

Sekisui House, Ltd.

Transcript for Earnings Results Briefing for FY2020 (Telephone Conference)

Date: March 4th, 2021, Thursday 17:00 – 18:00 JPT
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< Presentation >

Note: The following generally omits the details of financial results presented in the “Summary of Consolidated Financial Results”.

[Sheet 1] Overview

When we announced results for the first half of FY2020, we revised the projected operating income to ¥175.0 billion, taking the effect of COVID-19 into consideration. However, net sales hit a record high of ¥2,446.9 billion, reflecting a recovery of orders, particularly orders for custom detached houses, from the third quarter and strong results in the homebuilding business in the United States. Operating income stood at ¥186.5 billion, ¥11.5 billion more than the revised plan.

Orders were weak in the first half of FY2020 due to the adverse effects of the COVID-19 pandemic, but recovered from the third quarter owing to the success of online sales in quick response to COVID-19, an increase in demand for custom detached houses and remodeling, a positive effect of COVID-19, our lifestyle proposals, SMART-ECS, a new next-generation indoor environment system, housing loan tax breaks and the extension of the period of the government's COVID-19 relief measures, among other factors.

Looking at the overview of earnings results, net sales increased ¥31.7 billion year on year, to ¥2,446.9 billion, which is ¥31.9 billion than the plan.

Sales in the Built-to-Order Business rose year on year to be ¥5.9 billion higher than projected. Sales of Custom Detached Houses were ¥18.3 billion more than the plan. Sales of Rental Housing were in line with the plan. Sales in the Architectural / Civil Engineering increased 150.3% year on year because of the addition of Konoike Construction Co., Ltd. to the subsidiaries, but ¥9.1 billion less than projected. Sales in the Supplied Housing Business rose ¥11.1 billion year on year, to ¥698.7 billion. In the Remodeling Business, orders recovered from the third quarter but fell short of projections. In the Real Estate Management Fees Business, sales in the real estate agency business fell short of projections, but the occupancy rate remained high at 97.7%. Sales in the Development Business decreased ¥65.9 billion year on year, to ¥321.1 billion, which is ¥6.1 billion higher than projected. In the Houses for Sales Business, orders were strong and exceeded the plan. In the Condominiums Business, sales of Grande Maison were strong, but sales of condominiums at Sekisui House Real Estate companies were less than projected. Sales at the Urban Redevelopment Business were roughly on a par with the projection.

Sales in the Overseas Business fell ¥19.1 billion year on year, to ¥370.6 billion, but were ¥20.6 billion more than projected. In the multifamily business in the United States, the number of properties planned to be sold has changed to three from five (the remaining two properties will be sold from the next fiscal year or thereafter). Sales in the homebuilding, master-planned community business and China business exceeded projections.

Gross profit decreased ¥4.5 billion, to ¥473.5 billion, Gross margin decreased by 0.4p. An increase in retirement benefit expenses decreased the gross margin more than 0.1p, but the gross margin continued to improve owing to a high value-added strategy. Due to the unexpected COVID-19 pandemic, approval was not obtained for land for hotels that is held for sale and for the development of building lots for sale in the United States, which resulted in the posting of a valuation loss of ¥9.4 billion. Gross profit was ¥11.5 billion higher than the revised projection. The gross margin was 0.3p higher. In the Built-to-Order Business, gross profit was ¥8.9 billion higher than projected, and the gross margin was 0.8p higher. In the Supplied Housing Business, gross profit was ¥2.7 billion less than projected, and the gross margin was 0.3p lower. In the Development Business, the gross margin was 0.6p lower due to a valuation loss. In the Overseas Business, gross profit was ¥5.9 billion higher, and the gross margin was 0.5p higher. SG&A expenses rose ¥14.2 billion. A ¥9.7 billion increase in personnel expenses, including retirement benefit expenses, and SG&A expenses of ¥10.4 billion at Konoike Construction Co., Ltd., which has become a subsidiary, are included in the rise in SG&A expenses. Selling expenses, including advertising expenses, and travel and transportation expenses decreased.

