

## Bridge Report Leoplace21 Corporation (8848)

 Eisei Miyama, President	Company	Leoplace21 Corporation	
	Code No.	8848	
	Exchange	Tokyo Stock Exchange 1 <sup>st</sup> Section	
	Industry	Real Estate	
	President	Eisei Miyama	
	HQ	2-54-11 Honcho, Nakano-ku, Tokyo	
	Business Description	Leoplace21 provides “one stop shopping” services including construction, leasing, and sales of primarily apartments, condominiums, and other residential properties. The Company also acts as property manager for 550,000 residential properties across Japan.	
Year-end	March		
Website	<a href="http://eg.leoplace21.com/">http://eg.leoplace21.com/</a>		

### — Stock Information —

Share Price	Shares Outstanding		Market Cap	ROE (actual)	Trading Unit
¥656	262,874,485 shares		¥172.445 billion	18.7%	100 shares
DPS (Est.)	Dividend Yield (Est.)	EPS (Est.)	PER (Est.)	BPS (actual)	PBR (actual)
¥0.00	-%	¥45.65	14.4x	¥398.78	1.6x

\*Stock prices as of the close on Nov. 21, 2014. Number of shares issued at the end of the most recent quarter excluding treasury shares.

### — Consolidated Earnings Trends —

(Unit: Million Yen)

Fiscal Year	Sales	Operating Income	Ordinary Income	Net Income	EPS	DPS
March 2010	620,376	-29,727	-33,831	-79,075	-521.91	0.00
March 2011	484,390	-23,607	-31,808	-40,889	-261.03	0.00
March 2012	459,436	4,585	2,349	1,588	9.40	0.00
March 2013	454,222	7,413	11,091	13,335	74.50	0.00
March 2014	471,089	13,673	11,574	15,229	67.17	0.00
March 2015 Est.	493,500	14,500	13,000	12,000	45.65	0.00

\*Estimates are those of the Company.

This Bridge Report reviews Leoplace21's first half of the fiscal year March 2015 earnings results.

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<Reference> [New Midterm Business Plan “EXPANDING VALUE” \(Fiscal Years March 2015 to 2017\)](#)

## Key Points

•Sales rose by 0.6% year-on-year to ¥233.0 billion during the first half of fiscal year March 2015. Sales of the leasing business grew while sales of the construction business fell. Higher sales, general and administrative expenses were absorbed by increases in gross income, which allowed operating income to rise by 13.4% year-on-year. Consequently operating income exceeded estimates despite sales remaining basically in line with estimates.

•Leopalace21's full year earnings estimates remain unchanged and call for sales to rise by 4.8% year-on-year to ¥493.5 billion based on anticipation of gains in all business sector sales. Operating income is also expected to rise by 6.0% year-on-year to ¥14.5 billion. Anticipatory investments are expected to boost sales, general and administrative expenses and hold profit growth down to single digits, but both sales and profits are expected to grow during the second half. Dividend payments are expected to be forgone during the current term in continuation of the trend from the previous term.

•There have been no significant changes in the operating environment, business deployment strategy, and earnings trends. In the short-term, occupancy rates need to be watched closely. As a change from the strategies adopted during the Lehman Shock period, the goal of Leopalace21 is no longer to maximize the value of orders of the construction business but to focus upon long term stability in earnings of the leasing business. Therefore, investors should be reminded to closely watch this change in strategy and to avoid overreacting to fluctuations in near term orders.

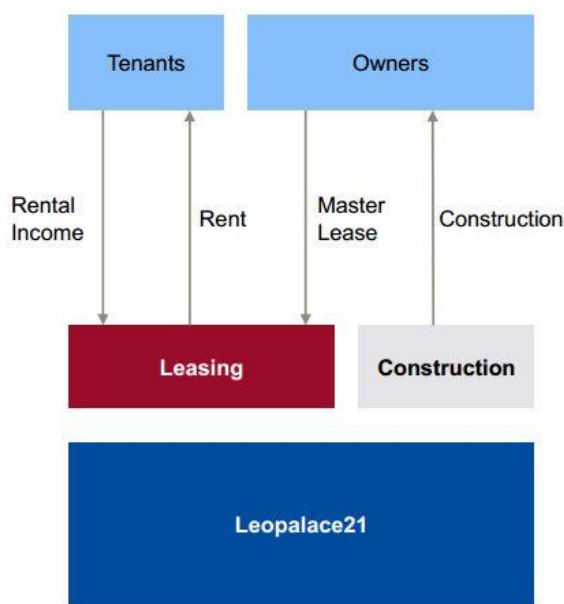
## 1. Company Overview

Leopalace21 was the first in the industry to offer “guaranteed leasing services” that integrate residential property and condominium construction, and management services after their construction to landowners seeking to make effective use of their real estate. Sales are primarily the rental income fees received from residents of apartments, condominiums, and other residential properties and construction work to build apartments and condominiums. Leopalace21 managed 551,545 units as of the end of September 2014 located primarily in the three major metropolitan areas of Japan including Tokyo, Nagoya, and Osaka. The Company is also aggressively promoting the installation of solar power electric generating systems and the deployment of its businesses in overseas markets.

### <Business Model>

Leopalace21 offers “guaranteed leasing services” that integrate residential property and condominium construction, and management services after their construction to landowners seeking to make effective use of their real estate. The “guaranteed leasing services” is a comprehensive support system where management and operational services for leased residential properties are provided to owners of apartments and condominiums. This system is an outsourcing service designed to reduce the burden of, and provide stable income to, rental property owners, and includes the specific functions of locating tenants, payment of rent, and management and repair services which are normally undertaken by the property owner themselves.

Leopalace21 enters into a contractual relationship with property owners for terms as long as 30 years, under which they agree to pay the property owners a fixed amount of rent regardless of whether or not the properties are occupied or vacant. After the initial fixed period is completed, the contract will be negotiated every two years to reflect actual prices in the real estate market. Sales of the “leasing business” are the rents paid by residents, and payment of rent to property owners is booked as the cost of sales. The “construction business” is another main source of the Company's revenues.



(Source: Leopalace21)

The potential for “negative spread” may occur in the event that a higher than expected amount of vacancies occurs during the fixed rent period. Therefore, holding down the amount of vacancies (Raising the resident occupancy rates), and acquiring appropriate levels of rental income are the most important factors for the profitability of Leopalace21.

“Increasing the provision of residential property construction by cultivating new property owners and expanding stable rental income through the acquisition of tenants” are the main factors driving Leopalace21’s earnings growth. However in the wake of the Lehman Shock in 2008, corporations were forced to reduce staff due to the rapid deterioration in their earnings. At Leopalace21, the increases in cancellation of its corporate contracts led to “negative spread” and a deterioration in the profitability of its leasing business. Furthermore, the tightening of loan screening requirements led to a sudden decline in the supply of new residential properties constructed, which had a large impact upon and led to stagnation in profitability of the construction business.

