II. Review of operations

1. Business and other risks

There were no business and other risks that newly arose during the three months ended February 29, 2016. 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 first quarter of the fiscal year under review.

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 February 29, 2016.

(1) Analysis of operating results

During the three months ended February 29, 2016, the Japanese economy remained on a moderate recovery track despite apparent weaknesses in some areas such as exports. Meanwhile, global economic uncertainties stemming from developments such as falling crude oil prices, slowing emerging market economies, and U.S. interest rate trends have been fueling concerns of potential downward pressure on the economy, but on the other hand more upbeat corporate earnings and robust personal consumption are giving rise to expectations that the moderate recovery will continue going forward.

In the real estate industry where Tosei Group operates, since the implementation of “Abenomics” (the economic policies taken by Prime Minister Shinzo Abe), the market for real estate transactions has been gaining momentum and domestic real estate transactions have been trending higher overall against a backdrop of monetary easing and various other policy measures. Nevertheless, beginning in the latter half of 2015, transactions have been heading lower amid decreasing cap rates due to a dwindling supply of properties on the open market, rising prices and other such factors. Consequently in 2015 overall, domestic real estate transactions by listed companies and other such entities decreased 14.3% year on year to ¥4.3 trillion (according to a survey by a private research institution).

In the Tokyo metropolitan area condominium market, sales prices have been surging due to persistently high building costs. The average sales price has been riding momentum heading toward the record-setting ¥61 million per unit level of Japan’s bubble-era economy, having reached ¥55.7 million per unit in January 2016, the most recent data available, for an increase of 25.0% compared with the same month of the previous fiscal year. Meanwhile, the contract rate decreased 16.3% compared with the same month of the previous fiscal year to 58.6%, substantially below the 70% threshold from which market conditions are viewed as favorable, as a result of demand having lost steam amid an intensifying trend of consumers refraining from making purchases. However, the Bank of Japan’s introduction of negative interest rates is likely to bring about lower rates on home loans and thereby stimulate demand (according to a survey by a private research institution).

In the Tokyo metropolitan area build-for-sale detached house market, housing starts for 2015 decreased by 3.4% year on year to 56,000 units. Despite somewhat weak and unchanging trends at hand, build-for-sale detached housing demand appears to be on its way up amid emerging perception that detached housing is undervalued for money given surging condominium prices (according to the Ministry of Land, Infrastructure, Transport and Tourism data).

At the same time, in the office leasing market of Tokyo’s five business wards, improvements in corporate earnings continue to fuel strong office expansion and relocation demand, falling vacancy rates and a trend of gradually increasing rents. As such, the vacancy rate in January 2016 declined to 4.0%, and the average asking rent was ¥17,790 per tsubo (1 tsubo = 3.3m^2), for a 3.9% increase of ¥681 compared with the same month of the previous fiscal year (according to a survey by a private research institution).

In the real estate securitization market, the financing environment remains favorable against a backdrop of more monetary easing by the Bank of Japan, while total acquisitions of J-REIT properties in 2015 amounted to ¥1.6 trillion, largely unchanged year on year (according to a survey by a private research institution). As of December 31, 2015, the total value of assets under management in the J-REIT market amounted to ¥14 trillion and private placement funds amounted to ¥14.8 trillion for a total market size of ¥28.8 trillion (according to a survey by a private research institution).

Amid this operating environment, in the Revitalization Business, the Tosei Group made steady progress in selling assets such as income-generating office buildings and apartments, while in the Development Business the Group pushed ahead with sales and development of commercial facilities and 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 three months ended February 29, 2016 totaled ¥13,527 million (up 17.4% year on year), operating profit was ¥4,127 million (up 74.5%), profit before tax was ¥3,914 million (up 78.7%), and profit for the period was ¥2,611 million (up 87.8%).

Performance by business segment is shown below.

Reportable segment classifications have been changed effective from the first quarter of the fiscal year ending November 30, 2016, and in the following quarterly comparisons figures for the same period of the previous fiscal year have been recalculated according to the segment after such change.

Revitalization Business

During the three months ended February 29, 2016, the segment sold five properties it had renovated, including Mini-mall Yokohama Aoba (Yokohama-shi, Kanagawa), Takaido Tosei Studio (Suginami-ku, Tokyo) and Grace Heiwadai (Nerima-ku, Tokyo). In addition, the segment sold 10 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 three months ended February 29, 2016, it also acquired a total of eight income-generating office buildings and apartments and one land lot for renovation and sales purposes.

As a result, revenue in this segment was ¥2,360 million (down 67.2% year on year) and the segment profit was ¥182 million (down 90.1%).