Operating income decreased 9.1%, down ¥18.7 billion. The Operating margin fell 0.9p, to 7.6%. Operating income was ¥11.5 billion higher than projected, and the operating margin was 0.4p higher. An increase in retirement benefit expenses reduced the operating margin by 0.3p. In the Built-to-Order Business, operating income fell 4.1%, to ¥95.3 billion. The operating margin declined 1.7p. An increase in retirement benefit expenses reduced the operating margin by 0.6p. Operating income was ¥9.8 billion more than projected, and the operating margin was 1.0p higher.

Operating income in the Supplied Housing Business decreased 0.4%, to ¥64.3 billion. The operating margin fell 0.2p. Operating income was ¥2.1 billion less than the projection, and the operating margin was 0.3p lower. In the Development Business, operating income dropped 16.4%, to ¥32.9 billion, and the operating margin increased 0.1p. Operating income was ¥1.0 billion less than projected, and the operating margin was 0.5p lower. In the Overseas Business, operating income decreased 10.9%, to ¥39.7 billion, and the operating margin fell 0.7p. Operating income was ¥4.8 billion higher than projected.

With respect to non-operating items decreased by ¥10.4 billion year on year, to -¥1.8 billion. Equity in earnings of affiliates decreased ¥9.8 billion, to ¥0.6 billion. The non-operating income/expenses included the addition of Konoike Construction Co., Ltd., ¥6.1 billion, and ¥3.3 billion related to the Overseas Business relations such as Singapore. Foreign exchange losses were ¥3.5 billion. Interest expenses were ¥2.7 billion. Ordinary income decreased 13.7% year on year, to ¥184.6 billion. This was ¥12.1 billion higher than projected.

Extraordinary income decreased ¥9.3 billion, to ¥3.5 billion due to the absence of a profit associated with the addition of Konoike Construction Co., Ltd. to the subsidiaries in the previous fiscal year. The extraordinary loss decreased ¥12.6 billion, to ¥2.7 billion. In the previous fiscal year, an impairment loss of ¥13.5 billion was posted. A loss on sales and retirement of non-current assets of ¥1.3 billion and a loss caused by COVID-19 of ¥0.6 billion were posted.

Profit attributable to owners of parent decreased 12.5%, to ¥123.5 billion, and was ¥9.5 billion above the projection. EPS was ¥181.18. We revised the dividend per share down to ¥82 after the first half, but have raised the dividend ¥2, to ¥84,

taking the rise in profit into consideration. The dividend payout ratio was 46.4%. ROE was 9.5%.

Orders received fell ¥78.1 billion year on year, to ¥2,401.8 billion. Orders rose ¥135.4 billion in the Built-to-Order Business and Supplied Housing Businesses and fell ¥200.9 billion in the Development Business and Overseas Businesses. The order backlog declined 3.2%, or ¥45.0 billion year on year, to ¥1,363.4 billion.

[Sheet 2] Financial position

Total assets decreased ¥8.8 billion, to ¥2,625.8 billion. Real estate for sale dropped ¥54.9 billion, to ¥923.9 billion. Real estate for sale in the Overseas Business decreased ¥67.6 billion, of which ¥20.3 billion was a decrease due to the stronger yen. Noncurrent assets increased ¥26.4 billion, to ¥845.1 billion. Net assets climbed ¥62.0 billion.

Interest-bearing debts decreased ¥23.9 billion, to ¥562.9 billion. The D/E ratio fell 4.0p, to 42.4%. The equity ratio was 50.5%. There was a greater-than-expected improvement in financial soundness. We will increase growth investment and improve EPS.