Against this backdrop, Leopalace21 maintained its business structure based on this system of guaranteed leasing services while also implementing the following measures to convert its business into a “stock basis” to acquire stable earnings.

Construction business contraction	Focus upon creating new supplies of housing in regions where high occupancy rates can be expected as a means of expanding earnings of the leasing business
Leasing business earnings improvement	Reducing costs of leasing, realizing appropriate rent
Construction of facilities that do not have guaranteed leasing	Expand the realm of construction business projects
Increase value addition of properties to increase resident satisfaction	Consider the viewpoint of tenants to increase stable, long-term tenant numbers

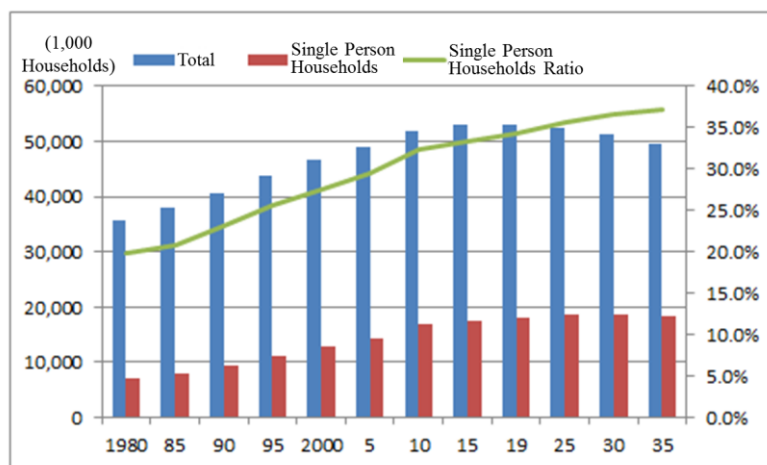
**<Market Environment>**

① Number of Household Trends

According the National Institute of Population and Social Security Research estimates, the number of Japanese households is expected to rise from 51.84 million in 2010 to a peak of 53.07 million in 2019, and thereafter decline to 49.56 million by 2035. Meanwhile, the number of single-person households is expected to rise from 16.79 million in 2010 to 18.46 million in 2035, and their share of total households is expected to rise from 32.4% to 37.2% over the same period.

The increase in single-person households represents a growing business opportunity for Leopalace21, which has traditionally focused upon the business of “one-room” studio type condominiums. Another key issue confronting the Company is how successfully it can expand its traditional customer base of younger aged tenants to include elderly tenants. In addition, Leopalace21 must also promote measures to capture individual resident contracts along with its traditional corporate contracts.

## <Trend in Number of Households in Japan>



Source: January 2013 Report, National Institute of Population and Social Security Research

\* Figures from 2010 and beyond are estimates. Right hand axis represents single person household share.

### ② New Housing Start Trends

New housing starts during fiscal year 2013 rose by 10.6% year-over-year to 987,254 units, marking the fourth consecutive year of growth. Furthermore, this double digit growth represents the highest growth rate in 26 years since 1987 when housing starts rose by 23.5%. The Ministry of Land, Infrastructure, Transport and Tourism attributes this strong rise to “both an improvement in consumer sentiment and extraordinary demand ahead of the implementation of a hike in the consumption tax” (Ministry of Land, Infrastructure, Transport and Tourism, Office for Statistical Research and Analysis on Economy in Construction Market).

While demand for real estate over the near to intermediate term is expected to remain strong in the run up to the Tokyo Olympics and Paralympics to be hosted by Tokyo in 2020, a continuation of this strong demand over the longer term is difficult to envision given the inevitability of population decline.

### ③ Rental Housing Replacement Construction Demand

However, with the view of “rental housing” from the perspective of being a “stock” business within the housing domain of Leopalace21’s business, a different prospect emerges.

According to data released in the Statistics Bureau, Ministry of Internal Affairs and Communications “2013 Housing and Land Statistics Survey Preliminary Estimates (Announced in July 2014),” of some 14.50 million units of privately owned rental homes, some 2.20 million homes were constructed before 1980.

With regard to the rental housing market, the overwhelmingly strong popularity and demand for newly constructed housing forces property owners to consider choosing between partial refurbishment and total rebuilding of their existing properties in order to raise occupancy rates. Consequently, Leopalace21 expects demand for reconstruction of the existing rental housing supply in the major cities throughout Japan to remain strong for the foreseeable future.

In addition to this replacement demand, revisions to the inheritance tax laws are also expected to act as a strong tailwind.

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Effective from January 1, 2015, the basic exemption for inheritance tax will be lowered and the amount subject to the inheritance tax will increase by a large margin. Consequently, demand for construction of rental housing is expected to increase significantly as property owners take advantage of property devaluation schemes by constructing rental housing.

## <Competitors>

The following list of companies may be considered to be competitors in the realm of the “guaranteed leasing services.”

Company	Market	Market Capitalization	Sales	Operating Income	Net Income	Assets	PER	PBR
Token Corporation (1766)	TSE1 <sup>st</sup>	70,189	266,610	9,475	5,895	53,076	11.9	1.3
Daito Trust Construction Co., Ltd. (1878)	TSE1 <sup>st</sup>	1,082,999	1,345,000	91,000	59,800	222,005	18.1	4.9
Japan Property Management Center Co., Ltd. (3276)	JQ	23,462	30,668	1,302	784	2,333	29.9	10.2
Leopalace21 Corporation (8848)	TSE1 <sup>st</sup>	172,445	493,500	14,500	12,000	104,860	14.4	1.6

\* Values are estimates of the current term. Net assets are as of end of the most recent quarter. Units are million yen. PER and PBR are ratios of the number of times. Market capitalization is based on November 21, 2014 closing share price.

Estimates based on the EPS target of ¥71.7 for fiscal year March 2017 according to the Midterm Business Plan call for PER to decrease to 9.1 times.

## <ROE Analysis>

	FY3/12	FY3/13	FY3/14
<b>ROE (%)</b>	4.8	29.0	18.7
Net Income to Sales Ratio (%)	0.4	2.9	3.2
Asset Turnover Ratio (x)	1.6	1.7	1.7
Leverage (x)	8.4	5.7	3.4

<Reference: TSE First Section ROE by Industry>

	FY3/13	FY3/14
All Industries (Exc. Finance)	5.28	8.71
Manufacturing	4.55	8.62
Non-Manufacturing	5.69	8.55
Real Estate	5.62	8.67

\* Source: TSE Homepage “Earnings Data Review”

Leopalace21’s ROE far exceeds the average for all industries and its own industry. In addition, while leverage declined due to the public offering conducted in December 2013, improvement in profit margins allowed the Company to achieve a high ROE of 18.7%. However, the impact of the increase in capital and the outlook for lower profits during the coming term is expected to lower ROE to just above 10%. Leopalace21 maintains an ROE target of 12.3%.

