, 2017, the Japanese economy remained on a moderate recovery track supported by favorable corporate earnings. Although it is necessary to keep in mind the uncertain prospects of the global economy and the policy trends of the United States and China, this moderate recovery is expected to continue going forward, backed by an improving employment and income environment and firm personal consumption.

In the real estate industry where the Tosei Group operates, transactions through J-REITs and private placement funds were active against the backdrop of a favorable financing environment. In addition, transactions by overseas investors, which had been in a declining trend, also showed signs of recovery, and commercial real estate transactions from January 2017 to March 2017 increased 15% year on year to ¥1.2 trillion. Despite a continued decrease in investment returns due to a rise in property prices, as well as partial signs of overheated transactions, investors’ desire to acquire property remains high (according to a survey by a private research institution).

In the Tokyo metropolitan area condominium market, the number of units sold in the fiscal year ended March 31, 2017 fell 4.4% year on year to 36,450. The average sales price remained at a high of ¥55.41 million due to a surge in construction costs, and the contract rate for the first month was 68.5%, which is below the 70% threshold from which market conditions are viewed as favorable. In the Tokyo metropolitan area build-for-sale detached house market, housing starts for the fiscal year ended March 31, 2017 rose 7.3% year on year to 61,284. Demand for detached houses, which are perceived to be undervalued compared to newly-built condominiums, continues to be strong, with low-interest housing loans also driving demand (according to a survey by a private research institution and the Ministry of Land, Infrastructure, Transport and Tourism data).

In the leasing market, there is strong office expansion and relocation demand among office buildings backed by robust corporate earnings. The vacancy rate in Tokyo’s five business wards declined 0.84 percentage points year on year to 3.39%, and the average asking rent was ¥18,774 per tsubo (1 tsubo = 3.3m2), a 3.95% increase year on year. The average asking rent is rising at a gradual pace ahead of an upsurge in the supply of large-scale office buildings from 2018. Among apartments, the average asking rent for a family-type apartment within Tokyo’s 23 wards in April 2017 rose only slightly to ¥10,979 per tsubo, a 0.4% increase year on year (according to a survey by a private research institution).

In the real estate securitization market, the total value of assets under management in the J-REIT market as of December 31, 2016 increased ¥1.5 trillion year on year to ¥15.5 trillion. In addition, the total value of assets under management in major private placement funds increased ¥0.8 trillion year on year to ¥15.6 trillion. Properties were proactively acquired through both J-REITs and private placement funds, and the market scale is expanding (according to a survey by a private research institution).

Amid this operating environment, in the Revitalization Business, the Group made steady progress in selling assets such as income-generating office buildings, apartments and hotels, while in the Development Business, the Group pushed ahead with sales of detached houses. In addition, we proactively acquired income-generating properties and land for development as future sources of income.

As a result, consolidated revenue for the six months ended May 31, 2017 totaled ¥26,360 million (down 14.0% year on year), operating profit was ¥6,241 million (down 18.7%), profit before tax was ¥5,857 million (down 19.1%), and profit for the period was ¥3,931 million (down 17.1%).

Performance by business segment is shown below.

Revitalization Business

During the six months ended May 31, 2017, the segment sold 37 properties it had renovated, including T's garden Urayasu (Urayasu-shi, Chiba), T's garden Urayasu Ⅱ (Urayasu-shi, Chiba), Kamiosaki 3cho-me Building (Shinagawa-ku, Tokyo), Onoecho 6cho-me Building (Yokohama-shi, Kanagawa), Kishino Building (Toshima-ku, Tokyo), NOUER Nakamachidai (Yokohama-shi, Kanagawa), Demeure Sagamihara (Sagamihara-shi, Kanagawa) In addition, the segment sold 22 units in the Restyling Business, including Hilltop Yokohama Negishi (Yokohama-shi, Kanagawa), Hilltop Yokohama Higashi Terao (Yokohama-shi, Kanagawa) and Renai Kamakura Ueki (Kamakura-shi, Kanagawa).

During the six months ended May 31, 2017, it also acquired a total of 24 income-generating office buildings and apartments and two land lots for renovation and sales purposes.

As part of the acquisition, our company acquired KS Properties, company holds income properties mainly in Suginami-ku, Tokyo, through M&A transaction and converted it into consolidated subsidiaries.

As a result, revenue in this segment was ¥17,948 million (up 16.4% year on year) and the segment profit was ¥4,800 million (up 32.3%).

