

## TECHNICAL PAPER

## Buoyant Hotel Market in Japan: Who is Doing What

## EXECUTIVE SUMMARY

The number of foreign visitors to Japan has been surging. In CY2015, it reached 19.74 million, just shy of 20 million, the official target set by Japanese government to be achieved in 2020. The total number of rooms at accommodation facilities has remained almost the same for the past 20 years. Nowadays, the shortage of accommodation has become an urgent issue, and many players, both existing and new comers, see as a big business opportunity.

In this report, we provide an overview of the current hotel market conditions in Japan, and examine the actual transactions made by the players.

## Overview of the Hotel Market in Japan

The number of foreign visitors to Japan surpassed 10 million in 2013, for the first time, and the figure has been increasing rapidly. In 2015, 19.74 million foreign people visited Japan, almost reaching the "20 million", official target of foreign visitors to be achieved in 2020. The Japanese government<sup>\*1</sup> has set a new target and the number of foreign visitors to Japan should be "40 million in 2020, and 60 million in 2030."

The total number of lodgers in accommodation facilities in Japan has been increasing. In CY2015, total number of guest nights by Japanese increased slightly YoY basis. On the other hand, the guest nights by foreign visitors increased drastically. It increased by around 48% YoY basis and stood at about 66.37 million. The percentage of foreign guests against total, reached 13%. (FIGURE 1)

Reportedly, one of the main reasons for the surge of foreign visitors is "Easing visa requirement." The policy was adopted in 2013 for south-east Asian countries as a part of "The Action Program for Making Japan a Tourism Nation." Additionally, in 2015, the visa requirements for Chinese Mainlanders

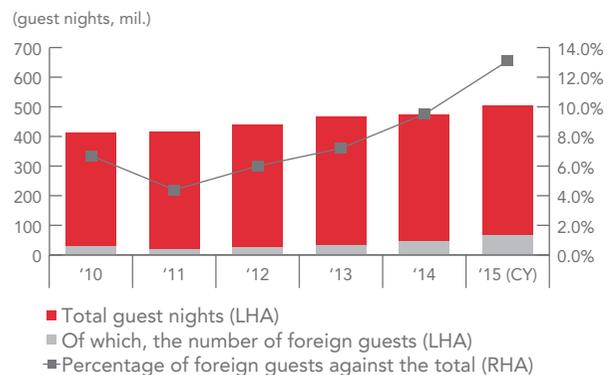
were also relaxed, which led to increase of the number and constituted about 25% of total foreign arrivals in the year.

That's why most part of the increase can be attributed to foreign visitors from Asia. With many visiting Japan for the first time, by joining group tours, which pushed up the occupancy rate of "reasonable class" hotels.

It is said that another reason is depreciation of Yen. Since the inauguration of the Second Abe Cabinet in Dec. 2012, Japanese Yen has depreciated from about 80 yen per USD to around 125 yen per USD in the middle of 2015. It has made visiting Japan much more affordable.

\*1: "Council for the Development of a Tourism Vision to Support the Future of Japan" chaired by Prime Minister Shinzo Abe.

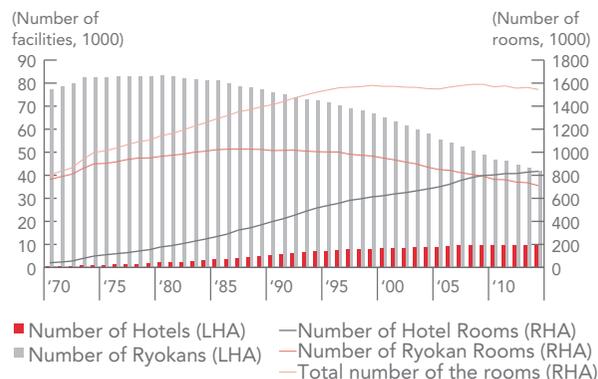
**(FIGURE 1) Guest nights in accommodations in Japan**



Source: Prepared by MUTB based on "Accommodation Survey" by Japan Tourism Agency (JTA)

New supply of accommodation facilities fails to keep pace with the rapidly growing demands. Although the numbers of hotels and hotel rooms have been increasing, those of Ryokans<sup>\*2</sup> and Ryokan rooms have been decreasing. As a result the total number of guest room has been the same for almost 20 years (FIGURE 2).

