Consolidated Financial Statements (Japanese Accounting Standard)

February 7, 2020

(For the nine months ended December 31, 2019)

Name of Company Listed: **Leopalace21 Corporation**
Stock Listing: Tokyo Stock Exchange
Code Number: 8848
URL: http://eg.leopalace21.com/
Location of Head Office: Tokyo
Representative: Position: President and CEO Name: Bunya Miyao
Name of Contact Person: Position: Executive Officer Name: Kiyoshi Arai Telephone: +81-50-2016-2907
Scheduled Date of Filing of Securities Report (Japanese only): February 12, 2020
Scheduled Date of Commencement of Dividend Payments: —
Supplemental Explanatory Material Prepared: Yes
Results Briefing Held: No

1. Results for the Nine Months ended December 31, 2019 (April 1, 2019 through December 31, 2019)

(1) Consolidated financial results

(Amounts less than one million yen are omitted)

(The percentage figures indicate rate of gain or loss compared with the same period last year)

	Net sales		Operating profit		Recurring profit		Net income attributable to shareholders of the parent	
	Million yen	%	Million yen	%	Million yen	%	Million yen	%
Nine months ended December 31, 2019	328,721	(12.7)	(22,805)	—	(22,131)	—	(24,137)	—
Nine months ended December 31, 2018	376,366	(2.4)	6,502	(65.3)	6,246	(66.4)	(43,989)	—

(Note) Comprehensive income in the nine months ended December 31, 2019: (24,324) million yen (—%);
Nine months ended December 31, 2018: (44,044) million yen (—%)

	Net income per share	Diluted net income per share
	Yen	Yen
Nine months ended December 31, 2019	(98.93)	—
Nine months ended December 31, 2018	(177.85)	—

(2) Consolidated financial position

	Total assets	Net assets	Equity ratio
	Million yen	Million yen	%
As of December 31, 2019	244,825	57,045	23.2
As of March 31, 2019	291,790	81,338	27.7

(Reference) Shareholders' equity as of December 31, 2019: 56,758 million yen; as of March 31, 2019: 80,915 million yen

2. Dividend Status

	Dividend per share				
	End of Q1	End of Q2	End of Q3	End of FY	Annual
	Yen	Yen	Yen	Yen	Yen
FY ended March 31, 2019	—	0.00	—	0.00	0.00
FY ending March 31, 2020	—	0.00	—		
FY ending March 31, 2020 (Estimate)				0.00	0.00

(Note) Restatement of most recent dividend forecast: None

3. Consolidated Earnings Forecasts for the Fiscal Year ending March 31, 2020 (April 1, 2019 through March 31, 2020)

(The percentage figures for full year indicate rate of gain or loss compared with the previous FY, while those for the interim period indicate rate of gain or loss compared with the same term in the previous FY)

	Net sales		Operating profit		Recurring profit		Net income attributable to shareholders of the parent		Net income per share
	Million yen	%	Million yen	%	Million yen	%	Million yen	%	Yen
FY ending March 31, 2020	447,300	(11.5)	(28,000)	—	(27,800)	—	(30,400)	—	(124.62)

(Note) Restatement of most recent consolidated earnings forecasts: None

4. Other

(1) Changes in major subsidiaries during the subject period (change in specific subsidiaries resulting in a change in the scope of consolidation): None

(2) Use of accounting procedures specific to the preparation of quarterly financial statements: Yes
(Note) Refer for details to p.11 "2. Consolidated financial statements (3) Notes Regarding Consolidated Financial Statements "Application of accounting methods specific to the preparation of quarterly consolidated financial statements."

(3) Changes in accounting principles, procedures or reporting methods used in preparation of financial statements
 (i) Changes in accounting policies accompanying revision of accounting standards, etc.: None
 (ii) Changes in accounting policies other than (i) above: None
 (iii) Changes in accounting estimates: None
 (iv) Restatements: None

(4) Total number of outstanding shares (common stock)
 (i) Total number of outstanding shares at term end (including treasury stock)
  As of December 31, 2019: 244,882,515 shares, As of March 31, 2019: 244,882,515 shares
 (ii) Total treasury stock at term end
  As of December 31, 2019: 771,210 shares, As of March 31, 2019: 1,067,510 shares
 (iii) Average number of outstanding shares during the period (on a quarterly cumulative basis)
  As of December 31, 2019: 243,978,188 shares, As of December 31, 2018: 247,343,718 shares

*Indication regarding the status of auditing:
These financial statements are not subject to auditing under the Financial Instruments and Exchange Act.

