Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the First Quarter of FY2020 (Telephone Conference)

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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

Record-high quarterly sales were achieved. Konoike Construction Co., Ltd., which was converted into a consolidated subsidiary, made a contribution. Sales and profits increased in all business models.

Konoike Construction Co., Ltd., which was converted into a consolidated subsidiary, made a contribution. Sales and profits increased in all business models. However, orders received declined significantly in the Custom Detached Houses Business and the Rental Housing Business associated with a fall in negotiation opportunities due to our voluntary decision to suspend sales activities during the COVID-19 outbreak.

Net sales increased 25.3%, to ¥598.0 billion. Sales increased ¥64.8 billion in the Built-to-Order Business. Sales declined in the Custom Detached Houses Business associated with a fall in orders received since the second half of the previous year, but increased in the Rental Housing Business due to the abundant order backlog. Sales rose significantly in the Architectural and Civil Engineering Business because of the addition of Konoike Construction Co., Ltd. In the Supplied Housing Business, sales increased 3.4%, to ¥171.4 billion. Sales declined in the Remodeling Business but increased in the Real Estate Management Fees Business. In the Development Business, sales rose 30.1%, to ¥92.3 billion. While sales decreased in the Houses for Sale Business, sales increased in the Condominiums Business due to the steady delivery and rose in the Urban Redevelopment Business due to progress in property sales. In the Overseas Business, sales increased 73.0% due to good progress in property sales in the multifamily business in the United States and the delivery of condominiums in Suzhou, China.

Gross profit increased ¥22.1 billion to ¥120.8 billion, and the gross margin dropped 0.5p, to 20.2%. The gross margin fell 2.2p in the Built-to-Order Business as a result of the addition of the Architectural and Civil Engineering Business, but improved 0.3p in the Supplied Housing Business and 2.6p in the Development Business. In the Overseas Business, the gross margin dropped 3.5p, to 21.6%.

SG&A expenses increased 8.5%, to ¥69.9 billion. The SG&A ratio improved 1.8p, to 11.7% due to the increase in sales. Personnel expenses rose ¥2.5 billion, of which retirement benefit expenses increased ¥1.2 billion. In addition, the rise in SG&A expenses as a result of the addition of Konoike Construction Co., Ltd. as a consolidated subsidiary was ¥3.0 billion.

Operating income grew 48.8% to ¥50.8 billion, and the Operating margin improved 1.3p, to 8.5%.

The operating margin fell in the Built-to-Order Business due to an increase in retirement benefit expenses and a rise in the fixed cost burden caused by smaller sales in the Custom Detached Houses Business. In the Supplied Housing Business, operating income increased ¥0.5 billion, to ¥16.6 billion, and the operating margin was the same as in the previous fiscal year at 9.7%. In the Development Business, operating income rose ¥6.0 billion, to ¥13.8 billion, and the operating margin improved 4.0p, to 15.0%. An improvement in the operating margin in the Urban Redevelopment Business made a contribution. In the Overseas Business, operating income was up ¥5.1 billion, to ¥8.1 billion. Operating income rose in the United States, China and Australia.

The balance of non-operating items decreased by ¥4.0 billion year on year, to -¥3.2 billion this quarter. Equity in earnings of affiliates was ¥0.4 billion. ¥1.0 billion equity in Otori Holdings, Co., Ltd. (the holding company of Konoike Construction Co., Ltd.), which was made a subsidiary, for the previous fiscal year decreased.

The impact of foreign exchange included foreign exchange losses of ¥3.3 billion in the current fiscal year, mainly due to the transfer of some of loans to businesses in Singapore to equity capital.

Of the extraordinary loss of ¥0.7 billion, of which, loss on valuation of investment security was ¥0.4 billion.

Orders received decreased to ¥571.7 billion, a fall of ¥24.3 billion. The Custom Detached Houses Business and the Rental Housing Business saw declines. The order backlog decreased 1.9%, to ¥1,382.1 billion.

[Sheet 2] Financial position

Current assets decreased ¥103.1 billion, to ¥1,712.8 billion. A major item was a decrease of ¥98.9 billion in cash and deposits. Factors for this included the payment of notes and accounts payables in the first quarter as well as the payment of income taxes, consumption taxes and dividends. Real estate for sale decreased ¥6.0 billion in Japan and ¥26.4 billion overseas. Of the decrease, ¥24.6 billion was due to the impact of foreign exchanges. Of a decline of ¥12.6 billion in noncurrent assets, property, plant and equipment increased ¥2.6 billion. Capital expenditures decreased ¥6.7 billion, to ¥19.7 billion, of which investment in real estate for lease was ¥16.0 billion.

Total liabilities declined ¥84.7 billion from the end of the previous fiscal year, mainly reflecting decreases in accounts payable and accrued income taxes. Interest-bearing debts decreased ¥25.3 billion to ¥561.5 billion. The D/E ratio decreased 0.9p, to 45.5%.

Net assets decreased ¥31.0 billion from the end of the previous fiscal year. Translation adjustments declined ¥18.3 billion. The equity ratio rose 0.9p, to 49.0%.

Looking at cash flows, cash flows from operating activities improved mainly due to a decrease in inventories and an increase in profit during this quarter. Cash flows from investing activities improved. As a result, free cash flows improved ¥27.8 billion. Cash and cash equivalents at the end of the period increased ¥220.3 billion year on year, to ¥484.4 billion.