Looking at cash flows, cash provided by operating activities decreased ¥171.7 billion, to ¥191.9 billion in reaction to the high level of sales of properties in the Overseas and Urban Redevelopment Businesses in the previous year. Cash used in investing activities were ¥95.5 billion, reflecting an increase in capital expenditures. Free cash flows decreased ¥202.0 billion to ¥96.4 billion. Cash used in financing activities was ¥77.6 billion, reflecting dividends paid, repurchased company shares and reduction of interest-bearing debt. Those cash flows resulted in cash and cash equivalents of ¥600.2 billion, an increase of ¥16.9 billion.

Capital expenditures stood at ¥96.6 billion, which included an investment in real estate for lease of ¥79.3 billion. Depreciation and amortization stood at ¥21.7 billion. In FY2021, we plan to make capital expenditures of ¥100.0 billion, including an investment in real estate for lease of ¥75.0 billion and depreciation and amortization of ¥22.0 billion.

[Sheet 3] Segment information (Built-to-Order Business)

The Custom Detached Houses Business recorded declines in sales and profit. The gross margin improved 0.2p, while operating margin declined 1.8p. Retirement benefit expenses reduced the gross margin 0.4p and the operating margin 0.8p, but the gross margin and operating margin exceeded projections by 1.0p and 1.8p, respectively, owing to the improvement of the gross profit margin attributable to increased recognition of the brand name and a rise in sales due to the recovery of orders from the third quarter. Orders in the full year dropped 6.9% year on year, but recovered. In the first half, orders declined 19.5%, but in the second half, orders increased 8.5%. ASP per building rose ¥1.45 million, to ¥41.38 million. The ratio of Green First Zero was 86%.

The Rental Housing Business recorded declines in sales and profits. The gross margin fell 0.4p, and the operating margin declined 0.7p. As in the Custom Detached Houses, those figures reflect the effects of retirement benefit expenses, which reduced the gross margin and operating margin by 0.5p and 0.8p, respectively. The gross margin and operating margin were 0.3p and 0.7% above the projections, respectively. In the full year, orders declined 9.5% year on year, to ¥354.9 billion, but were on a recovery trend. Orders dropped 21.1% in the first half and decreased 6.7% in the second half. Orders for non-housing buildings were weak, but orders for Sha-Maison clearly recovered, rising 0.6% in the second half. ASP per building and the ratio of three-to-four-story houses also rose. Orders for Sha-Maison ZEH increased from 450 units in the first half to 2,976 units.

In the Architectural/Civil Engineering Business, both sales and profits increased owing to the addition of Konoike Construction Co., Ltd. to the subsidiaries. The gross margin and operating margin improved 1.4p and 2.2p, respectively. Orders fell short of the plan due to intensifying competition among general contractors.

[Sheet 3] Segment information (Supplied Housing Business)

The Remodeling Business registered declines in sales and profit. The gross margin improved 0.2p, but the operating margin declined 0.9p. Orders decreased 5.4% in the full year, to ¥141.6 billion, but recovered. In the second half, orders rose 8.2%. Major proposal-based remodeling projects increased to account for a third of all remodeling projects.

The Real Estate Management Fees Business achieved growth in both sales and profits. Both the gross margin and operating margin improved. The number of units under management increased approximately 17 thousand units from the end of the previous fiscal period, and the occupancy ratio was 97.7% remained at a high level.

[Sheet 4] Segment information (Development Business)

The Houses for Sale Business recorded declines in sales and profit. Both the gross margin and operating margin declined. The decline reflected the absence of the sale of large building lots and public housing for disaster victims in the Tohoku region in the previous fiscal year. Orders increased 1.4%, or ¥2.0 billion, to ¥145.3 billion. Orders were strong particularly in the second half and rose 24.3%.

The Condominiums Business posted a decrease in sales and profits. Due to strong sales of Grande Maison, both the gross margin and operating margin improved. Completed inventory for which no contract has been signed was 52 units.

The Urban Redevelopment Business registered decreases in sales and profits. However, the gross margin and operating margin improved 4.0p and 2.9p, respectively. Net sales and profit from the sale of properties stood at ¥72.4 billion and ¥15.5 billion, respectively. A valuation loss of ¥3.5 billion was posted for land for hotels. The properties sold were part of the Ritz-Carlton Kyoto and properties in Nagoya and Fukuoka.