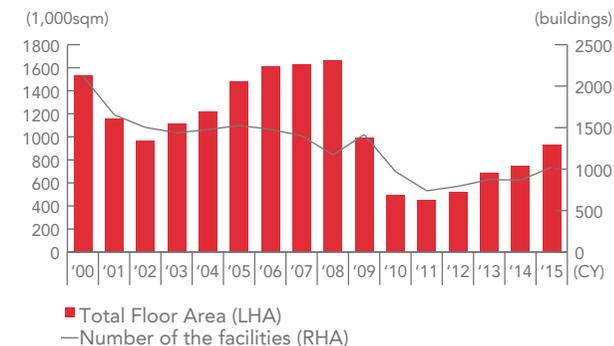
**(FIGURE 2) The number of hotels, Ryokans and their rooms**



Source: Prepared by MUTB based on "Report on Public Health Administration and Services" by Ministry of Health, Labour and Welfare (MHLW)

When it comes to the volume of accommodation facilities when construction starts, both the number of facilities and floor areas have been increasing since 2011. However, their levels are still low, compared to those in the past (FIGURE 3).

**(FIGURE 3) Volume of accommodation facilities when construction starts**



Source: Prepared by MUTB based on "Construction Starts" by MLIT

Shortage of accommodation facilities has already become a serious problem especially in major metropolitan areas and famous sightseeing spots. It is also expected that this problem will be more serious and spread into other areas, due to increasing demands for accommodation in Japan. Although the authorities have started giving consideration to the "Min-Paku"<sup>\*3</sup> system, they have not yet established official management standard or regulation.

\*2: Ryokan is a Japanese style hotel, with guest rooms of tatami mats, etc.

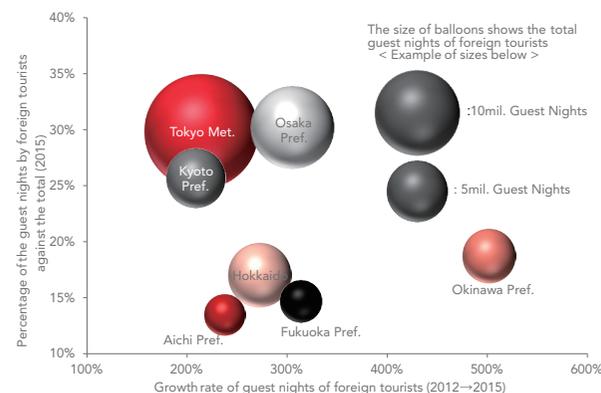
\*3: "Min-Paku" is, so to speak, a private-house accommodation. It is said that there are many issues to be solved, i.e. making consistency with the existing "Hotel Business Act," issue of public hygiene etc. However, a few municipalities, Osaka Pref. and Ota ward in Tokyo Met., adopted or implemented their own code for "Min-Paku."

Given the shortage of accommodation, the Japanese government has undertaken additional steps. Reportedly, Ministry of Land, Infrastructure, Transport and Tourism (MLIT) has elected to relax the regulation on “floor-area ratio” for newly planned hotels. Keiichi Ishii, Minister of MLIT, said at a regular press briefing that it was important to study measures which improve the environment for encouraging new developments and conversions for accommodations. He also said that large-scale investments by private sector were expected, due to the newly set target.

### Trends of Foreign Visitors in Major Prefectures

FIGURE 4 shows the number of “guest nights” by foreign visitors in 2015, growth rate of the number of foreign visitors and percentage of foreign visitors against the total, by prefecture. In all of the prefectures shown in the figure, the “guest nights” in 2015 has more than doubled since 2012, and the percentage of foreign visitors reached almost 30% in Tokyo and Osaka.