*Explanation on the proper use of the business forecasts, and other special notices:
(Note on the business forecasts and other forward-looking statements)
The business forecasts and other forward-looking statements contained in this report are based on information currently available to Leopalace21 (hereinafter the "Company") and on certain assumptions that the Company has judged to be reasonable. Readers should be aware that a variety of factors might cause actual results to differ significantly from these forecasts.
For assumptions of business forecasts and notes on the proper use of these forecasts, please refer to p. 6 "1. Business Results (3) Explanation of Consolidated Earnings Forecasts and Other Future Predictions."

(Method for the acquisition of supplemental explanatory material)
Supplemental Explanatory Material on quarterly financial statements is scheduled to be posted on the Company's website on February 7, 2020.

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1. Business Results
(1) Analysis of Business Results

Before explanations concerning business results, we sincerely apologize to the parties concerned, including the owners and tenants of properties constructed by the Company as well as all our stakeholders, for the distress and trouble we have caused due to construction defects confirmed in certain properties constructed by the Company. Construction defects include parting walls defects, discrepancies of insulation materials in parting walls, exterior wall structures not meeting qualifications certified by the Minister of Land, Infrastructure, Transport and Tourism (hereinafter the "Minister"), defects in the ceilings, and the noncompliant parting walls in fire-proof structure with the specifications certified by the Minister (the defects mentioned above collectively hereinafter the "defects related to parting walls and other things").

The Company takes seriously the defects problem related to parting walls and other things which should not have been caused by a construction company dealing in apartment buildings. We will continue to conduct repair works of apartments in unison and make every effort to prevent recurrence of such a problem.

(Million yen)

	Net sales	Operating profit	Recurring profit	Net income attributable to shareholders of the parent
Nine months ended December 31, 2019	328,721	(22,805)	(22,131)	(24,137)
Nine months ended December 31, 2018	376,366	6,502	6,246	(43,989)
Difference	(47,645)	(29,308)	(28,378)	19,852

During the subject nine months, although weakness has continued mainly in exports, the domestic economy showed gradual progression supported by improvements in corporate earnings, employment, and individual income.

New housing starts of leased units decreased in the past 16 months in a row, a reduction of 15.5% year-on-year, due to the financial institutions' more cautious loan approval policy in place. While the number of vacant houses continues to increase and recovery in nationwide demand seems not realistic, it is essential for the Company to achieve stable occupancy rates by implementing the differentiation measures such as constructing apartments in the areas with continuing high demand, and providing further value-added services based on the Company's strengths.

Under these conditions, the Leopalace21 Group (hereinafter the "Group") makes all efforts in progressing the repair works for resolving the construction defects problem including parting walls and deals with creating corporate and new social value with the basic policy of "Supporting continuous growth of core businesses in ways that further increase corporate value while constructing a base for growth areas" to realize the Medium-term Management Plan "Creative Evolution 2020".

As a result, consolidated net sales for the subject nine months came to 328,721 million yen (down 12.7% year-on-year), operating loss was 22,805 million yen (operating profit was 6,502 million yen in the same period of the previous year), and ordinary loss was 22,131 million yen (ordinary profit was 6,246 million yen in the same period of the previous year). Net loss attributable to shareholders of the parent was 24,137million yen (improved by 19,852 million yen in the same period of the previous year). This was due to extraordinary loss of 12,583 million yen recorded as a reserve for repairs related to construction defects including parting walls.