[Sheet 4] Segment information (Overseas Business)

The Overseas Business recorded declines in sales and profit. The gross margin improved 0.5p, while the operating margin fell 0.7p. Orders decreased 30.5%, reflecting a decrease in properties for sale in China and a fall in property sales in the multifamily business in the United States. The order backlog dropped ¥27.7 billion, to ¥199.6 billion. The investment balance in the Overseas Business decreased ¥70.0 billion, to ¥678.9 billion, reflecting progress in sales in the China business.

In the United States, both sales and profits fell. Operating income was ¥5.4 billion higher than the plan, reflecting more-than-expected income in the homebuilding business and master-planned community business, despite the postponement of the sale of multifamily properties due to COVID-19. The investment balance fell ¥16.1 billion, to ¥428.4 billion. With respect to results in each business segment, in the multifamily business segment, net sales were ¥62.4 billion, operating income was ¥10.3 billion, orders received were ¥46.4 billion, and the investment balance was ¥221.3 billion. In the master-planned community business segment, net sales were ¥57.5 billion, operating income was ¥4.9 billion, orders received were ¥65.2 billion, and the investment balance was ¥111.1 billion. In the homebuilding business, net sales were ¥119.1 billion, operating income was ¥8.6 billion, orders received were ¥151.3 billion, and the investment balance was ¥94.4 billion.

In Australia, net sales increased ¥14.4 billion and operating income rose ¥2.7 billion. The business struggled in the first half due to the adverse effect of COVID-19. In the second half, sales recovered owing to government subsidies for purchasing homes, the reduction or exemption of stamp duty and a policy rate cut early in the year.

In China, net sales increased ¥34.7 billion and operating income climbed ¥11.3 billion. In the China business, of 6,693 units, contracts are yet to be concluded for only 277 units. All units have been sold in Suzhou, Taicang I and Taicang II. There are units yet to be sold in Shenyang and Wuxi. Orders dropped ¥97.2 billion. The investment balance fell ¥64.6 billion.

[Sheet 5] Full-Year Forecasts

Net sales will amount to ¥2,552.0 billion, up 4.3% year on year. We aim to improve earnings by achieving a recovery of orders in the Custom Detached Houses Business, Rental Housing Business and Remodeling Business, among other businesses. We plan to increase operating income 7.2%, or ¥13.4 billion, to ¥200.0 billion.

In the Built-to-Order Business, we plan to expand net sales 6.4% and increase operating income 10.1%, to ¥105.0 billion.

In the Custom Detached Houses Business, orders are rising, and we expect that both sales and profits will rise. It is anticipated that the profit margin will improve significantly. The Rental Housing Business is affected by the order decrease in the first half of last year. However, we plan to increase both sales and profits, considering the status of the order backlog and a recovery in orders of Sha-Maison. In the Architectural / Civil Engineering Business, we are taking into consideration the decline in the profit margin due to the deterioration of the environment surrounding the receiving of orders. In the Supplied Housing Business, we forecast that net sales will rise 6.3% and operating income will climb 18.9%, to ¥76.5 billion. In the Remodeling Business, proposal-based remodeling and environmental-based remodeling will continue to perform well against the backdrop of the growing need for comfortable living. In the Real Estate Management Fees Business, occupancy will remain high, and the business will continue to grow steadily. In the Development Business, we expect that net sales will increase 9.0%, to ¥350.0 billion and operating income will rise 1.6%. In the Houses for Sale Business, demand from first-time buyers will remain strong. In the Condominiums Business, a high-rise condominium with 870 units in Umeda, Osaka will be completed. In the Urban Redevelopment Business, we expect property sales of approximately ¥72.0 billion and a gain on sales of ¥10.0 billion.