## <Business Description>

Leopalace21’s businesses can be divided into the five segments of “leasing,” “construction,” “elderly care,” “hotels and resort,” and “other” businesses. The main business segments are the “leasing” and “construction” businesses and they account for about 96% of total sales.

## <Leasing Business>

### Sales and Operating Income of ¥388.768 and ¥15.567 Billion Recorded in FY3/14

Leasing is Leopalace21’s main business, and it includes the guaranteed leasing services of apartments and condominiums

constructed, leasing, and property management services. In the leasing services, two contract types are provided including the straight forward “lease contract” that reduces the initial expenses of monthly management fees, and the “monthly contract” that assumes all of the costs for furnishing and utilities in exchange for a single upfront fee payment to the property owner. In both these instances, Leopalace21 books the rent received from tenants as sales. The rent net of service fees and other costs paid to landlords are booked as cost of sales.

## <Construction Business>

### **Sales and Operating Income of ¥63.135 and ¥2.954 Billion Recorded in FY3/14**

Construction of apartments, condominiums and other structures is conducted in this business segment. In recent years, Leopalace21 has begun focusing upon construction of commercial and nursing home facilities, which are not related to the guaranteed leasing services, in addition to construction connected to its guaranteed leasing services. Furthermore, the Company has also begun to focus its efforts upon sales of solar power electricity generating systems, and started the roof-lease solar power electric generation business from February 2013.

## <Elderly Care Business>

### **Sales and Operating Loss of ¥10.171 and ¥0.610 Billion Recorded in FY3/14**

As of end March 2014, a total of 61 facilities including “nursing home facilities,” “day care services,” “short stay services,” and “group homes” called “Azumi En” were operated in the Tokyo and surrounding six prefectures in an attempt to provide care service in local communities. In order to capture growing demand sparked by an expansion in the market, Leopalace21 is opening new facilities.

## <Hotels and Resort Business>

### **Sales and Operating Loss of ¥7.571 and ¥1.118 Billion Recorded in FY3/14**

Leopalace Guam Corporation, an overseas subsidiary, operates various resort facilities including golf courses, baseball fields, hotels, condominiums and other facilities on the island of Guam. Leopalace21 also operates another eight hotels within Japan. The hotels and resort business acts to support the expansion in Leopalace21’s main leasing and construction businesses. When conducting proposal based marketing to property owners, the recognition and reliability associated with Leopalace21’s hotel operations contributes to smooth negotiations. While this business currently operates at a loss, it boasts of positive cash flow and currently stands little risk of becoming the subject to impairment accounting.

## <Other Business>

### **Sales and Operating Income of ¥1.442 and ¥0.137 Billion Recorded in FY3/14**

In addition to the provision of short-term insurance on household items to residents of rental housing, Leopalace21 also provides finance, real estate sales, solar power electric generation facilities sales and other services through its subsidiary.

## 2. Characteristics and Strengths

### <Focus Upon Three Major Metropolitan Areas>

Of the approximately 550,000 rooms under management nationwide, about 70% are located in the greater Tokyo, Nagoya and Osaka regions. In these three regions there is still an inflow of population and by focusing on these regions, Leopalace21 is able to maintain high occupancy rates.

### <Strong Product Development Capability>

Leopalace21 remains in step with market conditions by developing products and services that match the market needs. Furthermore, it was the first company in the industry to introduce “rooms with lofts,” “guaranteed leasing services,” “monthly rentals,” “broadband-facilitated rooms,” and “furnished rooms.” Residents-oriented services and introduction of systems such as installation of furniture and home electrical appliances, “Room Customize”, and installation of security system contributed to the improvement in occupancy rates.



## Room Customize



(Source: Leopalace21)

### <High Quality Studio Apartments>

Because higher rental income is derived from one room type studio apartments rather than single family homes for the same floor space and property size under conditions when stable occupancy rates can be achieved, most property owners choose to build studio apartments or have Leopalace21 manage their smaller properties located primarily in metropolitan areas. The Company provides effective solutions to property owners with the ability to flexibly build studio apartments on properties where it would be difficult to build single family homes.

### <Nationwide Business Deployment>

As of end September 2014, Leopalace21 operated 179 offices directly and 149 offices through franchises for a total of 328 offices throughout Japan. This network enables the Company to provide services and products to customers nationwide, including services to help students and employees find conveniently located new residences. Another characteristic of Leopalace21 is its bountiful database of nationwide information on owners of idle and property characteristics, and the ability to propose effective solutions to these property owners.

## 3. First Half of Fiscal Year March 2015 Earnings Results Overview

### (1) Consolidated Earnings

(Units: Million Yen)

	1H FY3/14	Share	1H FY3/15	Share	YY Change	Divergence from Est.
Sales	231,673	100.0%	233,037	100.0%	+0.6%	-0.0%
Gross Income	32,329	14.0%	35,501	15.2%	+9.8%	+4.4%
SG&A	26,959	11.6%	29,413	12.6%	+9.1%	-2.0%
Operating Income	5,369	2.3%	6,087	2.6%	+13.4%	+52.2%
Ordinary Income	4,375	1.9%	5,546	2.4%	+26.8%	+58.5%
Net Income	3,921	1.7%	5,066	2.2%	+29.2%	+68.9%

### Sales, Profits Rise from Previous First Half, Sales in Line with Estimates

Sales rose by 0.6% year-on-year to ¥233.0 billion. While leasing business sales rose, construction business recorded a decline in sales. Sales, general and administrative expenses exceeded the previous first half, but the higher gross income absorbed these expenses and allowed operating income to rise by 13.4% year-on-year. The refund of noncurrent asset taxes and declines in interest payments allowed ordinary income to rise by 26.7% year-on-year, and reductions in corporate tax payments allowed net income to rise by approximately 30% year-on-year. While first half sales were basically in line with estimates, profits exceeded estimates.

### (2) Earnings Trends by Segment

(Units: Million Yen)

	Sales				Operating Income			
	1H FY3/14	1H FY3/15	YY Change	Divergence from Est.	1H FY3/14	1H FY3/15	YY Change	Divergence from Est.