(Actual figures by segment)

(Million yen)

	Net sales			Operating profit		
	Nine months ended December 31, 2018	Nine months ended December 31, 2019	Difference	Nine months ended December 31, 2018	Nine months ended December 31, 2019	Difference
Leasing Business	323,351	292,406	(30,944)	14,313	(12,610)	(26,923)
Development Business	38,252	20,542	(17,709)	(2,619)	(3,695)	(1,076)
Elderly Care Business	10,436	11,007	570	(707)	(385)	321
Hotels, Resort & Other Businesses	4,325	4,764	438	(1,045)	(536)	509
Adjustments	—	—	—	(3,438)	(5,577)	(2,139)
Total	376,366	328,721	(47,645)	6,502	(22,805)	(29,308)

(i) Leasing Business

In the Leasing Business, the Company provides value-added services such as “my DIY” which allows the tenants to customize a selected single wall of the room without paying dilapidation cost at the time of moving out, promotion of smart apartments which enable remote control of electrical appliances and lock and unlock the door, introduction of the industry’s first electronic processing system of tenancy agreements, and security system installations in alliance with leading security companies. Also, in order to achieve stable occupancy rates, the Company is strengthening sales to the corporate customers for the apartment use by their employees and increasing support for the foreign national tenants. In the ASEAN region, the Company develops and manages serviced apartments and offices.

The occupancy rate at the end of the subject quarter was 78.91% (down 6.35 points from the end of the same period of the previous year) and the average occupancy rate for the period was 80.47% (down 8.95 points year-on-year). This was caused by the delay in repair works and in new tenants’ recruitment vis-à-vis higher priority on all-building investigations. The number of units under own management at the end of the subject third quarter was 575,000 (increasing 0 from the end of the previous fiscal year).

In addition to a decrease in rent income due to a decrease in the occupancy rate, and as a result of reserve for vacancy loss of 3,862 million yen, net sales amounted to 292,406 million yen (down 9.6% year-on-year), and operating loss was 12,610 million yen (decrease of operating profits by 14,313 million yen year-on-year).

(ii) Development Business

In the Development Business, the Company has been trying to improve profitability with the measures such as supplying apartments in the three metropolitan areas where solid leasing demand is anticipated by an increasing population, providing high quality and forefront strategic products, expanding construction variation offerings to make effective use of the land, and reviewing suppliers and product pricing policy.

Morizou Co., Ltd. a subsidiary of the Company provides luxury custom-built homes made of Kiso-hinoki, Japanese cypress.

As a result of the Company’s cease of bookings from new customers because of the construction defects problem amid the intensified competition in the metropolitan areas and the changes in the environment of apartment loans, orders received during the subject quarter amounted to 6,140 million yen (down 88.4% year-on-year) and outstanding orders received stood at 33,236 million yen (down 53.3% from the end of the same period of the previous year).

The Company sold the shares in Life Living Co., Ltd., which was a consolidated subsidiary, and therefore the orders received and outstanding orders of Life Living Co., Ltd. are not included in the consolidated results.

As a result, net sales came to 20,542 million yen (down 46.3% year-on-year) and operating loss was 3,695 million yen (increase the loss by 1,076 million yen year on year).

(iii) Elderly Care Business

The profitability of the Elderly Care Business, a strategic growth business, improved due to increases in the occupancy rate of existing facilities, and is steadily shifting to become black in the final year of the medium-term management plan.

Net sales during the nine months was 11,007 million yen (up 5.5% year-on-year), and operating loss was 385 million yen (improvement of 321 million yen year-on-year).

(iv) Hotels, Resort & Other Businesses

Net sales of the segment covering resort facilities in Guam, hotels in Japan, and other businesses including traveling business and finance business were 4,764 million yen (up 10.1% year-on-year) and operating loss was 536 million yen (an improvement of 509 million yen compared to the same period of the previous year).

(2) Analysis of Consolidated Financial Position

(Assets, Liabilities, and Net Assets)

(Million yen)

	Assets	Liabilities	Net assets
As of December 31, 2019	244,825	187,780	57,045
As of March 31, 2019	291,790	210,452	81,338
Difference	(46,965)	(22,672)	(24,293)

Total assets at the end of the subject quarter decreased by 46,965 million yen from the end of the previous fiscal year to 244,825 million yen. This was mainly attributable to an increase of 1,309 million yen in deferred tax assets and decreases of 5,168 million yen in cash and cash equivalents, 3,444 million yen in leased assets (net), 3,409 million yen in investment securities, 12,545 million yen in buildings and structures due to the sale of own rental housing and hotels, 9,765 million yen in land.