Development Business

During the six months ended May 31, 2017, the segment focused on the sale of detached houses, for which there was firm demand. The segment sold 53 detached houses at such properties as THE Palms Court Kashiwa Hatsuishi (Kashiwa-shi, Chiba), THE Palms Court Koshigaya Lake Town (Koshigaya-shi, Saitama) and THE Palms Court Machida Tsurukawa (Mitaka-shi, Tokyo)

During the six months ended May 31, 2017, it also acquired a land lot for hotel project, a land for condominium project and a land lot for 18 detached housings.

As a result, revenue in this segment was ¥2,144 million (down 78.8% year on year) and the segment loss was ¥219 million (in comparison with segment profit of ¥3,659 million in the same period of the previous fiscal year).

During the six months ended May 31, 2017, all the segment revenue came from detached houses sale. On the other hand, in the same period of the previous fiscal year the segment sold two commercial facilities. For this reason, the segment revenue and profit decreased.

Rental Business

During the six months ended May 31, 2017, while the segment sold 22 buildings of its inventory assets held for leasing purposes, it newly acquired 17 properties including income-generating office buildings and apartments. In addition, the segment made efforts to lease vacancies out following acquisitions and also focused on leasing activities for its existing non-current assets and inventory assets.

As a result, revenue in this segment was ¥2,988 million (up 23.6% year on year) and the segment profit was ¥1,303 million (up 29.9%).

Fund and Consulting Business

During the six months ended May 31, 2017, while ¥17,625 million was subtracted from the balance of assets under management (Note), due mainly to property dispositions by funds, ¥68,572 million was added to the balance of Assets under management ¥448,186 for the end of the previous fiscal year, due mainly to new asset management contracts of large projects the segment obtained. The balance of assets under management as of May 31, 2017, was ¥499,133 million. The acquisition of such large project contracts increased asset management fees and contributed to revenue.

As a result, revenue in this segment was ¥1,641 million (up 52.3% year on year) and the segment profit was ¥915 million (up 112.6%).

Note: The balance of assets under management includes the balance of assets that were subject to consulting contracts, etc.

Property Management Business

During the six months ended May 31, 2017, the segment worked to win new contracts and maintain existing contracts. Consequently, the total number of properties under management was 634 as of May 31, 2017, an increase of 40 properties from May 31, 2016, with that total comprising 385 office buildings, hotels, schools and other such properties, and 249 condominiums and apartments.

As a result, revenue in this segment was ¥1,636 million (up 13.9% year on year) and segment profit was ¥134 million (up 91.4%).

Other

For the six months ended May 31, 2017, there was no revenue in this segment (in comparison with revenue of ¥201 million in the same period of the previous fiscal year) and the segment profit was ¥1 million (in comparison with segment loss of ¥23 million in the same period of the previous fiscal year).

(2) Analysis of financial position

As of May 31, 2017, total assets were ¥123,366 million, an increase of ¥2,089 million compared with November 30, 2016, while total liabilities were ¥79,457 million, a decrease of ¥808 million.

Increase in total assets were primarily due to increase in inventories. Decrease in liabilities were due to decrease in accrued income tax.

Total equity increased by ¥2,898 million to ¥43,908 million, mainly due to an increase in retained earnings and payment of cash dividends.

(3) Analysis of cash flows

Cash and cash equivalents (hereinafter “cash”) as of May 31, 2017 totaled ¥22,934 million, up ¥1,293 million compared with November 30, 2016.

The cash flows for the six months ended May 31, 2017 and factors contributing to those amounts are as follows:

Cash Flows from Operating Activities

Net cash provided by operating activities totaled ¥2,497 million (¥870 million used in the same period of the previous fiscal year). This is mainly due to profit before tax of ¥5,857 million, as well as an increase in inventories of ¥1,182 million, which was a result of property acquisitions in the Revitalization Business and Development Business, and income taxes paid of ¥2,155 million.

Cash Flows from Investing Activities

Net cash provided by investing activities totaled ¥535 million (¥5,455 million used in the same period of the previous fiscal year). This is primarily due to payments of loans receivable of ¥1,085 million and collection of loans receivable of ¥1,675 million.

Cash Flows from Financing Activities

Net cash used in financing activities totaled ¥1,739 million (¥10,166 million provided by the same period of the previous fiscal year). This mainly reflects ¥14,053 million in the repayments of non-current borrowings and ¥1,060 million in cash dividends paid, despite ¥14,505 million in proceeds from non-current borrowings.