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Leasing	191,876	197,432	+2.9%	+0.7%	6,201	9,561	+54.2%	+34.7%
Construction	30,415	24,650	-19.0%	-8.4%	970	-1,374	-2,344	-874
Elderly Care	5,050	5,275	+4.5%	+1.4%	-320	-237	+83	+163
Hotels and Resort	3,640	4,258	+17.0%	+3.9%	-320	-130	+190	+70
Other	690	1,418	+105.6%	+28.9%	150	262	+74.3%	+162.0%
Adjustments	-	-	-	-	-1,312	-1,994	-	-
Consolidated Total	231,673	233,037	+0.6%	-0.0%	5,369	6,087	+13.4%	+52.2%

\* Sales are those to external customers

## <Leasing Business>

- ✓ Sales rose by 2.9% year-on-year to ¥197.4 billion, exceeding estimates by 0.7%. Operating income reached ¥9.5 billion, exceeding that of both the previous first half and estimates by large margins.
- ✓ Leopalace21 recorded ¥1.5 billion in reversals from vacancy loss reserves compared with end of the previous fiscal year. Reversals in the full fiscal year are expected to reach ¥3.3 billion.
- ✓ Occupancy rates at the end of the first half rose by 2.05% points from the end of the previous first half to 86.33%, and the average occupancy rate during the first half also trended favorably rising 2.24% points year-on-year to 85.96%. Various efforts to improve customer satisfaction have contributed to the lengthening of lease contract periods and stabilized occupancy rates. Leopalace21 expects an average occupancy rate of 86.8% during fiscal year March 2015.
- ✓ Rent of new lease contracts rose by 1.4% year-on-year and 0.9% relative to estimates.
- ✓ Because of the popularity of newly constructed structures, occupancy rates in the Tokyo metropolitan region remain high. Strong demand in the 23 wards of central Tokyo ensures that rooms at newly constructed homes are immediately leased.
- ✓ The total number of offices stood at 336 at the end of September 2014, including 187 directly operated (Up 3 from the end of FY3/14, overseas offices remained unchanged at 8) and 149 franchise partner operated offices (Down 15 from the end of FY3/14). Leopalace21 will continue to pursue a strategy of “quality” over “quantity” and will fortify its training and instruction of franchise partners.
- ✓ Fortification of the corporate marketing function allowed the number of corporate contracts to rise by 7.4% year-on-year to 244,967 units, and the share of corporate contracts of all contracted units rose to 51.4%. At the same time, a new marketing team targeting schools for individual residential contracts was newly established. Therefore marketing efforts will be strengthened during the second half.
- ✓ The number of resident contracts formed with foreigners stood at 12,667 units at the end of September 2014, and the establishment of a special team and call center for foreigners has contributed to a steady increase in the number of contracts. By country of origin, foreigners from China, Vietnam and Korea accounted for 6,297, 1,496 and 1,293 units respectively. Residents from Vietnam surpassed Korea to become the second largest nationality of foreign residents due to the increase in the overall number of Vietnamese coming to Japan, including students. Furthermore, Leopalace21 is one of the few Japanese companies with capabilities in the Vietnamese language. Moreover, a local company was established in Kampuchea, an office in Myanmar, and a local company in Shanghai (For real estate sales) during August 2014.
- ✓ The “Room Customize” service has been received favorably by the market, and has become an important factor differentiating Leopalace21 from its competitors. The total number of aggregated units of this customized room service stood at 16,604 over the period from May 2012 to end September 2014. Coverage of this service by both television and magazines has contributed to an increase in its recognition and increased its popularity. Compared with the normal ratio of male to female residents of 70% to 30%, female residents of this “Room Customize” service account for 50% of the total, a reflection of the success in this service’s ability to capture female residents.
- ✓ LEONET (An Internet service that does not require separate contracts with specific providers), Leopalace Online Shopping, cleaning, delivery dry cleaning and other services have been launched for residents and can be accessed from the special resident website called “MY PAGE”. Other efforts to improve resident satisfaction are also being implemented through collaboration with corporations that are clients, and Leopalace21 seeks to achieve an



overwhelming level of comprehensive services that none of its competitors can approach.

- ✓ The number of security systems installed reached 206,407 units at the end of September 2014, for 37.4% installation rate. However, when the fact that the Company's strategy of installing security systems only in residential units that are less than 15 years old is considered, the installation rate of this target of residential units is approximately 50% of these newer residences. In addition to booking installation work as maintenance income, monthly usage fees are included in rent and is therefore a stock based form of income. Also, security cameras have already been installed in 4,184 buildings. Leopalace21 expects to fortify its competitive positioning through the installation of security cameras and shutters to increase the security and safety levels of its residential properties, and in response to the growing needs of female residents for increased security measures.

## <Construction Business>

- ✓ Sales fell below both the previous first half level and estimates to ¥24.6 billion. Installation of solar panels at the expense of the owners has been completed, and now the focus is shifting towards installation of solar panels on rented rooftop space by Leopalace21. Operating income also fell below the previous first half level and estimates due to intensified competition and increased costs. First half orders fell by ¥2.8 billion from the previous first half due primarily to the solar electric power systems, but orders for apartment construction actually turned favorable. Fortification of marketing function through increases in sales staff will be implemented and the focus upon certain geographic regions will be continued to grow orders.
- ✓ While orders during the April to June period were slightly weak, the goal of the construction business is not to merely maximize the value of orders, but to acquire orders for construction projects that will lead to stability in leasing earnings. Therefore investors should not be put off by volatility in month to month orders as it is a reflection of a deliberate effort to become more selective in orders booked.
- ✓ At the same time, the rise in construction costs during the second quarter (July to September) is a slight concern.
- ✓ The number of construction business offices stood at 60 at the end of September 2014. Due to the deliberate selective order booking strategy, 44% of construction sales were derived from the Tokyo metropolitan region, with 64% being derived from the three major metropolitan regions.
- ✓ Sales of "UNI-BIRTH" package that includes installments sought after by residents living alone for the first time (Including wireless LAN, security systems, bunk beds, separate wash basins, interior clothes drying racks, heated toilet seats with cleaning function, and others) were started in May 2014.
- ✓ Improvements were made to the sound insulating and isolating facility "Non Sound Floor," which was launched in April 2013, to create a new system called "Non Sound System." "Non Sound Floor" has been installed in steel framed housing units as standard equipment since July 2013.
- ✓ Leopalace21 formed an alliance with Morizou Co., Ltd., which sells custom built homes using cypress wood construction materials, for the sale of "TAIGA" custom built homes from May 2014. Preparation of an extensive lineup of various homes that maximize the efficient use of real estate has been underway.
- ✓ Construction sales of business-use buildings for senior citizens rose by a large margin of ¥0.81 billion from the previous first half to ¥2.24 billion in the current term, but sales of commercial facilities declined from the previous first half.
- ✓ The total aggregated number of solar panel electric generating systems installed by owners stood at 6,816 at the end of September 2014. The number installed by Leopalace21 on rented rooftop space stood at 4,054, for a combined total of 10,870 installations.

## <Elderly Care Business>

The chain of nursing care facilities named "Azumi En" boasted of 61 facilities operating in Tokyo and six prefectures as of the end of September 2014. The midterm business plan calls for the opening of another 29 facilities over three years, bringing the total number of facilities to 90. On November 1, 2014, "Azumi En Kisarazu" (Chiba prefecture) was opened.

During the first half, operating rates of short stay and pay nursing care homes exceeded both the previous first half level and estimates. However, operating rates of day services fell below both the previous first half and estimates. Losses continue to be booked at the operating level, however Leopalace21 is endeavoring to achieve profitability on the back of

growth in the number of users. Furthermore, nursing care robots are being introduced.

