

Sekisui House, Ltd.

Transcript for Question and Answer Session of Fifth Mid-Term Management Plan (FY2020 - FY2022) Briefing

Date: March 6th, 2020, Friday 13:30 – 15:00 JPT

Participants: Yoshihiro Nakai, President and Representative Director
Toru Ishii, Managing Officer and Chief Manager of Overseas Department
Hideyuki Kamijo, In charge of Accounting & Finance, Managing Officer
Keizo Yoshimoto, In charge of General Affairs & Legal, Executive Officer
Atsushi Yoshida, Chief Manager of Investor Relations Department

< Summary of Question and Answer Session >

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

Question

- Q1 Describe your views on securing of adequate human resources and quality assurance in the Custom Detached Houses Business in the United States.
- Q2 The Platform House Concept is classified as a new business. Do you plan to change demand for detached houses in accordance with the concept or will you develop a new market?

Answer

- A1 We will hire local human resources. As for quality, we will enhance accuracy in construction during the period of the current Mid-Term Management Plan. For the time being, we will strive to enhance accuracy in construction, particularly in the construction of Woodside Homes. In the United States, we have been lacking in human resources for product development. We will create a committee to review construction, product development and cost and will develop a system for proposing lifestyles.
- A2 This year, we will have a pilot sale of 30 to 50 houses. We will then review the algorithm and would like to implement the system in all houses that we will provide. Sekisui House remodeling companies are also eager to implement the system, therefore, we will promote the implementation of the system in existing homes as well as our newly built homes.

Question

- Q1 The earnings plan in the Fifth Mid-Term Management Plan seems very conservative. In the past, a downturn in the Overseas Business was offset by results in the Urban Redevelopment Business. If there were a downturn in a segment during the period of the new mid-term management plan, is there any way to offset it? Will the plan for China be adversely affected by the Covid-19 outbreak?
- Q2 If you were to develop the SHAWOOD business in the United States, do you have any new ideas, such as M&A and the construction of plants?

Answer

- A1 To mitigate downside risk, in FY2019, we concluded contracts for sales of large projects in the U.S. multifamily (rental housing development) business in the first half and delivered and sold properties in the second half. We achieved the plan in this way. We will continue this during the current fiscal year. We have already delivered a property in a large project. We plan to sell another property in the first half and expect to achieve the earnings plan for this fiscal year. We have almost prepared plans, including plans for properties, for the next three years in the multifamily business. A half year ago, we said that we planned to record operating income of 35 billion yen. Now, we already have pipelines for operating income of 40 billion yen. We will achieve our plans without fail, creating synergy between the domestic and overseas businesses. In the China business, of the plan for this fiscal year, 12 billion yen, Suzhou accounts for 80%. In Suzhou, contracts have been made for 90% of the plan, and delivery has already started. Actual delivery is below the initial plan due to the spread of the novel coronavirus, but there have been no new cases in the southern area in the past three weeks. The situation is expected to improve gradually, particularly in Taicang. We believe that we will be able to achieve the plan without fail if delivery starts in earnest.
- A2 We think we can promote homebuilding on land that we sell in the community development business in the United States as a built-to-order business. To achieve 10,000 detached houses, we need to actively acquire land for detached houses. To that end, we can choose between real estate investment or M&A of companies with properties. We have not yet made any decisions. In the United States, the technologies required differ by state or area and we are examining the best form of plants.

Question

- Q1 Regarding shareholder returns, the total return ratio was 53%, a high level in the industry, in FY2019, if share buybacks are taken into consideration. Will you continue to aim for a total return ratio of 50% or more in the period of the Mid-Term Management Plan? Will you flexibly buy back shares every year and disclose the scale?
- Q2 Has the tightening of apartment building loans had any effects? Has it made your customers' financing difficult? Some say that the amendment to the Civil Code in April will make the examination of tenants more rigorous and will lead to the tightening of loans. Will that have any impact?

Answer

- A1 We made an announcement of flexible share buybacks, setting the scale at 15 billion yen this fiscal year. However, we refrained from announcing, for example, the specific total amount in the next three years. We will examine and announce the scale of share buybacks every year, if possible, considering the balance of growth investment and earnings, among other factors.
- A2 Basically there is no impact. Our strategy focuses on S and A areas (prime city center locations). We actually feel the tightening of loans and the prolongation of examination periods in the provinces. However, we do not build rental apartments in those areas. In our case that properties whose management is stable in the long term, we see the prolongation of the examination, but ultimately loans can be received. With regard to the amendment to the Civil Code, we have been examining tenants rigorously. The amendment to the Civil Code will rather have a positive effect because we have been examining tenants rigorously for more than 30 years to ensure long-term, stable management.

Question

- Q1 I think that the average selling price (ASP) per building will be raised in the Custom Detached Houses Business by providing high-value-added products. Can we expect the profit margin to rise accordingly?
- Q2 I understand that in the Overseas Business, you aim to provide 10,000 detached houses in six years. Do you plan to allocate resources and make investments in the next three or six years to achieve this goal?