Total liabilities decreased by 22,672 million yen from the end of the previous fiscal year to 187,780 million yen. This was mainly attributed to the increase of 3,862 million yen in reserve for vacancy loss and the reductions of 8,490 million yen in interest-bearing debt, 6,412 million yen in short and long term advance received, 3,564 million yen in accounts payable for completed projects, and 2,625 million yen in accounts payable.

Net assets decreased by 24,293 million yen from the end of the previous fiscal year to 57,045 million yen. This was mainly due to a recording of 24,137 million yen in net loss attributable to shareholders of the parent. The ratio of shareholders' equity to assets dropped by 4.5 points from the end of the previous fiscal year to 23.2%.

(3) Explanation of Consolidated Earnings Forecasts and Other Future Predictions

Concerning consolidated earnings forecasts, there has been no change from those announced on November 8, 2019, titled "Notice Concerning Corrected Revision of Earnings."

Earnings forecasts are judged by the Company based on information currently available to the Company as of the publication of this statement, and actual results may differ from these forecasts due to a variety of factors.

2. Consolidated Financial Statements and Main Notes
(1) Consolidated Balance Sheets

(Million yen)

	December 31, 2019	March 31, 2019
<Assets>		
Current assets		
Cash and cash equivalents	79,367	84,536
Trade receivables	6,433	6,908
Accounts receivable for completed projects	924	1,709
Operating loans	153	256
Real estate for sale	289	1,027
Real estate for sale in progress	2,791	5,554
Payment for construction in progress	534	680
Prepaid expenses	3,305	2,952
Others	4,886	7,274
Allowance for doubtful accounts	(149)	(142)
Total current assets	**98,537**	**110,757**
Non-current assets		
Property, plant, and equipment		
Buildings and structures (net)	27,996	40,542
Machinery, equipment, and vehicles (net)	10,211	11,185
Land	39,455	49,221
Leased assets (net)	8,287	11,732
Construction in progress	280	3,470
Others (net)	7,476	7,062
Total property, plant, and equipment	**93,709**	**123,215**
Intangible fixed assets		
Goodwill	138	2,324
Others	5,836	7,250
Total intangible fixed assets	**5,975**	**9,575**
Investments and other assets		
Investment securities	13,493	16,903
Long-term loans	1,109	501
Long-term prepaid expenses	2,465	3,252
Deferred tax assets	24,959	23,650
Others	5,317	4,548
Allowance for doubtful accounts	(988)	(941)
Total investments and other assets	**46,356**	**47,914**
Total non-current assets	**146,040**	**180,705**
Deferred assets	**247**	**327**
Total assets	**244,825**	**291,790**

(Million yen)

	December 31, 2019	March 31, 2019
<Liabilities>		
Current liabilities		
Electronically recorded obligations -operating	212	897
Accounts payable	3,312	4,037
Accounts payable for completed projects	1,151	4,715
Short-term borrowings	3,574	3,838
Bonds due within one year	3,066	3,966
Lease obligations	4,569	5,320
Accounts payable -other	12,297	14,922
Accrued income taxes	435	798
Advances received	30,088	34,635
Customer advances for projects in progress	2,298	3,651
Provision for bonuses	27	—
Reserve for warranty obligations on completed projects	225	347
Reserve for fulfillment of guarantees	1,047	1,138
Reserve for loss related to repairs	14,627	50,707
Reserve for apartment vacancy loss	12,688	8,826
Others	3,431	3,963
Total current liabilities	**93,054**	**141,765**
Non-current liabilities		
Bonds	6,570	8,103
Long-term debt	16,306	18,318
Lease obligations	5,470	8,501
Long-term advances received	10,004	11,869
Lease/guarantee deposits received	6,300	6,599
Reserve for loss related to repairs	34,674	—
Deferred tax liabilities	5	5
Reserve for apartment vacancy loss	3,902	3,902
Liability for retirement benefit	8,425	8,213
Others	3,067	3,172
Total non-current liabilities	**94,726**	**68,687**
Total liabilities	**187,780**	**210,452**
<Net assets>		
Shareholders' equity		
Common stock	75,282	75,282
Capital surplus	45,148	45,148
Retained earnings	(62,787)	(38,635)
Treasury stock	(473)	(655)
Total shareholders' equity	**57,169**	**81,140**
Accumulated other comprehensive income		
Net unrealized gains on "other securities"	803	280
Foreign currency translation adjustments	(1,004)	(176)
Remeasurements of defined benefit plans	(209)	(327)
Total accumulated other comprehensive income	**(410)**	**(224)**
Share subscription rights	269	404
Non-controlling interests	17	17
Total net assets	**57,045**	**81,338**
Total liabilities and net assets	**244,825**	**291,790**