#### <Hotels and Resort Business>

Sales of hotels within Japan recorded growth compared with the previous first half to ¥1.2 billion, but fell short of estimates. Occupancy rates exceeded both the previous first half level and estimates. Consequently, the Company recorded operating income of ¥10 million, exceeding estimates but falling short of the previous year's level.

Sales of the Guam resort hotel exceeded both the previous first half and estimates on the back of favorable occupancy rates. In order to increase occupancy rates by raising the number of military staff accompanying the military tactical exercises staying at the facility, a comprehensive usage contract was formed with the United States military at the end of April 2014. Usage by United States military started in August.

#### < Business of Installing Solar Panel Electric Generating Systems on Rented Rooftop >

¥14.6 of the ¥24.6 billion of funds sourced in the public offering of shares conducted last year was used for the “business of installing solar power electric generating systems on rented rooftop.” The business boasts of approximately 2,900 installations with a power output capacity of 45.5 MW, electric power sales of ¥1.1 billion and electric output of 30,000 MWh. Furthermore, efforts are being made to install another 1,000 units of solar panel electric generating systems on rented rooftops for which approval has already been received and bank loans have been sourced. Electric power sales are booked under the “others” business category.

	FY3/14	1H FY3/15	FY3/15 Est.	Aggregate
Units Installed	1,114	1,678	3,800	2,792
Units Generating Electricity	680	1,845	3,600	2,525
Electric Power Output Capacity	21.4 MW	19.5 MW	55.0 MW	40.9 MW
Electric Power Sales	¥0.10bn	¥0.65bn	¥1.22bn	¥0.76bn
Electric Power Output	About 2,700 MWh	About 16,400 MWh	About 30,500 MWh	About 19,100 MWh

\* Fukushima validation model includes 67 units for 1.2 MW of capacity. Electric power output during each term.

“Leopalace Energy Co., Ltd.” was established as a new electric power company (PPS) in May 2014 and was capitalized at ¥20.00 million. In this business, electric power generated by systems placed on rooftops of apartments will be provided to customers needing electric power. With a view to the impending complete deregulation of small lot electric power sales in 2016, the Company is considering the sale of electricity to residents living in apartments.

\* New electric power company (PPS: Power Producer and Supplier): This name is given to companies with specific production capacity of electric power aside from the major general electric power companies (Hokkaido Electric Power Co., Inc., Tohoku Electric Power Co., Inc., Tokyo Electric Power Co., Inc., Hokuriku Electric Power Co., Inc., Chubu Electric Power Co., Inc., Kansai Electric Power Co., Inc., Chugoku Electric Power Co., Inc., Shikoku Electric Power Co., Inc., Kyushu Electric Power Co., Inc., Okinawa Electric Power Co., Inc.) that use electric power lines of general electric power companies to supply electricity to contracted users of over 50 KW. This marks the entry of Leopalace21 as a new electric power company.

#### <Leasing Business Overseas Deployment>

Real estate services for Japanese residents and companies in Korea and Taiwan have been started. Real estate services in Thailand and Vietnam were started in December 2013, and in Singapore, Myanmar and Shanghai on August 1, 2014. Moreover, Leopalace21 established a joint venture company called “Woori & Leo PMC Co., Ltd.” in February 2014 to leverage its knowhow cultivated within Japan to capture opportunities in leasing market in Korea, which is expected to grow. As of the end of September 2014, Woori & Leo PMC has booked consigned management contracts for 178 residential units. The initial growth in the business is slow due to the lack of familiarity with the leasing management system in Korea, but Woori & Leo PMC will conduct effective presentations to explain the system and to expand this business.

The number of overseas offices in China, Korea, Taiwan, Thailand, Vietnam, Singapore and Myanmar stood at 5, 3, 1, 1,

# Bridge Report



1, 1, and 1 respectively, for a total of 13 offices.

## (3) Financial Conditions and Cash Flow

### ◎Financial Conditions

(Unit: Million Yen)

	3/14 End	9/14 End		3/14 End	9/14 End
Cash, Equivalents	74,767	62,257	Payables	2,685	2,573
Receivables	5,490	4,351	Unpaid Construction Expenses	12,128	7,376
Outstanding Fees for Completed Construction	1,651	966	Short-Term Interest Bearing Liabilities	3,500	29,005
Prepayments	6,679	4,844	Outstanding Payments	16,001	13,022
Current Assets	102,324	85,637	Prepayments Received	45,051	39,668
Buildings, Structures	57,073	55,032	Current Liabilities	92,560	106,225
Land	81,800	81,338	Long-Term Interest Bearing Liabilities	27,997	2,378
Lease Assets	5,167	6,333	Long-Term Prepayments Received	27,628	23,527
Marketable Securities	7,257	7,043	Long-Term Security Deposits	8,492	8,277
Long-Term Expense Prepayments	3,719	3,230	Vacancy Loss Reserves	9,352	7,813
Noncurrent Assets	185,100	188,871	Retirement Reserves	10,050	8,697
Total Assets	287,459	274,536	Noncurrent Liabilities	90,037	58,120
			Total Liabilities	182,598	164,345
			Net Assets	104,860	110,190
			Total Liabilities, Net Assets	287,459	274,536

	3/10 End	3/11 End	3/12 End	3/13 End	3/14 End	9/14 End
Capital	70,890	33,025	33,804	58,133	104,829	110,172
Equity Ratio	17.9%	11.1%	12.8%	22.2%	36.5%	40.1%
Interest Bearing Liabilities	56,481	39,888	48,305	46,874	31,497	31,383
Cash, Equivalents	72,431	40,674	41,477	56,681	74,767	62,257
NDE Ratio	-0.23	-0.02	0.20	-0.17	-0.41	-0.28

\* Interest bearing liabilities exclude lease liabilities. NDE Ratio = (Interest bearing liabilities - Cash) / Capital

Compared with the end of March 2014, machinery equipment and transportation equipment associated with the solar power electric generating systems on rented rooftops business increased by ¥6.8 billion, while cash and equivalents and accounts receivables declined, causing total assets to fall by ¥12.9 billion from the end of the previous fiscal year to ¥274.5 billion.

With regards to liabilities, short-term liabilities grew while long-term liabilities fell, causing total interest bearing liabilities to remain in line with the level recorded at the end of the previous fiscal year. Declines in unpaid construction expense and vacancy loss reserves contributed to a ¥18.2 billion contraction in total liabilities to ¥164.3 billion over the same period. The negative balance of foreign exchange translation provisional account increased, but the higher profits and increases in shareholder's equity allowed net assets to rise by ¥5.3 billion to ¥110.1 billion over the same period. Consequently, equity ratio rose by 3.6% points to 40.1% over the same period.

