Question & Answer at Business Unit IR Meeting Part 2
(Living Related & Real Estate Business Unit)

[Date]	**December 2nd, 2021, 3:15pm - 4:00pm**	
[Speaker]	**Nobuki Ando**	**General Manager, Living Related & Real Estate Business Unit**
	Hiroki Takeno	**General Manager, Lifestyle & Retail Business Div.**
	Kei Sato	**General Manager, Food & Agriculture Business Div.**
	Hiroaki Murata	**General Manager, Materials, Supplies & Real Estate Div.**
	Masahiro Yamane	**General Manager, Investor Relations Department**

Question & Answer

Questioner 1: As for Fyffes, we have been told at briefings that since the acquisition, it has been in a difficult situation and the current situation and the fact that competition is tough. Please explain how much potential you see for a return to profitability.

Sato: I would like to refrain from commenting on specific numbers, but explain what has been going on. Compared to last year, the figure improved by about JPY6 billion in the first half alone, which can be almost explained by the improvement in revenues in melon and banana businesses.
As for the melon business, a lot of things happened last year due to the coronavirus. Players in Central and South America that were originally planning to export grapes and berries to China, but when China effectively banned the import of these products, suddenly turned the corner and came to North America in large quantities. In such a situation, the market price of melons fell sharply due to conflicts with them, which led to competition among mass merchandisers for the shelves. They were sold at extremely cheap price, and were eventually disposed of at the production site. In addition to this not happening this year, we have changed our sales approach. Although in North America, we have a 30% share of the melon market, which is the largest share in the market, we have changed from the conventional approach of mass production and mass sales to a new approach of narrowing down the volume and selling at a reasonable price. As a result of this change, we have been able to manage our business in a very good way.
As for the bananas business, we sell bananas in Europe and we purchase bananas from various countries. However, the quality of the bananas varied depending on the production sites, so we had to sort them out and ripe them while generating waste loss. By drastically changing the way of the business, we selected the production sites where the quality is very stable and well managed, then ripe them and sell them in mass markets, thereby decreasing waste loss and logistics costs. As a result, we have seen a significant improvement in profit. Considering the current rising cost of logistics and materials, I am getting more and more confident that we will be able to make the business fit our scale.

Questioner 1: As for the real estate SBU, you mentioned that you are aiming for JPY800 billion-level in assets and JPY40 billion-level in net profit in FY2023, please explain the details of assets and revenues in each business line.

Murata: At the beginning of this fiscal year, our division's total assets is about JPY700 billion, including about JPY100 billion for overseas operations. About half of the remaining JPY600 billion is for fixed assets, and the other half is for the capital recycling assets. About 1/3 of our revenues come from fixed assets, two-thirds from capital gain through the fixed assets sales, and the remaining 1/3 from capital recycling assets.

Questioner 1: Although the vacancy rate for offices has risen, is there not much to worry about in terms of real estate holdings at the moment?

Murata: Yes, that's right. 1 of the projects, called KANDA SQUARE, was completed last year and is a relatively large project for us. Fortunately, the tenant for this project was almost decided before Corona, and it is currently operating at 100%. In addition, the development of mid-sized high-end office buildings, which is our main focus, is progressing smoothly, and we are receiving many inquiries for tenant leasing. In addition, as I mentioned earlier, urban retail facilities have been slightly affected by the decline in inbound tourism. We participated in a major project in Ginza called Ginza SIX, and we have already exited this asset before Corona and have already realized the value of this asset. Also, we were able to sell our large-scale urban properties in Ebisu Bridge, Kansai area as planned immediately after Corona, so we don't have many assets to worry about at the moment.

Questioner 2: Despite the impact of Corona, the prices of real estate itself have risen in some area. I think your company's business is to sell them at a higher price while the cost of development goes up. Up to what market price do you intend to follow? In that context, what kind of asset allocation are you thinking about for each business line?

Murata: This situation varies depending on the asset type. As for housing, in the situation that the stock market is high and there is a surplus of money, at the moment, such high-priced condominiums are selling solidly despite the price hike, so we would like to challenge such markets within a certain range. On the other hand, in the suburbs as well, even in places that used to struggle a little, the impact of Corona has created a need for people to live in homes that are as spacious as possible, and the reality is that the market is solid.
In the office market, vacancy rates have risen slightly, and rents have fallen somewhat, but not to the level of the Lehman Shock, which saw a rapid fluctuation. I think that the office strategies of each tenant will gradually be examined according to the situation of the coronavirus, and will become a reality over the next 2 to 3 years. Although, in the office sector, it's not necessarily that rents for land and other properties are rising steadily, competition is becoming fierce. We would like to set a certain buffer and be cautious about the rents and future sales prices for future projects.