In the Overseas Business, we forecast that overall sales will fall 10.2%, to ¥333.0 billion and operating income will decline ¥9.2 billion, to ¥30.5 billion. In the United States, net sales are forecast to be ¥248.1 billion and operating income is forecast to decrease ¥0.5 billion, to ¥24.7 billion. In Australia, net sales are expected to be ¥38.9 billion and operating income will be ¥2.0 billion, an increase of ¥1.4 billion. In China, net sales will be ¥46.0 billion, half the level of the previous year, operating income will fall ¥10.0 billion, to ¥5.0 billion. We expect a decrease in both sales and profits due to a decline in properties to be delivered.

In the United States, the homebuilding business will continue to perform well, but we take a conservative view of the environment for the sale of properties in the multifamily business. We expect only two properties will be sold.

Ordinary income will be ¥200.0 billion. We expect extraordinary income of ¥3.0 billion and an extraordinary loss of ¥3.0 billion. Net income after deducting income taxes and minority interests is forecast to be ¥135.0 billion. We forecast an EPS of ¥200.62, an increase of 10.7%, and an ROE of 10.0%. The dividend per share will increase for the tenth consecutive fiscal year, to ¥86, an increase of ¥2.

For sustainable growth, we will appropriately invest in real estate and invest to lay the foundation for growth. We aim to

increase shareholder returns through the sustainable growth of dividends per share and through flexible repurchase company shares.

< Summary of Question and Answer Session >

Note: Matters previously described in the financial statements and documents subject to timely disclosure are omitted here.

Question

- **(Overseas Business) How much will sales and income be in each business in the United States in FY2021? You expect to sell two properties in the multifamily business. Why is your property sales forecast conservative? Could you explain the status of leasing?**
- **(Urban Redevelopment Business) What will income except the income from property sales be? What is your view on the sale of hotels?**

Answer

- In the multifamily business, sales will come to ¥47.5 billion, and operating income will be ¥5.9 billion. In the master-planned community business, sales will be ¥55.0 billion, and operating income will be ¥7.7 billion. In the homebuilding business, sales and operating income will be ¥143.1 billion and ¥10.5 billion, respectively. We expect to sell two properties because we are carefully watching the recovery of investor sentiment, which has declined due to the COVID-19 pandemic. We expect investor sentiment to recover beginning in the latter half of this year. If investor sentiment recovers earlier, property sales may increase. We are making good progress in leasing as the effects of COVID-19 are being mitigated.
- Operating income except income from property sales will be ¥1.0 billion, which is on par with FY2020. We are carefully watching the recovery in occupancy rates for hotels. Regarding the sale of properties, we will sell primarily office buildings and rental housing. We have a pipeline that includes properties valued at more than ¥300.0 billion.

Question

- **(Overseas Business) Could you explain your views on the timing for selling properties in the multifamily business in the United States in your plan for FY2021?**
- **(Rental Housing Business) Could you explain the effects of the suspension of designation of productive green land on demand and your outlook for orders?**

Answer

- We are making good progress in leasing for the two properties that we plan to sell in FY2021 and we can sell them. However, we will not sell them at a low price and will maximize the value of the properties. We will carefully assess investor sentiment to decide the timing for selling them. In our plan, we focus on property sales in the second half. However, we will put more importance on the behavior of investors.
- Sha-Maison properties are concentrated in the three major metropolitan areas. Many of them are located on land owned by corporations in urban areas. We are shifting our focus to areas where there is strong demand and little concern about the future occupancy. Thus, we believe that the effect of the suspension of the designation of productive green land will be small.

Question

- **(Architectural / Civil Engineering Business) What is your outlook for orders?**
- **Will you increase the total return ratio in the final year of the Medium-Term Management Plan (FY2022) and the preceding fiscal year? Do you think that financial conditions will improve every fiscal year?**

Answer

- The civil engineering business is performing well. However, the architectural business is facing intensifying competition for orders, and we expect the operating margin will fall, although orders will grow.
- We emphasize the continual increase of dividends per share and the flexible repurchase company shares. We plan to invest to lay a foundation for growth and invest in real estate to increase sustainable growth from the 6th Medium-Term Management Plan. The D/E ratio may deteriorate slightly this fiscal year and the next fiscal year.