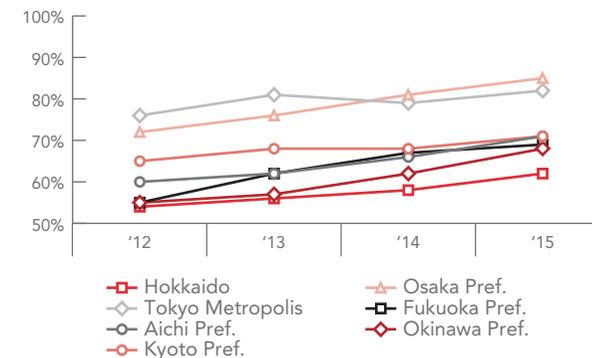
(FIGURE 4) Foreign visitors in major prefectures



Source: Prepared by MUTB based on “Accommodation Survey” by JTA

“Hotel Occupancy Rate” has been rising with increasing number of foreign visitors (FIGURE 5). According to our interviews, some operators said that the maximum limit of occupancy rate is around 90% for operational reasons. However, they also said that the occupancy rate in some hotels stood at almost 100%.

(FIGURE 5) Hotel occupancy rate in major prefectures



Source: Prepared by MUTB based on “Accommodation Survey” by JTA

Although the occupancy rate is approaching the maximum limit, it is said that Average Daily Rate (ADR)\*4 in Japan is relatively low, compared to those in other countries. It is expected that the ADR has room to improve which is gaining the attention of investors that the hotel sector is an asset class with potential upside. To take advantage of this opportunity, more and more players enter into development and operation business of hotels. In addition, other companies which want to own hotels just as income generating properties, also seek to acquire hotels.

\*4: Revenue of accommodation section in a certain term divided by total number of rooms actually sold in the same term.

## Development Projects of New Hotels

(FIGURE 6) Major projects of hotel development in recent reports

(Development cases)