(2) Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income
Consolidated Statements of Operations

(Million yen)

	Nine months ended December 31, 2019 (Apr 2019–Dec 2019)	Nine months ended December 31, 2018 (Apr 2018–Dec 2018)
Net sales	**328,721**	**376,366**
Cost of sales	**306,193**	**315,646**
Gross profit	**22,527**	**60,720**
Selling, general and administrative expense	**45,333**	**54,217**
Operating profit(loss)	**(22,805)**	**6,502**
Non-operating income		
Interest income	63	69
Dividend income	173	164
Anonymous partnership investment income	977	—
Valuation gains of investment securities	185	141
Foreign exchange gains	60	119
Other	207	164
Total non-operating income	**1,668**	**659**
Non-operating expenses		
Interest expenses	471	570
Bond issuance fee	126	145
Other	396	199
Total non-operating expenses	**994**	**915**
Recurring profit	**(22,131)**	**6,246**
Extraordinary income		
Gain on sale of property, plant and equipment	8,853	236
Gains on sale of investment securities	2,354	—
Gains on reversal of share acquisition rights	17	—
Gains on cancellation of contracts	350	—
Total extraordinary income	**11,575**	**236**
Extraordinary losses		
Loss on sale of property, plant and equipment	972	0
Loss on retirement of property, plant and equipment	25	76
Impairment loss	1,059	7,560
Provision of reserve for loss related to repairs	10,157	42,010
Loss related to repairs	2,426	1,443
Loss on sale of shares in the subsidiary	2	—
Total extraordinary losses	**14,642**	**51,091**
Income (loss) before taxes and other adjustments	**(25,199)**	**(44,608)**
Income taxes	**(1,061)**	**(586)**
Net income (loss)	**(24,137)**	**(44,021)**
Net income (loss) attributable to non-controlling interests	**(0)**	**(31)**
Net income (loss) attributable to shareholders of the parent	**(24,137)**	**(43,989)**

Consolidated Statements of Comprehensive Income

(Million yen)

	Nine months ended December 31, 2019 (Apr 2019–Dec 2019)	Nine months ended December 31, 2018 (Apr 2018–Dec 2018)
Net income (loss)	(24,137)	(44,021)
Other comprehensive income		
Net unrealized gains on “other securities”	522	(233)
Foreign currency translation adjustments	(820)	89
Remeasurements of defined benefit plans	118	123
Share of other comprehensive income of entities using equity method	(7)	(2)
Total other comprehensive income	(187)	(22)
Comprehensive income	(24,324)	(44,044)
(Breakdown)		
Comprehensive income attributable to shareholders of the parent	(24,324)	(44,012)
Comprehensive income attributable to non-controlling interests	(0)	(32)

(3) Notes Regarding Consolidated Financial Statements

(Notes regarding the premise of the Company as a going concern)

There are no relevant items.

(Notes regarding significant changes in shareholders' equity)

There are no relevant items.

(Application of accounting methods specific to the preparation of quarterly consolidated financial statements)

Tax expenses are calculated by multiplying net income before income taxes by a reasonably estimated effective tax rate, after applying the tax effect accounting to net income before income taxes for the consolidated fiscal year that includes the subject nine months. However, a legally designated effective tax rate will be applied if such tax expenses are found to be unreasonable after calculation based on the relevant estimated effective tax rate.

(Additional information)

(Change in the objective of holding the non-current assets)

The objective of holding a part of the non-current assets was changed during the second quarter of the current fiscal year. Accordingly 49 million yen of buildings and structures, 344 million yen of land and 4 million yen of others are reclassified to 102 million yen of real estate for sale and 295 million yen of real estate for sale in progress.