### ◎Cash Flow

(Unit: Million Yen)

	1H FY3/14	1H FY3/15	YY Change
Operating Cash Flow	-6,350	-3,675	+2,675
Investing Cash Flow	-1,205	-7,671	-6,466
Free Cash Flow	-7,555	-11,346	-3,791
Financing Cash Flow	-3,388	-1,138	+2,250

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Cash, Equivalents at Term End	45,583	61,640	+16,057
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Declines in vacancy loss reserves and reduction in the decline in prepayments received contributed to a contraction in the margin of net outflow of operating cash flow. Increases in the acquisition value of tangible noncurrent assets contributed to an expansion in the net outflow of investing cash flow. Consequently, the margin of net outflow in free cash flow expanded. The margin of net outflow of financing cash flow contracted due to the assumption of long-term debt. Consequently, cash position increased.

## 4. Fiscal Year March 2015 Earnings Estimates

### (1) Consolidated Earnings

(Units: Million Yen)

	FY3/14	Share	FY3/15 Est.	Share	YY Change	Attainment Rate
Sales	471,089	100.0%	493,500	100.0%	+4.8%	47.2%
Gross Income	69,579	14.8%	75,500	15.3%	+8.5%	47.0%
SG&A	55,906	11.9%	61,000	12.4%	+9.1%	48.2%
Operating Income	13,673	2.9%	14,500	2.9%	+6.0%	42.0%
Ordinary Income	11,574	2.5%	13,000	2.6%	+12.3%	42.7%
Net Income	15,229	3.2%	12,000	2.4%	-21.2%	42.2%

### Estimates Unchanged, Call for Small Rise in Sales, Margin of Increase in Operating Income Expected to Contract due to Anticipatory Investments

Leopalace21 maintained its existing earnings estimates without any changes. Consequently sales are expected to rise by 4.8% year-on-year to ¥493.5 billion on the back of increases in sales of all business segments. Operating income is expected rise by 6.0% year-on-year to ¥14.5 billion, on the back of a 0.5% point increase in gross income margin and increases in sales, general and administrative expenses arising from hiring of staff for the construction business, amortization from introduction of a new information system, and other anticipatory investments. Because of the outlook for the occurrence of a corporate tax adjustment amount of -¥5.1 billion for March 2014, net income is expected to decline by 21.2% year-on-year. Leopalace21 hopes to reinstate dividend payments as soon as possible.

### (2) Business Segment Trends

(Units: Million Yen)

	Sales				Operating Income			
	FY3/14	FY3/15 Est.	YY Change	Attainment Rate	FY3/14	FY3/15 Est.	YY Change	Attainment Rate
Leasing	388,768	397,000	+2.1%	49.7%	15,567	17,500	+12.4%	54.6%
Construction	63,135	75,000	+18.8%	32.9%	2,954	4,000	+35.4%	-
Elderly Care	10,171	10,500	+3.2%	50.2%	-610	-1,000	-390	-
Hotels and Resort	7,571	8,000	+5.7%	53.2%	-1,118	-700	+418	-
Other	1,442	3,000	+108.0%	47.3%	137	-100	-237	-
Adjustments	-	-	-	-	-3,256	-5,300	-	-
Total	471,089	493,500	+4.8%	47.2%	13,672	14,500	+6.0%	42.0%

\* Sales are to external clients.

#### <Leasing Business>

As described earlier in this report, Leopalace21 expects to boost its average occupancy rate by over 2% points from the previous term to 86.8% in fiscal year March 2015. Improvements in profitability are also expected to boost gross income margin from 13.9% to 14.8% over the same period.

#### <Construction Business>

Leopalace21 is expected to continue to focus upon booking of orders in regions that enjoy high occupancy rates.

However, a lack of manpower is contributing to increases in construction costs and gross income margin is expected to decline by 1% point year-on-year from 23.7% in the previous term to 22.7% in the current term.

While sales of the elderly care business are expected to rise, anticipatory investments are expected to cause the margin of loss to increase. Leopalace21 will endeavor to improve its hospitality a step further by focusing upon the provision of services that satisfy the needs of a wide range of stakeholders in its hotels and resort business.

## 5. Conclusions

There appears to be no large changes in the operating environment, business deployment strategy, and earnings trend. In the near term, occupancy rates need to be watched closely.

**At the same time, a change in strategies adopted during the Lehman Shock period is being implemented with a shift in the Company's focus from the maximization of the value of construction business orders to the securing of long-term stability in earnings of the leasing business. Therefore, investors should also be reminded to avoid overreacting to fluctuations in term orders on a monthly or quarterly basis.**

### <Reference>

#### **New Midterm Business Plan “EXPANDING VALUE” (Fiscal Years March 2015 to 2017)**

Fiscal year March 2015 marks the final year of the Midterm Business Plan “Creating Future” first announced in May 2010. However, given the large changes in the business environment since the initial announcement of the current plan, Leopalace21 has created and launched a new three year Midterm Business Plan “EXPANDING VALUE”.

#### <1. External Environment>

- ✓ New housing starts have recovered since the large declines recorded in the aftermath of the Lehman Shock and are increasing. The rush to beat the hike in the consumption tax at the end of fiscal year 2013 contributed to strong demand, and boosted new housing starts by 10.5% year-over-year to 987,000 units. And while a near term decline in the wake of the rush to beat the consumption tax hike is anticipated, demand overall during the coming year is expected to remain favorable.
- ✓ During the past three consecutive years, the seven regions that saw an excess of new residents were Tokyo, Kanagawa, Saitama, Aichi, Fukuoka, Osaka and Okinawa.
- ✓ As explained earlier, replacement demand for the some 800,000 privately owned rental homes is expected to expand in the major metropolitan regions (Tokyo, Nagoya, Osaka, and Fukuoka). In addition, demand to reduce inheritance tax by using rental housing property valuation reduction schemes is also expected to increase.
- ✓ In the run up to the 2020 Tokyo Olympics, real estate demand is expected to grow.

#### <2. Overview>

##### ① Corporate Motto

Leopalace21 maintains a basic strategy of “focus on core businesses and challenging itself with new business fields”. And in the pursuit of new value addition sought after currently, the Company will implement a strategy called “EXPANDING VALUE” to expand its realm of activities.

##### ② Reflecting Upon the Previous Midterm Business Plan

The basic goal of the previous Midterm Business Plan of “establishing a stable earnings structure that strikes a balance between the leasing and construction businesses” has been achieved.

