

Gaining a foothold for business expansion in the Tokyo metropolitan area on the completion of Onarimon Building

Corporate History

Our company was established in December 1948 as Keihanshin Horse Racing Co., Ltd. for the purpose of building the Hanshin Racetrack and promoting horse racing in the Kansai area. The Company changed its name to Keihanshin Real Estate Co., Ltd. in 1955, taking the opportunity to sell the Hanshin Racetrack to the Japan Racing Association (JRA). Reflecting the background to the company's foundation, it has always been involved in the business of renting off-course betting offices ('WINS') established in Umeda and Namba (both in Osaka) and a little later in Kyoto and Kobe. This WINS leasing continues to be one of our core businesses.

In 1962, we built an office building (Kawaramachi Building) in Osaka and entered into the office building rental business. At one stage in our history, we also dealt in sales of residential lots and condominiums, but later completely withdrew from this field. We decided to concentrate on real estate leasing and in 1976 started a commercial and logistics-related business of leasing commercial buildings such as stores and warehouses. We were a trailblazer in leasing buildings specifically designed as computer centers ('datacenter buildings') in 1988.

Meanwhile, on the capital front, the Hankyu Railway group, our largest shareholder since establishment, sold its shares to the Sumitomo Bank group (now Sumitomo Mitsui Banking Corporation) in 1970. Since that time, we have had presidents and executives seconded from Sumitomo Mitsui Banking Corporation as one of the companies that maintain close relationship with the bank. GINSEN Co., Ltd., which is also closely related to Sumitomo Mitsui Banking Corporation, remains the largest shareholder of our company, with a 14.0% stake.

Business Results by Division

We are currently engaged in the business of real estate leasing in four sectors: general office buildings, datacenter buildings, WINS, and commercial and logistics-related properties. The 25 leasehold properties we owned as of

end-March 2009 include 5 general office buildings, 6 datacenter buildings, 4 WINS offices, and 10 commercial and logistics-related properties. The total floor space we currently lease is approximately 57,000tsubo (189,000 m²).

Revenue from land and building rentals consisted of ¥2,505 million (22.4%) from general office buildings, ¥4,001 million (35.7%) from datacenter buildings, ¥3,154 million (28.1%) from WINS offices, and ¥1,546 million (13.8%) from commercial and logistics-related business. Datacenter buildings and office buildings have represented a growing share of rental revenue over the last 5 years, increasing by 5.2% and 8.9% respectively over that period owing to factors such as the sale of small, underperforming properties in the commercial and logistics-related business and the temporary closure of WINS Umeda Building B for reconstruction.

As for investment in new buildings, an office building was completed in Shinbashi, Minato-Ku, Tokyo in April 2009 (the Onarimon Building). The Onarimon Building, which is favorably located on Hibiya Street adjacent to the Onarimon subway, offers a superbly comfortable office environment with a number of plantings, rooftop gardens and greenery walls. It is also a state-of-the-art building equipped with a number of advanced safety features such as an earthquake-resistant design. We would like to make this building a foothold for the expansion of our business in the Tokyo metropolitan area.

WINS Umeda Building B, which is 40 years old and is the largest of the WINS offices we own in four locations, has been closed for an overall reconstruction since the end of June 2008 to increase customer convenience and further enhance our customer services. This reconstruction project is running smoothly, with partial completion expected by December 2009 and the full completion is scheduled for March 2010 including the “Excel Floor” (incorporating paid seats for the first time in the Kansai area)

In the datacenter building leasing business sector, a field in which the Company has been active for more than 20 years and has gained a significant amount of expertise, we acquired a site in Nishi-ku, Osaka in February 2009 for a datacenter building which, when constructed, will be the 7th such building we own. We are planning to construct this new datacenter building at an appropriate time, taking

economic conditions and trends among tenants into account, and have commenced a close study on a detailed plan.

A typical feature of the datacenter building business is that although prospective tenants tend to be slow in making leasing decisions due to the substantial initial capital investment required at the start of a tenancy, tenants who move in seldom leave for the same reason. Another such feature is that we enjoy good profitability in this business owing to certain revenue-generating factors such as electrical power rate revenue.

Outline of Consolidated Business Results for the Fiscal Year Ended March 2009

For many years the Company has maintained a vacancy rate which is lower than the industry average. However, our vacancy rate has gradually been rising due to the recent economic downturn, reaching 3.7% at the end of March 2009 from 2.3% at the end of September 2008. Furthermore, it is anticipated to rise to 6.9% by the end of September 2009. Rents are now trending downward again due to a worsened supply and demand balance and a rising vacancy rate, and tenant demand for rent reductions is intensifying.

In addition to the unfavorable business environment described above, we have lost rental revenue from WINS Umeda Building B from halfway through the current term due to its closure for reconstruction. Despite this severe situation, the fall in income was offset by an increased occupancy rate in the Midosuji Building (a general office building) and the Kitahorie Building (a datacenter building), which were both completed two years ago. Coupled with a substantial increase in orders for interior finishing work placed with us by tenants moving into datacenter buildings, we posted consolidated revenue of ¥13,220 million (year-on-year increase of 10.9%) in FY 2008.