(4) Operational and financial issues to be addressed

During the six months ended May 31, 2017, there was no significant change in issues to be addressed by the Tosei Group.

The Company has set the basic policy regarding the persons who control the decision-making on the financial and business policies of the Company. The contents of basic policy (matters set forth in Article 118, item 3 of the Ordinance for Enforcement of the Companies Act) are as follows:

a. Contents of basic policy

The Company believes that the persons who control decisions on the Company's financial and business policies need to be persons who fully understand the details of the Company's financial and business affairs and the source of the Company's corporate value and who will make it possible to continually and persistently ensure and enhance the Company's corporate value and, in turn, the common interests of its shareholders.

The Company believes that ultimately its shareholders as a whole must make the decision on any proposed acquisition that would involve a change of control of the Company. Also, the Company will not reject a large-scale acquisition of the shares in the Company if it will contribute to the corporate value of the Company and, in turn, the common interests of its shareholders.

Nonetheless, there are some forms of large-scale acquisition of shares that benefit neither the corporate value of the target company nor the common interests of its shareholders including those with a purpose that would obviously harm the corporate value of the target company and the common interests of its shareholders, those with the potential to substantially coerce shareholders into selling their shares; those that do not provide sufficient time or information for the target company's board of directors and shareholders to consider the details of the large-scale acquisition, or for the target company's board of directors to make an alternative proposal and those that require the target company to discuss or negotiate with the acquirer in order to procure more favorable terms for shareholders than those presented by the acquirer.

It is particularly necessary and essential for the persons who make decisions on the Company's financial and business policies to (i) maintain the system under which the Company internally covers the five business fields that allow the "integration of real estate and finance," which leads to maximization of the potential of the Company group, (ii) maintain employees who support that system with knowledge and experience specializing in real estate and finance, (iii) maintain the Company's trust in the real estate industry that has been built up over a long period of time based on the establishment of the ability and information networks supporting various value creation technologies, and (iv) master knowhow that enables comprehensive business. Unless the acquirer of a proposed large-scale acquisition of the shares in the Company understands the source of the corporate value of the Company as well as the details of financial and business affairs of the Company and would ensure and enhance these elements over the medium-to-long term, the corporate value of the Company and, in turn, the common interests of its shareholders would be harmed.

The Company believes that persons who would make a large-scale acquisition of the shares in the Company in a manner that does not contribute to the corporate value of the Company or the common interests of its shareholders would be inappropriate as persons that control decisions on the Company's financial and business policies. The Company believes that it is necessary to ensure the corporate value of the Company and, in turn, the common interests of its shareholders by taking necessary and reasonable countermeasures against a large-scale acquisition by such persons.

b. Overview of special measures to realize the basic policy

Under the medium-term management plan called "Advancing Together 2017" (the targeted period of the plan is three years from December 2014 to November 2017), the Company group aims to further strengthen the business infrastructure by expanding and developing of the existing five business areas and considering its advance to peripheral areas of business, to build optimum corporate governance for expansion of the Company group and increase of the employees which are entailed in expansion of the business, and to establish efficient organization management structure. Further, the Company group will emphasize the cultivation of the most valuable asset of the Company group, i.e. the human resources to increase satisfaction of the employees of the Company group. As the Basic Policy in the medium-term management plan for the further growth of the Company group, the Company group is determined to establish the original and distinctive "Tosei brand" by providing products ensuring high customer satisfaction and high-quality services. Based on these policies, the Company group is dedicated to redefine existing ideas with the spirit of challenge and advance as the risk-taking group of companies, to aim "creation of new values and sensation as the truly globally-minded and promising professionals".

The Company group has previously appointed multiple outside directors (two members), invited all Audit & Supervisory Board Members (four members) from outside the company, and has notified all of the above six outside directors and Audit & Supervisory Board Members as "independent directors and/or Audit & Supervisory Board Members" in accordance with the "Principles of Corporate

Governance for Listed Companies" of the Tokyo Stock Exchange. Also, the Company group has reinforced the business execution function by the introduction of the executive officer system, and the establishment of the corporate governance board, and will continue to endeavor to further strengthen corporate governance. Specifically, the Company group will focus on putting into practice actions based on a high-level awareness of compliance through raising awareness from the level of "role model" to that of "ideal" in accordance with the Compliance Principles of the Company, thorough implementation of risk management by correctly understanding and analyzing risks involved in corporate activities, continuous performance of accountability to various stakeholders including investors by promptly publicly disclosing correct corporate information under the spirit of fair disclosure, and other efforts for strengthening corporate governance.

c. Overview of measures to prevent decisions on the Company's financial and business policies from being controlled by persons deemed inappropriate according to the basic policy

The plan is a measure to prevent decisions on the Company's financial and business policies from being controlled by persons deemed inappropriate under the above basic policy, and its objective is to ensure and enhance the Company's corporate value and, in turn, the common interests of its shareholders.