|    | Reported Date | Name of Hotel or Project  | Project Implementing Body   | Location                      | Year of Opening or Completion | Number of Rooms (planned) | Notes   |
|----|---------------|---|---|-------------------------------|-------------------------------|---------------------------|---|
| 1  | 27, Feb, 2015 | APA HOTELS & RESORTS YOKOHAMA BAY TOWER                         | APA GROUP   | Yokohama City, Kanagawa Pref. | CY2019                        | Approx. 2,400             | APA GROUP won a bid, made by Urban Renaissance Agency (an incorporated administrative agency) for the land, at about 16.7 billion yen. The new hotel will have around 2,400 rooms, and that will make the hotel the largest in Japan.   |
| 2  | 31, Mar, 2015 | GINZA Asahi Bldg. (tentative name)                              | The Asahi Shimbun   | Chuo Ward, Tokyo Met.         | Autumn, 2017                  | -                         | Reconstruction project of "Tokyo Asahi Bldg." owned by Asahi Shimbun. Total cost for the project will amount to about 13 billion yen.   |
| 3  | 30, Jun, 2015 | Yurakucho 2 Chome Development Project (tentative name)          | Hulic Co.   | Chiyoda Ward, Tokyo Met.      | Jul. 2018                     | -                         | Redevelopment project of "New Tokyo bldg." and "Hulic Yurakucho bldg." The new building will accommodate shops and a hotel. Hulic Hotel Management Co. will rent the hotel section, open "The Gate Hotel" and operate it.   |
| 4  | 03, Sep, 2015 | -   | Great Eagle Holdings <Hong Kong>  | Minato Ward, Tokyo Met.       | CY2020                        | -                         | They acquired the land at about 22.2 billion yen. This is the first investment in Japan for the Great Eagle Holdings which operates real estate business and hotel business mainly in mainland China and Hong Kong as well as Asia Pacific Region, United States and U.K.               |
| 5  | 22, Oct, 2015 | HOTEL KEIHAN TSUKIJI GINZA (tentative name)                     | NAKAGAWA SPECIAL STEEL INC.   | Chuo Ward, Tokyo Met.         | Autumn, 2018                  | 300                       | Nakagawa special steel, the current owner of the land, will develop a new building and own it. Then Hotel Keihan will undertake its operation as its direct management hotel. Hotel Keihan is planning to have more than 15 direct management hotels nationwide by year 2020.           |
| 6  | 26, Oct, 2015 | First Cabin Atagoyama (SIB bldg.)                               | SIB Well (tentative translation by MUTB, an affiliated company of Pelican Soap Co.) | Minato Ward, Tokyo Met.       | Nov. 2015                     | 150                       | There was a parking structure owned by Pelican Soap. SIB Well has built a new building which consists of office section, hotel section and residential section.   |
| 7  | 28, Oct, 2015 | KEIO PRESSO INN Hamamatsucho (tentative name)                   | Keio Corporation  | Minato Ward, Tokyo Met.       | Oct. 2017                     | Approx. 330               | The land is an ex-site of headquarters building of NICHIAS Co. Keio Corporation will rent the land from NICHIAS and build a hotel. Then Keio Presso Inn, a member company of Keio Corporation, will operate it.   |
| 8  | 01, Dec, 2015 | HOTEL FORZA SAPPORO (tentative name)                            | FUKUOKA JISHO CO.   | Sapporo City, Hokkaido        | Jan. 2018                     | Approx. 190               | Fukuoka Jisho acquired the land and will construct a budget hotel, operated by a member company of the group. This is the first case for the company to open a new hotel outside of Kyushu island. It is planning to open new hotels in major cities nationwide.                        |
| 9  | 03, Dec, 2015 | TKP, Hotel Construction Project (tentative translation by MUTB) | TKP Corporation   | Sendai City, Miyagi Pref.     | Jul. 2017                     | -                         | It acquired the land from a whole sale company (the detail was not disclosed). TKP Co. will expand their hotel business in addition to their rental meeting room business.  |
| 10 | 04, Dec, 2015 | Shinbashi 1-Chome Plan (tentative name)                         | NTT Urban Development Co.   | Minato Ward, Tokyo Met.       | CY2019                        | 267                       | NTT Urban Development acquired the land from Tokyo Electric Power in 2012 at 25.05 billion yen. NTT will built a complex building with office section, hotel section and retail section. JR Kyushu (Kyushu Railway Company) will acquire the hotel section and it will operate a hotel. |

|    |               |   |   |  |              |             |  |
|----|---------------|---|---|--|--------------|-------------|--|
| 11 | 08, Dec, 2015 | CANDEO HOTELS HIGASHI-SHINSAIBASHI (tentative name) | THE SANKEIBUILDING Co., JR WEST REAL ESTATE & DEVELOPMENT COMPANY, Yasuda Real Estate Co. | Osaka City, Osaka Pref.                                      | Summer, 2017 | 496         | The three companies acquired the land in July 2015. CANDEO HOSPITALITY MANAGEMENT will rent the whole building, and operate a hotel.   |
| 12 | 24, Dec, 2015 | APA HOTEL RYOGOKU-EKIMAE (tentative name)           | APA (a member of APA GROUP)   | Sumida Ward, Tokyo Met.                                      | Spring, 2019 | 1,065       | APA rents the land from its owner, and will build a 31 story hotel with 1,065 guest rooms. APA GROUP has revealed their new strategy that they will promote projects with rented land, in addition to their conventional "land acquisition and construction" scheme.   |
| 13 | 20, Jan, 2016 | -   | MORI TRUST CO.  | Hakuba Village, Nagano Pref., Miyakojima City, Okinawa Pref. | 2019~2022    | -           | MORI TRUST acquired the lands as development sites of resort hotels. Recent years, the company has been focusing on hotel development and operating business, and is now developing and planning to develop hotels in Toranomon (Tokyo Met.), Hakone (Kanagawa pref.), Nara (Nara pref.), Sesoko island (Okinawa pref.) in addition to this project. |
| 14 | 02, Feb, 2016 | Keikyu EX Inn Haneda (tentative name)               | Keikyu Corporation  | Ota Ward, Tokyo Met.   | FY2017       | 313         | Keikyu Corp. will build a hotel on a part of the land, owned by Keihin Kyuko Bus Co. as its bus garage. After the completion, Keikyu EX Inn will operate the hotel.  |
| 15 | 23, Feb, 2016 | THE STRINGS HOTEL SHINJUKU (tentative name)         | TSUKADA GLOBAL HOLDINGS Inc.  | Shinjuku Ward, Tokyo Met.                                    | CY2018       | Approx. 200 | The development site is a land of ex-headquarters building of Kurita Water Industries. TSUKADA GLOBAL HOLDINGS, a wedding business company, rents the land, based on a contract of "fixed-term leasehold interest in land" for 60 years. The company will build and operate a hotel with wedding facilities.   |