Points Achieved	Outstanding Issues
<ul style="list-style-type: none"> <li>• Profit increase arising from improvement in leasing income</li> <li>• Promote solar power electricity generation, security systems, and other services to raise value of properties</li> </ul>	<ul style="list-style-type: none"> <li>• Acquire individual residents</li> <li>• Improve profitability of construction business</li> <li>• Expansion of new businesses (Overseas deployment)</li> </ul>



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• Promote orders, construction of structures other than apartments (Nursing homes, commercial facilities)	• Expansion of elderly care business
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### ③ Quantitative Targets

#### <Earnings Trend>

(Units: Billion Yen)

	FY3/13	FY3/14	FY3/15 Est.	FY3/16 Target	FY3/17 Target
Sales	454.2	471.0	493.5	525.0	540.0
Operating Income	7.4	13.6	14.5	19.5	22.0
Ordinary Income	11.0	11.5	13.0	18.0	21.0
Net Income	13.3	15.2	12.0	16.0	19.0
EPS (¥)	74.5	67.2	45.5	61.9	71.7
Equity Ratio	22.2%	36.5%	41.0%	45.0%	48.0%
ROE	29.0%	18.7%	10.0%	12.0%	12.3%
ROA	5.1%	5.5%	4.2%	5.5%	6.0%

\* From fiscal year March 2015 onwards, tax effect accounting is not anticipated.

Through the improvement of profitability based upon its core business, the New Midterm Business Plan calls for sales, and operating and net incomes to grow by 14.9%, 52.9% and 23.7% respectively in fiscal year March 2017 over fiscal year March 2014.

#### <Segment Business Trend>

(Units: Billion Yen)

	FY3/13	FY3/14	FY3/15 Est.	FY3/16 Target	FY3/17 Target
<b>Leasing</b>					
Sales	383.5	388.7	397.0	407.0	414.5
Operating Income	8.6	15.5	17.5	18.0	18.5
<b>Construction</b>					
Sales	53.3	63.1	75.0	92.5	100.0
Operating Income	2.7	2.9	4.0	7.5	9.0
<b>Elderly Care</b>					
Sales	9.4	10.1	10.5	13.5	15.0
Operating Income	-0.7	-0.6	-1.0	-1.4	-0.6
<b>Hotels and Resort</b>					
Sales	6.6	7.5	8.0	8.0	8.0
Operating Income	-1.0	-1.1	-0.7	-0.9	-0.9
<b>Others</b>					
Sales	1.1	1.4	3.0	3.5	3.5
Operating Income	0.0	0.1	-0.1	-0.1	0.0

Leopalace21 seeks to maintain stable growth in the earnings of its leasing business, while growing both sales and operating income of its construction business. At the same time, the elderly care business is expected to continue to see losses over the next three years due to anticipatory expenses to secure staff for its facilities. In addition, the increase in other business sales is expected to be derived from sales of solar power electricity generation systems.

### <3. Business Strategy>

#### ① Leasing Business

	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Term End Rooms Managed (1,000)	556	546	549	557	567	578
Term Average Occupancy Rates (%)	81.2	82.9	84.6	86.8	88.0	89.0

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- ✓ The targets for the number of rooms managed and occupancy rates are 580,000 and 89.0% respectively. These figures represent a conservative increase of 30,000 from the actual figure recorded in fiscal year March 2014 on the back of replacement demand.
- ✓ Therefore, Leopalace21 will leverage its directly operated offices as well as its “Leopalace Partners” franchised offices and partnerships with real estate companies to capture tenants.
- ✓ Furthermore, the Company seeks to differentiate itself from its competitors through an expansion of its tenant services.
- ✓ The “MY PAGE” website designed especially for tenants has begun to offer special services and products of collaborating companies. Currently, there are 15 collaborating companies that use this website to market their products and services. Given the large potential customer base of 550,000 tenants, this business is expected to grow strongly in the future.

## ② Construction Business

	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Sales (Billion Yen)	107.8	62.9	53.3	63.1	<b>75.0</b>	<b>92.5</b>	<b>100.0</b>
Operating Margin (%)	33.8	26.6	24.7	23.7	<b>22.8</b>	<b>24.5</b>	<b>25.1</b>

- ✓ The hosting of the 2020 Olympics by Tokyo is expected to allow occupancy rates in the leasing business to trend strongly in the major metropolitan areas. Based upon this outlook, Leopalace21 is expected to leverage this opportunity to expand its sales to achieve its sales target of ¥100.0 billion in the final year of the New Midterm Business Plan.
- ✓ In order to achieve this sales target, the number of offices has been expanded to 60, and the number of staff has been doubled from the level two years previous to 510 at end April 2014.
- ✓ Among the specific strategies are measures to expand orders and construction of apartments that have been fortified to respond to the needs of tenants. Also, efforts to fortify product lineup to respond to the requirements of various properties are also anticipated for nursing homes, commercial facilities, and custom ordered homes.
- ✓ With regard to custom ordered homes, the Company has taken orders for about 10 units each year since some time ago. However in order to prepare for full scale construction, Leopalace21 has formed a collaborative alliance with “Morizou Co., Ltd.,” which boasts of a track record in homes using Japanese cypress trees, and has begun to take orders. This product lineup targets property owners rather than developing a wide range of customers and acts as a product to expand earnings.

## ③ Elderly Care Business

- ✓ In order to respond to the expansion in the number of senior citizens, the elderly care business segment has been identified as a strategically important business and a “marketing division” function has been added to this segment in reflection of its growing importance as a core business.
- ✓ Leopalace21 will promote opening of new nursing home facilities through proposal to property owners and pursue economies of scale.
- ✓ As of March 2014, a total of 61 facilities were in operation, and the target is 90 in the final year of the New Midterm Business Plan.
- ✓ The securing of employees to staff new facility openings is expected to contribute to increased expenses and continued losses during fiscal years March 2015 and 2016. However in the final year of the New Plan, a profit at the operating level is expected to be achieved.

## ④ Hotels and Resort Business

Leopalace21 seeks to provide high quality hospitality and the best possible service to its stakeholders at the Leopalace Hotels and Guam Resort. Also, this business will contribute to the promotion of sales in its core businesses (Leasing and construction).

**⑤ Solar Power Electricity Generation Business**

- ✓ In addition to the traditional flow type business of solar power electricity generation business, the electric power generation subsidiary “Leopalace Power” will rent rooftop space to install its own solar power electricity generating systems.
- ✓ As of end March 2014, Leopalace21 had installed solar power electricity generating systems on a total of 9,001 buildings, including the installation of systems by the expense of property owners and by Leopalace21.
- ✓ Approximately ¥15.0 billion of the total funds raised by the financing through public offering conducted in December 2013, is expected to be spent on installing solar panels on 3,000 buildings. As of now, solar panels have been installed on 2,792 buildings.
- ✓ Most all of the divisions in the “others” business segment are expected to see increases in sales. Profitability in this business is expected to begin contributing to overall earnings from the fourth year of operations due to the large depreciation burden in the initial phases of this business.

**⑥ Overseas Business**

- ✓ Leopalace21 will fortify both its inbound and outbound business services in Southeast Asia, and strengthen its relations with companies inside Japan..
- ✓ Leopalace21 currently operates 12 offices in six countries, and targets 20 offices to be operating in the final year of the New Plan.
- ✓ In addition, the Company is expected to continue to secure additional staff for both its construction and elderly care business segments.