The plan stipulates procedures that must be followed in any cases of purchase, etc. of share certificates, etc. of the Company ((i) a purchase or other acquisition that would result in the holding ratio of share certificates, etc. *(kabuken tou hoyuu wariai)*of a holder *(hoyuusha)* totaling at least 20% of the share certificates, etc. issued by the company; or (ii)a tender offer *(koukai kaitsuke)* that would result in the party conducting the tender offer's ownership ratio of share certificates, etc. and the ownership ratio of share certificates, etc. of a person having a special relationship totaling at least 20% of the share certificates, etc. issued by the Company; or (iii) any similar action to (i) or (ii) above)

In practical terms, the acquirer must provide the Company a statement of undertaking (acquirer's statement) and an acquisition document that includes essential information, etc. before making the acquisition, etc.

Upon receiving these documents, the independent committee, while obtaining independent expert advice, will conduct its consideration of the acquisition terms; collection of information on materials such as the management plans and business plans of the acquirer and the Company's board of directors and comparison thereof; consideration of any alternative plan presented by the Company's board of directors, and the like; and discussion and negotiation with the acquirer. The Company will disclose information in a timely manner.

When (i) the acquisition is not in compliance with the procedures prescribed in the plan or (ii) it threatens to cause obvious harm to the corporate value of the Company, and, in turn, to the common interests of shareholders, (iii) and it is reasonable to implement the gratis allotment of stock acquisition rights, the independent committee will recommend the implementation the gratis allotment of stock acquisition rights to the Company's board of directors. In addition, when a meeting of shareholders is convened to confirm the intent of the Company's shareholders, the Company's board of directors will respond to the shareholders' intent. These stock acquisition rights will be allotted with an exercise condition that does not allow, as a general rule, the acquirer to exercise the rights and an acquisition provision to the effect that the Company may acquire the stock acquisition rights in exchange for shares in the Company from persons other than the acquirer. The Company's board of directors, in exercising its role under the Companies Act, will pass a resolution relating to the implementation or non-implementation of the gratis allotment of stock acquisition rights, respecting the recommendation of the Independent Committee to the maximum extent. In addition, when a meeting of shareholders is convened to confirm the intent of the Company's shareholders, the Company's board of directors will respond to the shareholders' intent. If the procedures for the plan have commenced, the acquirer must not effect an acquisition until and unless the Company's board of directors resolves not to trigger the plan. The effective period of the plan expires at the conclusion of the ordinary general meeting of shareholders for the last fiscal year ending within three years after the conclusion of the 65th Ordinary General Meeting of Shareholders. However, if, before the expiration of the effective period, the Company's board of directors resolves to abolish the plan, the plan will be abolished at that time.

d. Decisions by the Company's board of directors regarding specific measures and reasons therefor

Company's board of directors deems that the new medium-term management plan and other measures such as the efforts to enhance the corporate value and the strengthening of corporate governance were established as specific measures to continuously and sustainably enhance the corporate value of the Company and, in turn, the common interests of its shareholders, and that these are truly in accordance with the basic policy, not detrimental to the common interests of the Company's shareholders and not for the purpose of maintaining the positions of the Company's corporate officers.

In addition, the Company's board of directors deems that the plan is not detrimental to the common interests of the Company's shareholders, not for the purpose of maintaining the positions of the Company's corporate officers, and in accordance with the basic policy based on the following reasoning: approval from the general meeting of shareholders must be obtained for its renewal; its effective period is stipulated as a maximum of three years and it can be abolished at any time by the resolution of the Company's board of directors; an independent committee, which is composed of members who are independent from the management of the Company, has been established; in the event that the plan's countermeasures are triggered, the Company must obtain a resolution by the independent committee when making a decision for triggering the countermeasures in the plan, and the plan fully satisfies the three principles set out in the Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests released by the Ministry of Economy, Trade and Industry and the Ministry of Justice on May 27, 2005.

(5) Research and development activities

No item to report.