(Conversion cases)

|    |               |                     |                      |  |                        |  |   |
|----|---------------|---------------------|----------------------|--|------------------------|--|---|
| 16 | 26, Mar, 2015 | TokyoGinzaBAY HOTEL | CHUO TOCHI CO.       | Chuo Ward, Tokyo Met.                      | Jul. 2015              | 228                                    | A conversion project of a hospital.   |
| 17 | 21, Aug, 2015 | -                   | ReBITA Inc.          | Kanazawa City, Ishikawa Pref. (2 projects) | Spring or Summer, 2016 | (250 beds in total for the 2 projects) | ReBITA has converted an office and a retail property into the "shared complex hotels". These are the first cases and the company is planning to expand the business in some local cities, such as Kyoto, Hakodate, Okayama etc. as well as major three metropolitan areas, opening a few new hotels annually. |
| 18 | 25, Sep, 2015 | 9h ninehours Sendai | Hoosiers Corporation | Sendai City, Miyagi Pref.                  | Nov. 2015              | 140                                    | Hoosiers Corporation acquired a vacant building in January 2015, and converted a part of office section into hotel rooms.   |

Source: Prepared by MUTB based on "Nikkei Real Estate Market Report" by Nikkei BP.

Hulic Co.: a company of real estate holding, leasing, sales and brokerage.

Nippon View Hotels: a company with some direct management hotels, and hotel operation business.

NTT Urban Development: a company of sale and buy, and management of real estate, leasing, brokerage and appraisal etc.

Hiramatsu Inc.: a company of class restaurant business and wedding business.

Sun Frontier Fudosan Co.: a company of real estate revitalization and real estate services.

Tosei Corporation: a company of revitalization, development and rental of real estate, property management; funding and consulting.

B-Lot Company: a real estate and financial consulting company.

### FEATURE 1: More and more players expand and enter into hotel business

The number of new players who enter into hotel business has been increasing, and existing players are expanding their business. Especially, in the last 12 months, real estate companies have made headlines.

Hulic Co., which set the “Consolidation of Tourism business” as one of main pillars in its “Medium-Term Management Plan”, acquired 25% of the equity in the Nippon View Hotels, aiming to expand its hotel business. NTT Urban Development established “Hotel and Resort Business Department” in October 2015, and formed a capital and business alliance with Hiramatsu Inc. In addition, Sun Frontier Fudosan Co. announced that it formed a JV company with Spring Airlines Investment Management, a member of Spring Airline Group which is one of major LCC companies in China, to develop a hotel chain for foreign visitors in Japan. Tosei Corporation also announced that it established its wholly owned subsidiary, Tosei Hotel Management Co., to tap into hotel market. There are many new movements like the above.

### FEATURE 2: Effective utilization of properties owned by general business companies are seen

There are some cases where a general business company attracts a hotel to utilize its property effectively (Case #2, #15 etc. in FIGURE 6).

The development site of Case 15 is an ex-headquarters site of Kurita Water Industries. Kurita had moved to a newly constructed rental building, mainly due to decrepitude of the ex-headquarters building. Then the company leased the headquarters’ site to TSUKADA GLOBAL HOLDINGS, and TSUKADA will build and operate a hotel with 200 guest rooms and wedding facilities.