Question

- **I think capital expenditures, which are now ¥100 billion, may increase. What kinds of properties will you increase investment in, considering the current investment environment and investment opportunities?**
- **(Overseas Business) Could you describe the downside risks in the homebuilding business in the United States, including the decrease of any positive effects caused by COVID-19 and rising interest rates?**

Answer

- A large percentage of investment has been investment in hotels, but investment in rental housing, which is stable, and office buildings in land in favorable locations, like the location of the Kokusai Akasaka Building, will become the majority of investments. Demand for hotels declined due to the COVID-19 pandemic, which has enabled us to buy land for rental housing. There is not much land for office buildings available.
- The cost of materials and personnel costs are rising, and we need to estimate costs cautiously. However, the

environment for selling land and buildings is favorable, and we think housing sales will be strong for some time to come.

Question

- **Will you achieve operating income of ¥220.0 billion in the third year of the Medium-Term Management Plan?**
- **You appear to have abundant cash on hand. How much of cash do you think will be appropriate?**

Answer

- The operating income forecast for FY2021 has changed to ¥200.0 billion from ¥210.0 billion, the amount announced together with the Medium-Term Management Plan, because operating income in the Overseas Business was ¥5.0 billion short of what was initial plan and operating income in the Urban Redevelopment Business was ¥3.0 billion less than initial plan. Operating income of ¥220.0 billion in FY2022 is based on the assumption that the multifamily business in the United States, for which we need to carefully assess investor sentiment, will recover and the hotel business and the Urban Redevelopment Business will improve when the COVID-19 pandemic subsides as people become vaccinated. We think the operating income of ¥220.0 billion in FY2022 is a minimum target. We seek to more than recover the shortfalls in FY2020 and FY2021.
- The approximately ¥200.0 billion in the Overseas Business significantly contributes to cash on hand. Cash is abundant particularly in China, where we have ¥130.0 billion. This is due to incomplete liquidation proceedings for an SPC. An increase in cash owing to the addition of Konoike Construction Co., Ltd. to the consolidated subsidiaries is also a major factor. We will invest that cash to lay a foundation for growth.

Question

- **(Real Estate Management Fees Business) Why did you fail to achieve projections in the real estate agency business?**
- **(Custom Detached Houses Business and Rental Housing Business) Could you describe the unit selling prices for each business?**

Answer

- The real estate agency business fell ¥2.5 billion short of projections. We think the main factor was the COVID-19 pandemic, including a decrease in the flow of people.

In the Custom Detached Houses Business, we seek to move the houses in the 1st range that Sekisui House noie's houses, 2nd range and 3rd range fall under to higher price ranges and expand sales of houses in the 3rd price range, which is more than ¥50 million, thereby raising the unit selling price. In the Rental Housing Business, the unit selling prices of two-story houses and three-story houses are significantly different. The ratio of three-to-four-story houses is about 76%, and the unit selling price is more than ¥200 million. We will continue to raise the ratio of three-to-four-

story houses and the unit selling price.

Question

- **Are any segments affected by the population migration from city centers to suburban areas?**

Answer

- In the second half of FY2020, compared to the first half, orders in the Custom Detached Houses Business rose more than 8%, and orders in the Houses for Sale Business increased 24.3%. We think those numbers have resulted from the effects of the migration. At 97.7%, the occupancy rate of the rental housing that we manage is high. The houses in both city centers and suburban areas are almost fully occupied.

Question

- **(Condominiums Business) Why is the growth of operating income high in FY2021?**

Answer

- In FY2020, sales of condominiums at the Sekisui House Real Estate Group fell short of projections and total sales, ¥8.8 billion, were ¥1.2 billion short of the projected ¥10.0 billion. In FY2021, it is projected that sales at the Sekisui House Real Estate Group will remain flat, and we plan to increase sales of Grande Maison, a Sekisui House brand whose profit margin is high.