On the other hand, our gross profit margin dropped to 39.9% (44.4% in the previous year) due to a decrease in rental revenue from the WINS offices, which carry high margins. As a result, gross profit dropped to ¥5,279 million (year-on-year decrease of ¥15 million). Operating income was ¥4,554 million (year-on-year decrease of ¥33 million) and ordinary income was ¥4,112 million

(year-on-year decrease of ¥12 million).

In addition, we recorded an extraordinary loss of ¥2,100 million in FY2008, which included a loss of ¥1,438 million on disposal of property and equipment caused by the demolition of WINS Umeda Building B, etc., and ¥623 million on devaluation of investment securities due to the decline in stock prices. As a result, our net income decreased to ¥1,521 million (year-on-year decrease of 36.3%).

Our total assets were ¥77,513 million (year-on-year decrease of ¥669 million) as of end-March 2009. Tangible fixed assets increased by ¥2,713 million from the previous year due to the acquisition of a building site for our datacenter building. On the other hand, investment securities decreased by ¥2,735 million due to the decline in stock prices, and guarantee money deposited and lease deposits decreased by ¥1,478 million due to the expiry of lease agreements.

Total liabilities in FY2008 were ¥42,319 million (year-on-year decrease of ¥23 million) and total equity stood at ¥35,194 million; as a result, our equity to total assets ratio was 45.4% (year-on-year decrease of 0.4%).

Capital investments for the last 5 years have amounted to ¥31,300 million. Nearly 80% of this amount has been funded by operating cash flow of ¥24,300 million, but interest-bearing liabilities increased by ¥8,600 million during the same period. We use a figure obtained by dividing interest-bearing liabilities by annual operating cash flow as a management index; this was 5.2 at the end of FY2008. We will continue to control our capital investments and interest-bearing liabilities so that this index will not exceed 10.

We will pay a year-end dividend of ¥6.5 per share including a special 60th anniversary dividend of ¥1, making an annual dividend of ¥12 per share (year-on-year increase of ¥1). This means we will have increased our dividend 3 times in the last 4 years, moving from ¥9 to ¥12 (an increase of 33%) in that time. Our dividend payout ratio thus becomes 35.9% on a consolidated basis.

Forecast of Business Results for FY2009 and Beyond

One of the characteristics of property leasing business is that the effects of tenant

departures and rent reductions manifest themselves after a time lag. Thus, the present economic situation will influence the FY2009 business results somewhat.

We anticipate that our revenue in FY2009, which ends in March 2010, will decrease to ¥11,800 million (year-on-year decrease of 10.7%) due to factors such as a rise in the vacancy rate. On the profit front, although we will endeavor to achieve cost reductions to offset a drop in rental revenue, we expect operating income will decrease to ¥4,100 million (year-on-year decrease of 10.0%) and ordinary income to ¥3,600 million (year-on-year decrease of 12.5%).

Our net income for FY2009, on the other hand, is forecast to increase to ¥2,000 million (year-on-year increase of 31.5%), as there will be no extraordinary losses such as those we experienced in FY2008. The annual dividend per share is planned to be ¥12, switching the current year's commemorative dividend of ¥1 to an ordinary dividend.

In FY2010 ending March 2011, WINS Umeda Building B will operate to capacity following its full completion, and the vacancy rate is expected to drop gradually. Therefore, we anticipate that the decline in earnings experienced this financial year will not recur and that our business performance will improve in FY2010 and beyond.

Future Business Challenges

First: the most pressing business challenge we need to tackle is how to prevent the vacancy rate from rising further than currently anticipated. Although it is difficult to secure new tenants in the prevailing economic uncertainty, we will strongly commit ourselves to minimizing the decline in our earnings by lowering our vacancy rate.

Second: we will make new investments in a proactive and continuous manner to realize further expansion of our business and increased profitability. In our view, the current economic environment is also an opportunity to acquire new properties. At the same time, we will work on issues such as withdrawing from or disposing of underperforming properties and replacing assets.

Third: the renewal of existing properties is also an important issue in view of the fact

that safety and environmental standards are becoming even more stringent. We will properly and promptly address the need to reconstruct existing properties with a focus on structural safety, environmental issues, compliance aspects and customer satisfaction. In doing so, another critical issue is how we can compensate for a decrease in revenue and income during the reconstruction periods.

Fourth: we will work towards realizing efficient management practices by continuing to foster our traditional characteristics and strengths, i.e., running our businesses with a select group of experts and an intense outsourcing strategy. At the same time, it is our intention to avoid overreaching and to implement management practices which maintain a good balance between stability and growth.

Fifth: we aim to upgrade our long-term credit rating and to enhance our corporate value by focusing on cash flow, lowering our degree of dependence on debts, and striving to further improve our financial standing.

In conclusion, we are committed to steadily performing these tasks, to maintaining a good balance between growth and stability, and to achieving continued steady growth, guided by our focus on 'safety,' 'high-grade environment,' 'customer satisfaction' and 'compliance.'

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Takeharu Nagata, President