### FEATURE 3: The number of conversion is increasing since construction cost remains high

To deal with construction cost, which still remains high, and increasing foreign visitors, conversion of existing buildings is appropriate in terms of cost and construction period. Therefore, the number of companies, undertaking or considering this approach is increasing.

In addition to Case #16 to #18 shown above, “First Cabin Tsukiji,” Case #3 in FIGURE 7, is another example of conversion. Originally, it was an office building. Then, B-Lot Company acquired it, carried out conversion into a hotel and sold it.

### Investment Activities into Hotels

Investment activities into hotels have become active (FIGURE 7). We can find many J-REITs among buyers. In 2014, Invincible Investment Co. announced that it changed its investment policy<sup>5</sup> and it would focus on acquisition of hotels, because of their growth potential. Since then, it has acquired 46 hotels up to the end of March 2016, and hotel properties now account for 65.9% of its total asset value (acquisition price basis).

We also see many actions for new listing of J-REIT specialized in hotel properties. Ichigo Hotel REIT was listed in November 2015, and MORI TRUST is preparing for the listing of its hotel REIT by the end of FY2016 at the latest.

In addition, the number of acquisitions made by foreign funds etc., especially investments by Asian investors, is increasing. Reportedly, Government of Singapore Investment Corporation (GIC), which is well known as it acquired Pacific Century Place Marunouchi, is also interested in acquisition of hotels in Japan. So, its future action will attract people’s attention.

When it comes to hotel investments by “private REIT,” we found two acquisition cases (i.e. #4 and #14 in FIGURE 7). Meanwhile, according to “Private REIT Quarterly, as of Mar. 2016” by the Association for Real Estate Securitization (ARES), “hotel investment” is included in “Others” category which is only about 4% of total asset. Therefore, we think that, even now, “hotel” seems a minor investment sector for private REITs.

<sup>5</sup>5: Up to year 2014, Invincible was a diversity fund, mainly focusing on residential properties. According to its securities report since 2014, hotels and residential properties are its main investment targets.