**⑦ New Businesses Endeavors**

Leopalace21 is expected to make aggressive investments to secure growth in peripheral businesses (Solar power electricity generation systems installed on rented rooftops, nursing home construction, elderly care business) related to its core business segments (Leasing and construction businesses) and new businesses (Overseas real estate, ASEAN region real estate development).

**<4. Finance>****① Cash Flow**

Operating cash flow is expected to increase along with the Company’s earnings. The net outflow of cash in investing activities is expected to increase during fiscal year March 2015 due to investments in solar power electricity generation systems. But in fiscal year March 2016 and 2017, free cash flow is expected to improve considerably.

(Units: Billion Yen)

Cash Flow	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Operating	6.0	15.5	<b>18.0</b>	<b>22.0</b>	<b>26.0</b>
Investing	-0.0	-6.9	<b>-11.0</b>	<b>-2.5</b>	<b>-2.5</b>
Free	6.0	8.6	<b>7.0</b>	<b>19.5</b>	<b>23.5</b>

**② Capital Strategy**

Net assets are expected to be fortified in the coming terms along with strong performance in net income. Based upon this fortified financial position, aggressive investments are expected to be made in new businesses.

(Units: Billion Yen, %)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Net Assets	58.1	104.8	<b>117.0</b>	<b>133.0</b>	<b>152.0</b>
Equity Ratio	22.2	36.5	<b>41.0</b>	<b>45.0</b>	<b>48.0</b>

**③ Dividend Strategy**



(Units: Billion Yen)

	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Retained Earnings	-51.1	-49.7	-37.9	-23.3	-11.0	5.0	22.0
Capital	56.5	56.5	62.8	75.2	75.2	75.2	75.2
Capital Reserves	33.7	33.2	39.4	51.5	51.5	51.5	51.5

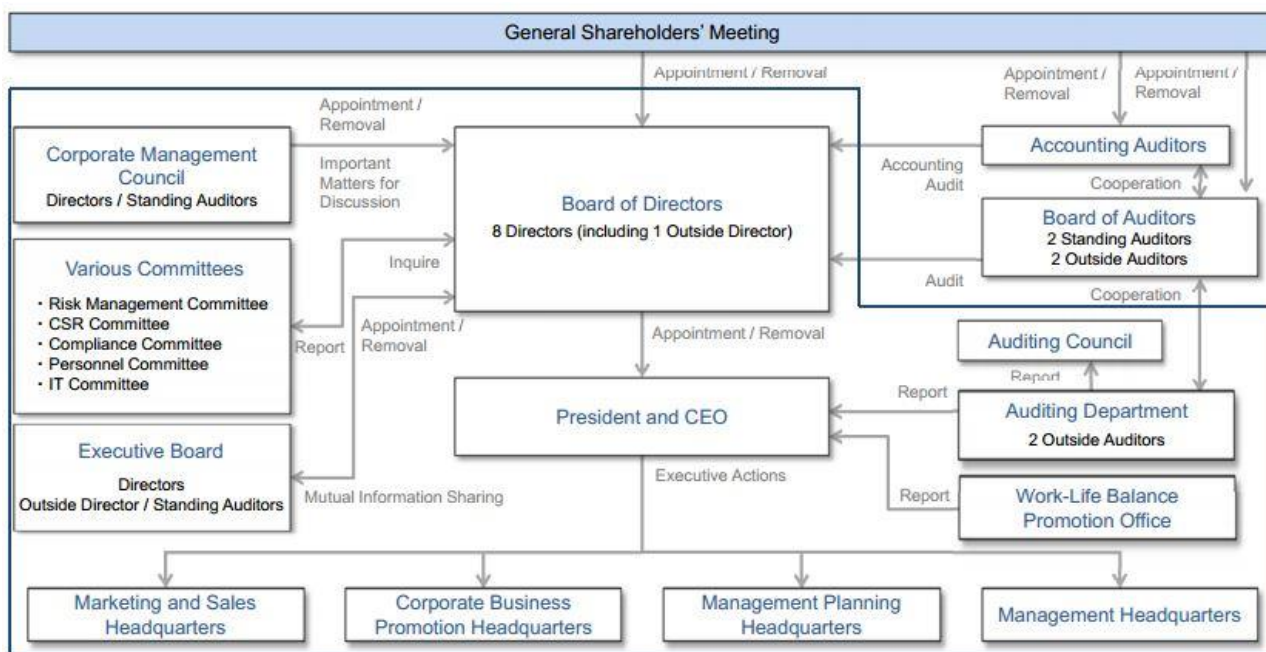
The stockpiling of earnings is expected to allow retained earnings to grow and enable Leopalace21 to reinstate dividend payments at an early stage.

<5. Governance, CSR>

① Corporate Governance

Leopalace21 identifies the maintenance of a strong corporate governance structure as a highly important management issue. Furthermore, the Company will endeavor to conduct a management strategy that achieves high levels of transparency, fairness and efficiency to promote higher value addition for all of its stakeholders.

Moreover, an external director has been appointed as one of the eight directors.



(Source: Leopalace21)

② CSR

Based upon the corporate philosophy of “creating new value,” Leopalace21 endeavors to contribute to a sustainable society, in addition to respond to the expectations of its customers and various stakeholders and contribute to their development. Specifically, the Company is implementing the measures listed below.

Provision of housing that matches tenant lifestyles
24 hour apartment supervision services
ISO 9001 certification acquisition
Cleanup campaigns of the areas surrounding managed properties
Introduction of solar power electricity generation systems
Promotion of good work-life balance
Diversification of human resources through hiring of foreigners and women
Aggressive investor relations activities

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From the perspective of securing human resources given the declining population caused by falling birthrates and aging of the population, the number of companies increasing their hiring of a diverse range of human resources is on the rise and Leopalace21 is seeks to provide work opportunities for foreigners and women.

With regard to the development of one room studio type condominium products such as “Arma-L” and “Arma-L tri-EL,” hit products have been created by taking the opinions of female employees into consideration. At the same time, a special sales team composed of only female staff has been formed to conduct marketing to industries where female sales staff are more effective. Female staff are also selected to become team leaders and are increasingly selected for managerial positions.

In addition, Leopalace21’s businesses are being offered both inbound and outbound to Japan and in overseas markets, with rapid increases in employment of local staff in overseas markets and foreigners within Japan being seen in recent years. At the same time, foreign employees are increasingly being selected to serve in managerial positions.

Employee Numbers	End 3/12	End 3/13	End 3/14	as of Oct. 1
Males	4,225	4,366	4,542	4,664
Females	2,151	2,330	2,584	2,701
Female Managers	36	39	44	58
Foreigners	120	157	185	195
Foreigner Managers	16	16	18	22

\*Consolidated basis

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