Answer

- A1 As the ASP per building rises, profit margin will definitely rise. We are being affected by the reaction to the consumption tax hike and retirement benefit expenses of 8.0 billion yen. Profit margin might improve from the next fiscal year.
- A2 We will make preparations in the next three years, including the construction of plants, the acquisition of land, and the establishment of a delivery system and a supply chain for 3,000 houses. We believe that we will be able to increase the number of detached houses sharply from the fourth year. Currently, the main business is the multifamily business, but in the Sixth Mid-Term Management Plan, the homebuilding business will also become a major business.

Question

- Q1 What steps are you taking as a product development partner of Woodside Homes?
- Q2 What is your outlook for the D/E ratio and free cash flow in the next three years?

Answer

- A1 We have just created a team after recruiting a few members through headhunting. We will raise the level and create synergy.

A2 We expect that the D/E ratio will remain flat (at 0.46) next year. One of the reasons why we set the goal at 0.45 is that we considered the restrictive clause related to the refinancing of hybrid bonds. The clause stipulated that the D/E ratio, excluding lease obligations, should be 0.44 or less, and we thought we would maintain the D/E ratio of 0.45 for a financial reason. As for free cash flow, we are at a stage where we should increase investment. We will not increase cash sharply. We will strike a balance between investment and return on investment. Next year, investment may exceed return on investment, and cash may fall. According to the existing plan, in the third year, cash will increase. However, we expect free cash flow to remain flat, considering possible growth investment and other factors.

Question

- Q1 What is the breakdown of planned investment overseas by country like in the three-year period of the mid-term management plan?
- Q2 Describe the details of the executive officer system reform.

Answer

- A1 We will earn back around 100 billion yen from China and will invest that amount in the United States. The investment balance in the entire Overseas Business will remain flat.
- A2 Cultivating executive officers is important, including building a strong leader pipeline and cultivating director candidates. The Company has introduced a system where officers are assigned to each division: Business Strategy Division, Investor Relations Division, Administration Division and Technology Division. There are two types of executive officer systems: the delegation type, where retired employees are appointed as executive officers, and the employment type, where employees are appointed executive officers and continue to serve the Company. We are discussing which type we should choose. We believe that the executive officer system is the key to the building of a strong pipeline, including the relationship between human resources development and treatment and active promotion.

Question

- Q1 You expect the operating margin to improve particularly in Custom Detached Houses, Rental Housing and Real Estate Management Fees. Can you achieve the plan?
- Q2 (In response to the answer to Q1) Will plans for FY2021 and FY2022 also be conservative?

Answer

- A.1 In FY2020, Architectural/Civil Engineering segment, a new segment consisting of Konoike Construction and the RC division of the former Rental Housing Business, are added to the Built-to-Order Business. Operating income of 13 billion yen at Konoike Construction will contribute, but will be offset by retirement benefit expenses of 8 billion yen and a reactionary fall in orders in Custom Detached Houses. Orders in

Custom Detached Houses, which declined in reaction to the consumption tax hike, recovered in January and February, and we hope that the upward trend will continue in March and April. However, the number of visitors to display homes is expected to fall in March due to the spread of coronavirus. We are not holding big events and have shifted to sales visits. We hope that our performance will recover if the effect of the spread of coronavirus decreases. For now, we plan to offset the decline in Custom Detached Houses with performance in Rental Housing and Architectural/Civil Engineering. In the Rental Housing, we will increase our share particularly in S and A areas (prime city center locations) and CRE/PRE business. We are creating synergy with Konoike Construction in the construction of mid-rise and high-rise buildings and the development of Michi-no-Eki. We believe that we will be able to achieve the plan for the Built-to-Order Business. Six companies in the Sekisui House Real Estate Group are responsible for the Real Estate Management Fees Business. We have established the Broking and Leasing Business Headquarters at the head office and have established governance in revenue planning. Monthly rent will increase 1,000 yen, which means a 7.2 billion yen increase in sales. We believe that we can raise rent through renovations and can improve profit margin, taking advantage of our high-value-added stock.

A2 Yes.

Question

- Q1 You have approximately 500 display homes in Japan. Do you think that reducing the number of display homes will result in a cost cut?
- Q2 What do you emphasize in SEKISUI HOUSE noie?

Answer

- A1 The number of our display homes has decreased to about 350. In the past 10 years, we have exhibited products, considering cost effectiveness. Therefore, the scale at present is appropriate.
- A2 The prices of the noie products are 23 million yen to 24 million yen. Because the same construction companies as that of Sekisui House, Sekiwa Construction companies, constructs houses, the same level of quality, sense of security and after-sales service as those of Sekisui House is provided. That is the strength of noie. The strength cannot be imitated by the competitors. We are selling noie products, emphasizing that strength. The housing performance of noie houses, including earthquake resistance and thermal insulation, meets the adequate standard. However, not all technologies that Sekisui House has developed, including SHEQAS, Airkis and Bellburn exterior wall, are introduced, which is reflected in the differences in price.