Questioner 2: As fort Tomod's, how has the number of stores changed over the past few years. Also, due to the coronavirus Tomod's business performance does not seem to be growing much. How will Tomod's increase its profits in the future?

Takeno: Since Tomod's is located in the heart of the city and has many stores, it has been difficult for us to capture the demand of those stores during the past year because life style changes, such as working from home. In the case of Tomod's, it's store has both drugstores and dispensaries, and the drugstore sector has been on a downward trend due to a decrease in the flow of people in the city center. On the other hand, as for the dispensing of prescription drugs, the figures are now exceeding those of the previous year, and we are on track to achieve the budget for FY2021 as well.
However, it is difficult for urban-type stores, so we are trying to change the areas where we open stores. For example, joint store openings and adjoining stores with Summit. In this way, we will rebuild Tomod's foundation by opening new stores closer to people's daily lives, with an eye on the living environment and the post-Corona society, and we will work to achieve long-term sustainable growth.
Actually, we have been opening about 15 stores a year and we have 224 stores now. The role of pharmacies will become more and more important in the future in the area of comprehensive regional care, so we would like to achieve further growth by acquiring pharmacies specializing in dispensing drugs.

Questioner 2: Urban stores are small in size, so dispensing drugs can generate a certain amount of sales and make a profit. As the size of stores become large in suburban areas, the ratio of goods sold increases, making it easier to get caught up in the price competition among drugstores. In order to use the strengths of Summit, It seems that you have to change strategy in a different way. What kind of strategy do you think?

Takeno: Basically, products of Tomod's and Summit are separated, and Tomod's is trying to enhance its healthcare products instead of selling food products. Due to adjoining stores, Summit will be able to offer more specialized products, which will increase the number of customers. Tomod's will be located next to the Summit where many customers who want to shop will come. Then, it will be easier for Tomod's to enjoy the synergy and Tomod's are growing larger, so we would like to continue to have many of these adjoining stores. We also think that there is a possibility of opening stores jointly with other supermarkets.

Questioner 2: So, rather than opening suburban stores with large floor space in the suburbs, you will be basically focusing on opening jointly with supermarkets?

Takeno: You are right. In the category of superdrug, which is around 400－600 tsubo, competition is tough there, and we have to compete with other businesses, so we are thinking of fighting with our own size of 100 tsubo or so, where we can make use of our expertise.

Questioner 3: I understand that Summit has a high profit margin among supermarkets sector and Summit has a well-planned strategy. What are your thoughts on whether or not you will be able to maintain your profit margins and strengths as you expand dramatically in scale and become a leading food supermarket?

Takeno: Summit's operating income margin now stands at about 4%, which is 1 of the best in the industry. Although the influence of the coronavirus was also present at the beginning, this is the result of our continuous management efforts, and more than anything, it is the result of the confidence of our customers. In the past, Summit was known for its efficient operations, but we have been able to increase the number of customers and achieve a higher profit margin by adding emotional value, such as making our flyers more interesting and being more attentive to our customers.
When it comes to sustaining this growth, I believe that retail DX, or DX as I mentioned earlier, will become very important. The retail industry, and supermarkets in particular, are labor-intensive industries, so retail DX is very important to improve management efficiency. I believe that Summit can achieve sustainable growth on its own by achieving initiatives of increases in customer traffic, decreases in costs, as well as the demand forecast.
On the other hand, if we look at the performance of other supermarkets, there are winners and losers during triggerd by Corona. Those who had problems before Corona are falling behind. I think that these companies will be forced to leave the market. I think it is possible for us to buy out these companies in order to improve performance of these companies by using the strength of our operations, the strength of our emotional value, and the performance improvement capabilities refined through retail DX. However, the performance of each supermarkets company is quite good at the moment, so we are closely talking about the current situation.

Questioner 3: On page 15, you don't use the term Summit, but instead refer to the domestic supermarket business. Do you use this somewhat broad interpretation of the term to include brands other than Summit?

Takeno: Yes. We have a 20% stake in a company called Mammy Mart. We are also taking a DX approach to Mammy Mart, on which Lifestyle & Retail Business Div. and Digital Business Div. are working together.

Questioner 3: As for Fyffes, is the fruit and vegetable industry in Europe and the Americas a red ocean market, as well as Fyffes? Or do you think that Fyffes is inferior in terms of profit margin or competitiveness? How do you feel about that relative to the rest of the market?

Sato: I think it depends on how we sell. The price of banana can vary quite a bit in supermarkets. In the past, the way Fyffes has been selling its products was such that although it has had the largest market share in Europe due to its price-appealing approach, it has been more focused on providing large quantities of products at relatively low prices and stable supply. Now, with the rise of discounters and the growing power of mass merchandisers, Fyffes has changed its sales policy in its mid-term strategy. Handling organic bananas, developing display racks in collaboration with mass merchandisers, and increasing Fyffes' brand power are examples. Especially, since the interest of sustainability is very high in Europe and Americas, enhancing sustainability will raise the value of Fyffes' own brand and products and we can get out of the price-appealing red ocean world.