Development Business

During the three months ended February 29, 2016, the segment focused on the sale of detached houses, for which there was firm demand. The segment sold 25 detached houses at such properties as THE Palms Court Kashiwa Hatsuishi (Kashiwa-shi, Chiba), THE Palms Court Koshigaya Lake Town (Koshigaya-shi, Saitama), THE Palms Court Mitaka Osawa (Mitaka-shi, Tokyo). In addition, the segment sold new commercial facilities T’s BRIGHTIA Minami Aoyama (Minato-ku, Tokyo) and T’s BRIGHTIA Tsunashima (Yokohama-shi, Kanagawa), and one land lot.

During the three months ended February 29, 2016, it also acquired two land lots for detached housing projects and one land lot for commercial facility projects.

In the three months ended February 29, 2016, the segment embarked on efforts to enhance acquisition and sales networks in the outskirts of Tokyo and the Kanagawa area, facilitated by the Company making Urban Home Corporation based in Machida-shi, Tokyo a consolidated subsidiary.

As a result, revenue in this segment was ¥8,724 million (up 275.3% year on year) and the segment profit was ¥3,580 million (up 775.1%).

Rental Business

During the three months ended February 29, 2016, while the segment sold three buildings of its inventory assets held for leasing purposes, it newly acquired seven 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 ¥1,100 million (up 27.2% year on year) and the segment profit was ¥461 million (up 26.3%).

Fund and Consulting Business

During the three months ended February 29, 2016, while ¥14,529 million was subtracted from the balance of assets under management, due mainly to property dispositions by funds, ¥56,613 million was added to the balance of assets under management, due mainly to new asset management contracts of large projects the segment obtained. The acquisition of such large project contracts increased asset management fees and contributed to revenue.

As a result, revenue in this segment was ¥563 million (up 117.4% year on year) and the segment profit was ¥210 million (up 312.5%).

As of February 29, 2016, the balance of assets under management (Note) totaled ¥463,875 million.

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

Property Management Business

During the three months ended February 29, 2016, the number of fund properties managed by the segment increased as a result of efforts to win new contracts and maintain existing contracts. Consequently, the total number of properties under management was 581 as of February 29, 2016, an increase of 41 from February 28, 2015, with the total comprising 359 office buildings, hotels, schools and other such properties, and 222 condominiums and apartments.

As a result, revenue in this segment was ¥642 million (down 8.1% year on year) and segment profit was ¥28 million (up 7.3%).

Other

For the three months ended February 29, 2016, revenue in this segment was ¥136 million (down 19.7% year on year) and the segment loss was ¥1 million (in comparison with segment profit of ¥29 million in the same period of the previous fiscal year).

(2) Analysis of financial position

As of February 29, 2016, total assets were ¥102,869 million, an increase of ¥9,672 million compared with November 30, 2015, while total liabilities were ¥64,812 million, an increase of ¥7,844 million.

This was primarily due to an increase in inventories resulting from purchase of properties exceeding sales of properties in the Revitalization Business and Development Business, and an increase in borrowings from financial institutions.

Total equity increased by ¥1,828 million to ¥38,056 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 February 29, 2016 totaled ¥20,221 million, up ¥1,430 million compared with November 30, 2015.

The cash flows for the three months ended February 29, 2016 and factors contributing to those amounts are as follows:

Cash Flows from Operating Activities

Net cash used in operating activities totaled ¥3,450 million (up 355.5% year on year). This is mainly due to profit before tax of ¥3,914 million, as well as an increase in inventories of ¥7,785 million, which was a result of property acquisitions in the Revitalization Business and Development Business, and income taxes paid of ¥1,169 million.

Cash Flows from Investing Activities

Net cash provided by investing activities totaled ¥10 million (net cash used in investing activities totaled ¥238 million in the same period of the previous fiscal year). This is primarily due to proceeds from purchase of investments in subsidiaries resulting in change in scope of consolidation totaling ¥31 million.

Cash Flows from Financing Activities

Net cash provided by financing activities totaled ¥4,876 million (up 76.8% year on year). This mainly reflects ¥5,769 million in the repayments of non-current borrowings and ¥772 million in cash dividends paid, despite ¥11,383 million in proceeds from non-current borrowings.

(4) Operational and financial issues to be addressed

During the three months ended February 29, 2016, 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 six business fields (Note) 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 new 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 six business (Note) 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 new 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 (five members) from outside the company, and has notified all of the above seven 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.

(Note) Reportable segment classifications have been changed effective from the first quarter of the fiscal year ending November 30, 2016. For details, please refer to "5. Segment information" in "IV. Accounting, 1. Condensed Quarterly Consolidated Financial Statements, (5) Notes to Condensed Quarterly Consolidated Financial Statements."

(5) Research and development activities

No item to report.

(6) Number of employees

In the three months ended February 29, 2016, the number of employees increased by 47 persons compared with November 30, 2015, largely as a result of acquisitions through M&A transactions of Urban Home Corporation and Urban Next Co., Ltd., which operate real estate development business and real estate fund and consulting business.