(Reserve for loss related to repairs)

The total amount was recorded in the category of current liabilities in the past. In view of the progress of repair works, amount of reserve for loss related to repairs which is posted at the end of the third quarter period but not planned to be used within a year is now recorded as a non-current liability.

(Segment Information)

I. Nine months ended December 31, 2018 (April 1, 2018 through December 31, 2018)

(i) Net sales, operating profit (loss) by reportable segment

(Million yen)

	Reportable segments					Adjustments (Note 1)	Consolidated Total (Note 2)
	Leasing Business	Development Business	Elderly Care Business	Hotels, Resort & Other Businesses	Total		
Net sales							
Sales to customers	323,351	38,252	10,436	4,325	376,366	—	376,366
Inter-segment sales and transfers	161	0	—	2,780	2,943	(2,943)	—
Total	323,513	38,253	10,436	7,106	379,309	(2,943)	376,366
Segment profit (or loss)	14,313	(2,619)	(707)	(1,045)	9,941	(3,438)	6,502

(Note) 1. Adjustments in segment profit (loss) of (3,438) million yen included inter-segment eliminations of (120) million yen and corporate expenses not part of reportable segments of (3,317) million yen. Corporate expenses consisted mainly of general administrative expenses for administrative departments that were not part of reportable segments.
2. Segment profit (loss) was adjusted to the operating profit on the Consolidated Statements of Operations

(ii) Impairment loss by reportable segment

For leasing business segment, 7,560 million yen of impairment loss was recorded in the extraordinary losses for the difference of the book value for the to-be sold properties for rent use and its recoverable amount.

II. Nine months ended December 31, 2019 (April 1, 2019 through December 31, 2019)

(i) Net sales, operating profit (loss) by reportable segment

(Million yen)

	Reportable segments					Adjustments (Note 1)	Consolidated Total (Note 2)
	Leasing Business	Development Business	Elderly Care Business	Hotels, Resort & Other Businesses	Total		
Net sales							
Sales to customers	292,406	20,542	11,007	4,764	328,721	—	328,721
Inter-segment sales and transfers	204	27	—	1,883	2,115	(2,115)	—
Total	292,610	20,570	11,007	6,648	330,836	(2,115)	328,721
Segment profit (or loss)	(12,610)	(3,695)	(385)	(536)	(17,228)	(5,577)	(22,805)

(Note) 1. Adjustments in segment profit (loss) of (5,577) million yen includes inter-segment eliminations of (128) million yen and corporate expenses not part of reportable segments of (5,449) million yen. Corporate expenses consist mainly of general administrative expenses for administrative departments that are not part of reportable segments.
2. Segment profit (loss) is adjusted to the operating profit on the Consolidated Statements of Operations

(ii) Impairment loss by reportable segment

For leasing business segment, 76 million yen of impairment loss is recorded in the extraordinary losses for the difference of the book value and the recoverable amount for the properties for rent use whose profitability was significantly reduced.

For development business, the goodwill associated with the acquisition of Morizou Co., Ltd. is revaluated in view of the realizable profitability. As a result, 982 million yen, the full amount of unamortized balance of the goodwill is recorded as impairment loss.

3.Others

Important item regarding premise of the Company as a going concern

There is a relevant item with respect to Leopalace Power Corporation, a subsidiary of the Company and its loan agreement with a financial institution for which the Company acts as guarantor. The Group suffered from net loss attributable to shareholders of the parent and negative cash flow from operating activities during the previous fiscal year because of the construction defects confirmed in certain properties constructed by the Company; in addition the Company's consolidated net assets failed to satisfy the required standard at the end of the previous fiscal year, the Company does not meet the financial covenant in the loan agreement.

The Company has been concentrating its management resources on the repair works and accelerate with organizational efforts so that it can resume the tenant recruitment as soon as possible. In parallel, the Company maintains sufficient level of cash required for the business operations through measures including a sale of properties and therefore secures good financial conditions to meet the planned capital requirement.

As to the conflict with the financial covenant, the financial institution confirmed that they will not exercise the right of forfeiture of the benefit of time.

As described above, the Company does not believe that there is any significant uncertainty regarding the premise of the Company as a going concern.