Questioner 4: On page 15, it's described as a rapid expansion of Summit in scale. In order to achieve rapid expansion, how do you distribute management resources including CAPEX, and plan to entry online supermarkets or to do M&A activities? Please explain about the initiatives beyond improving the management efficiency.

Takeno: Summit is considering entering the online supermarket market as a one of the new core businesses, as well as retail DX, during this medium-term management plan. In FY2023, we expect retail DX to have a significant economic impact, so we believe that we can expand the revenues and increase their scale.
I believe that M&A is an option that can be taken, whether it is during this medium-term management plan or not. If there is a chance, I would like to take it. In fact, I've heard various stories and the story of the Kansai Super Market is also a hot topic right now. We want to go into M&A with retail DX, which is another weapon for improving profitability and we will achieve to make rapid expansion by both the experience of Summit and this new weapon.

Questioner 4: As for real estate, in the expanding of your assets to JPY800 billion, please explain the details of the income in each business line or proportions of income gains and capital gains.

Murata: We are trying to maintain a good balance between capital gains and income gains, but we do not have a specific ratio for that. We have a certain amount of income from fixed assets, so this is about 1/3 of our total stable income. There are 2 types for the remaining parts. 1 is capital gains from high-turnover inventories in relation to the development and sale of condominiums, logistics facilities, and retail facilities. The other is that We will periodically realize the value of our some fixed assets, mainly offices, starting with those with low efficiency and low yield because we will not continue to hold the same fixed assets for a long period of time. Our strategy is to use the recovered funds to repeatedly invest in the next asset, and in this medium-term management plan, we have factored in the forecast that we will sell some of our high-quality assets to generate profits.

Questioner 4: Due to the rising of real estate price, I wonder income gains become the main source of income and the expansion of assets equals a decrease in the profit margin. However, is it correct to think that you should replace the fixed assets and control the total risk return including capital gains?

Murata: Yes, as you understand.

Questioner 5: I think stock market participants understand that the performance of Living Related & Real Estate Business Unit is stable. In addition to this, what are the strategies that will further increase ROA as the overall direction of the Business Unit.

Ando: Living Related & Real Estate Business Unit has stable performance. On the other hand, with respect to the ROA which is required for Japanese trading companies or ROIC exceeding WACC, its profitability is not very high. The WACC is determined by the nature of each business, so in order to raise ROIC or ROA to high level, buying businesses would be to abandon competition. So, we have changed our business model to increase the ROIC for the past few years. For example, we improved Fyffes or restructured part of the food business to concentrate management resources. In order to increase returns, we use a large amount of assets in real estate, and supermarkets businesses. Since supermarkets are also an asset-heavy business, the returns will improve significantly with improvements in the field and initiatives of DX.
It is very difficult to raise them in the real estate business. When comparing the balance between capital recycling assets and fixed assets, if other real estate companies have 70% fixed assets and 30% capital recycling assets, we have half or a little more for capital recycling assets and then our profitability is higher. The other is to utilize external funds to shift toward highly efficient assets. We are now working on this thoroughly.
In addition, one of the strengths of our company is that we have a leasing company, Sumitomo Mitsui Finance and Leasing, which is an equity method affiliate of Sumitomo Mitsui Financial Group. We are already working to expand our real estate business while thoroughly using the balance sheet of the company. As a result of our efforts, although we are still in the process, our profitability are high compared to other real estate companies. Now we are promoting initiatives in order to take this profitability to the next level.
We plan to increase real estate business assets to around JPY800 billion. However, we don't consider that we want to increase assets to JPY900 billion and then JPY1 trillion. We are focusing on increasing returns without increasing assets too much and have this business model in place. Major developers don't take this strategy because their proportion of fixed assets is large, and other Japanese trading companies have relatively small size real estate business except for REITs. We have the strong leasing company mentioned

earlier in our affiliates, and last year, we acquired Kenedix, an asset management company. There is an overwhelming difference in this area. We believe that this is a new challenge in the way real estate business to improve capital efficiency, and the low profitability business unit will catch up with the ROA required for trading companies.

Ando: We are very grateful for the opportunity to explain to you over a long period of time, and we have received a lot of questions from you. As I mentioned earlier, including Living Related & Real Estate Business Unit, our entire company, underwent major structural reforms in the last fiscal year, and it was a year of selecting what to do, what not to do, what to stop doing, and what to focus on.
In today's Q&A session, I believe that your exact questions about our focus areas, such as Fyffes and real estate business. I would like to thank you all for your kind comments and warm support, as we will use your questions and comments as a reference in our determined efforts.

[END]