(FIGURE 7) Major investment activities in hotels reported or announced recently

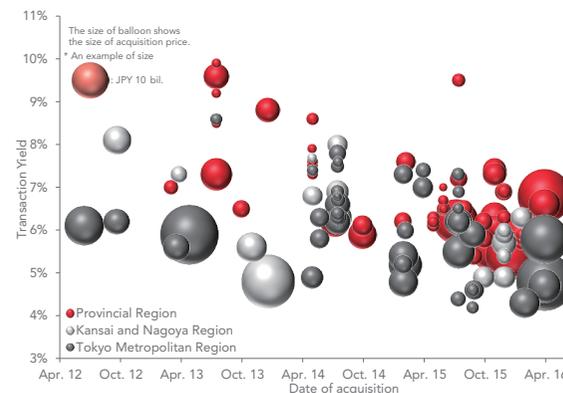
|    | Announcement or Reported Date  | Property Name   | Seller   | Buyer   | Location                               | Price (billion yen)         |
|----|--------------------------------|---|--|---|--|-----------------------------|
| 1  | 28, Jul, 2014<br>24, Sep, 2014 | Tokyo Bay Maihama Hotel Club Resort   | Maihama Elite Partners (tentative translation by MUTB)   | Hulic (50% of the quasi-co-ownership was sold to Kenedix, Inc. on Sep.24)                             | Urayasu City, Chiba Pref.              | More than 30.00 (estimated) |
| 2  | 18, Sep, 2014                  | Dormy Inn PREMIUM Otaru, Hakodate Rich Hotel Goryokaku  | SPC by Urban Renewal Association of Japan etc. and a subsidiary of YokoToshi Kaihatsu                            | SPC by SiS International Holdings   | Otaru City and Hakodate City, Hokkaido | 3.30 in total               |
| 3  | 21, Apr, 2015                  | First Cabin Tsukiji   | B-Lot Company  |   | Chuo Ward, Tokyo Met.                  | 1.97                        |
| 4  | 03, Jun, 2015                  | Nittochi Kawasaki Bldg. (Hotel Sunroute Kawasaki)   | NIPPON TOCHI-TATEMONO Co.  | NIPPON TOCHI-TATEMONO Private REIT Inc.   | Kawasaki City, Kanagawa Pref.          | -                           |
| 5  | 04, Jun, 2015                  | Okinawa Marriott Resort & Spa   | SPC by Lone Star   | Japan Hotel REIT Investment Co.   | Nago City, Okinawa Pref.               | 14.95                       |
| 6  | 09, Sep, 2015                  | Hotel Seven Seas Ginza  | ESTAX Co. (a Japanese company)   | Ginza Shintomi Private Ltd. (a Singaporean corporation) (the name is a tentative translation by MUTB) | Chuo Ward, Tokyo Met.                  | -                           |
| 7  | 7, Oct, 2015<br>26, Nov, 2015  | The Dojima Hotel  | Roru Management (tentative translation by MUTB)  | SPC jointly established by Wealth Management Inc. (a Japanese company) and Goldman Sachs Group        | Osaka City, Osaka Pref.                | -                           |
| 8  | 08, Oct, 2015                  | ANA Crowne Plaza Hiroshima, Fukuoka, Kanazawa, Toyama and two other hotels with other brands      | Horizon Hotels etc.  | Hoshino Resorts REIT, Inc.  | Hiroshima City, Hiroshima Pref. etc.   | 42.83 in total              |
| 9  | 02, Nov, 2015                  | Centurion Hotel Grand Akasaka   | Insupaia (a Japanese company) (tentative translation by MUTB)  | Taisei-Yuraku Real Estate Co.   | Minato Ward, Tokyo Met.                | -                           |
| 10 | 13, Nov, 2015                  | Hoshino Resorts TOMAMU (transaction of the company)   | Matakite BV (an investment fund with Netherland nationality backed by an American company), Hoshino Resorts Inc. | Shanghai Yuyuan Tourist Mart Co.  | Shimukappu Village, Hokkaido           | 18.36                       |
| 11 | 30, Nov, 2015                  | 9 hotels including Smile Hotel Kyotoshijo and 8 hotels with various brands                        | SPC by Ichigo Inc. and other entities  | Ichigo Hotel REIT Investment Co.  | Kyoto City, Kyoto Pref. etc.           | 20.41 in total              |
| 12 | 15, Dec, 2015                  | Hakodate Twin Tower Bldg.   | Nippon Life Insurance Co.  | Ken Corporation   | Hakodate City, Hokkaido                | -                           |
| 13 | 22, Jan, 2016                  | LOISIR HOTEL NAHA, LOISIR SPA TOWER NAHA  | SPC by Morgan Stanley and other entities   | United Urban Investment Co. (J-REIT)  | Naha City, Okinawa Pref.               | 20.00                       |
| 14 | 08, Mar, 2016                  | Centurion Hotel Cabin Tower   | RIFA (An affiliated company in Japan of RIFA Co., a Korean company)  | Marubeni Private Reit Inc.  | Minato Ward, Tokyo Met.                | -                           |
| 15 | 10, Mar, 2016                  | 4 hotels including HOTEL MYSTAYS Gotanda Station, Fukuoka Tenjin, Hamamatsucho, and another brand | SPC related to Fortress Investment Group   | Invincible Investment Co. (J-REIT)  | Shinagawa Ward, Tokyo Met. etc.        | 61.7 in total               |

Source: Prepared by MUTB based on "Nikkei Real Estate Market Report" by Nikkei BP. and disclosed information.

Transaction yields have been declining, since the hotel market has become active. According to acquisitions by J-REITs, there are some cases where transaction yield stands at 4.0% to 4.5% in central Tokyo, and 4.0% to 5.0% in central Osaka and central Kyoto (FIGURE 8)

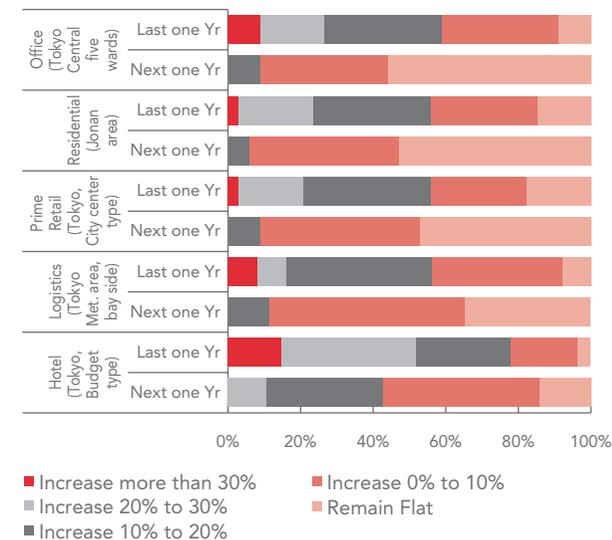
Although prices of hotels are rising significantly, due to declining yield and increasing profitability, they still attract investors' attention as an asset category with the potential for further profitability. According to our interviews of asset management companies, in terms of the four sectors, i.e. "Office", "Residential", "Prime Retail", "Logistics", almost 90% or more of the respondents said that price levels in 12 month would "Remain Flat" or "Increase 0% to 10%". In short, most of them thought that these prices would remain flat or increase "at most" 10%. On the other hand, as for the hotel sector, more than 40% of respondents said that the price level would "increase 10% to 20%" or "increase 20% to 30%." So, much more respondents are bullish only on the hotel sector (FIGURE 9).

(FIGURE 8) Transaction yield\*<sup>6</sup> of hotels acquired by J-REIT since april 2012



Source: Prepared by MUTB based on disclosed information.

(FIGURE 9) Price changes for the last and next one year



Source: "Private Fund Survey (January, 2016)" by MUTB

Tokyo central five wards: Chiyoda, Chuo, Minato, Shinjuku, Shibuya ward

Jonan area: Southern part of Tokyo 23 wards.

\* There was no answer of "decrease."

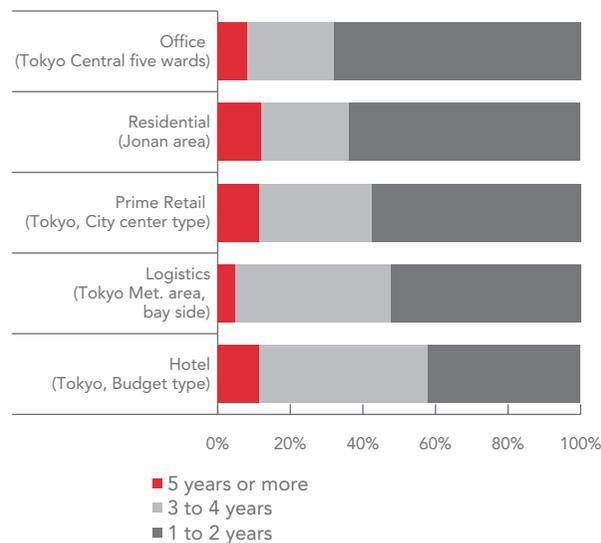
\*6: Dividing "estimated NOI by J-REIT" or "appraisal NOI at transaction date" by acquisition value.

## Why are the Players so Bullish about "Hotel" Sector?

FIGURE 10 shows players' expectation about time spans towards the peak of each sector. In all sectors, except for "Hotel," the majority said "the sector will hit the peak in one to two years." However, in the hotel sector, almost 60% of the players replied, "it will hit the peak in three to four years, or after."

In addition, as mentioned previously, ADR of hotels in Japan is relatively low. Therefore, some players may expect that there is some room of improvement of ADR, i.e. the profitability of hotel will increase.

(FIGURE 10) Expected duration of price increase by sector



Source: "Private Fund Survey (January, 2016)" by MUTB

Nowadays, hotel sector in Japan attracts investors' attention. Needless to say, there will be a pitfall in property investments, whatever the sector is.

We will observe the hotel market in Japan carefully, expecting its healthy development.

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