[Sheet 3] Segment information (Built-to-order business)

The Custom Detached Houses Business posted a fall in sales associated with a decline in orders received from the second half of the previous fiscal year. The gross margin fell 0.4p. The operating margin dropped due to a decrease in net sales and a rise in the burden of retirement benefit expenses, which was unable to make up for the burden of fixed costs. These were results within the scope of the assumption, because we had taken a strict stance in the initial plan. Orders received decreased 23.3%. Factors for this include the voluntary suspension of sales activities at housing exhibitions, the cancellation of events and a decrease in negotiation opportunities due to the voluntary ban on leaving home because of the effects of COVID-19. We will pay close attention to orders received after June.

ASP per building improved ¥1.64 million to ¥41.57 million, and ratio of Green First Zero was 89%.

The Rental Housing Business recorded an increase in sales due to the abundant order backlog at the end of the previous fiscal year. The gross margin fell 1.0p, of which the negative impact of the increasing burden of retirement benefit expenses was 0.5p. Orders received decreased 14.9% due to a fall in negotiation opportunities, as in the Custom Detached Houses Business.

ASP per building increased ¥11.07 million from the end of the previous fiscal year, to ¥113.48 million, and the ratio of three- and four-story houses rose to 80.4%.

The Architectural and Civil Engineering Business was added in the current fiscal year. It consists of the construction of RC (reinforced-concrete) structures other than properties using materials shipped from the factory, which had belonged to the Rental Housing Business until the previous fiscal year, and Konoike Construction Co., Ltd., which became a subsidiary in October 2019. Both sales and profits increased in this segment, with a rise of ¥72.5 billion in net sales and an increase of ¥9.5 billion in operating income. This segment made progress as expected in the full-year plan, and COVID-19 has almost no impact on profits as of this moment.

[Sheet 3] Segment information (Supplied Housing Business)

The Remodeling Business recorded falls in sales and profits. Reflecting the strong tendency to refrain from proceeding due to the necessity of confirming the current situation of the interior, orders received decreased ¥10.6 billion, to ¥31.8 billion.

The Real Estate Management Fees segment achieved growth in both sales and profits. The number of units under management increased approximately 5,500 units compared to the end of the previous fiscal year, and the occupancy rate improved 0.3p, to 98.0%. Sekiwa Real Estate changed its trade name to Sekisui House Real Estate in the current fiscal year to strive to maintain higher occupancy rates by further infiltrating the Sha Maison brand and providing high-quality services.

[Sheet 4] Segment information (Development Business)

The Houses for Sale Business recorded declines in sales and profits. Orders received decreased ¥5.9 billion, to ¥30.8 billion due to the sale of commercial land in large building lots for sale and large housing complexes in the previous fiscal year.

The Condominiums segment posted increases in sales and profits. The operating margin improved 0.7p, to 15.1%. Progress was made as planned mainly in the delivery of tower condominiums, which were completed at the end of the previous fiscal year. Orders received decreased ¥0.5 billion, to ¥14.2 billion, despite the closure of model rooms. Completed inventory fell 54 units from the end of the previous fiscal year, to 24 units.

The Urban Redevelopment Business registered increases in sales and profits. Net sales from property sales amounted to ¥28.4 billion. This was due to the sale of part of the stake in the Ritz-Carlton Kyoto.

[Sheet 4] Segment information (Overseas Business)

In Australia, both sales and profits increased. The sale of condominiums in Brisbane made a contribution. Orders received increased ¥1.2 billion. While remote sales play a chief role at the moment, business environment is improving as the economic recovery policy resumed in May. Orders for slightly less than 60% of sales for the current fiscal year have already been received. A fall of ¥18.8 billion in the investment balance was almost due to the impact of foreign exchange (a decrease of ¥19.3 billion).

In China, both sales and profits increased, reflecting progress in the delivery of condominiums in Suzhou that were contracted in the previous fiscal year. While progress in sales and construction and order activities were hindered by the effects of COVID-19, they have recovered and there is almost no impact. The investment balance decreased ¥11.2 billion from the end of the previous fiscal year, to ¥105.6 billion.

In the United States, both sales and profits increased. Net sales stood at ¥16.8 billion in the rental housing development business mainly due to property sales in Denver. Net sales were ¥9.7 billion in the community development segment and ¥22.7 billion in the homebuilding business. Operating income was ¥3.1 billion in the rental housing development business, ¥1.0 billion in the community development segment and ¥1.0 billion in the homebuilding business. Orders received declined ¥24.3 billion, but increased ¥10.2 billion in businesses other than the rental housing development. With respect to the rental housing development business, there is a possibility that the initially assumed time of sales will be delayed due to the delay in leasing and a fall in investor confidence. The community development segment and the homebuilding business received strong orders in the first quarter. They have also secured the order backlog. While the brakes were put on sales in March, we expect that the recovery trend will continue, given that the situation has been improving since May.

Equity in earnings of affiliates posted in Singapore increased ¥0.3 billion, and investment balance of Singapore business totaled ¥42.8 billion.

In the United Kingdom, we made an investment in 2019 by participating in a project for new homes with modern pre-engineered method. Equity in earnings of affiliates came to a loss of ¥0.2 billion.

[Sheet 5] Full-Year Forecasts

The full-year forecasts remain unchanged. We will closely examine them by paying close attention to the situation of orders received in Japan and overseas in June and July. If any facts that could impact the financial results and should be announced occur, we will promptly disclose them.

< Summary of Question and Answer Session >

Note: Matters previously described in the financial statements and documents subject to timely disclosure

are omitted here.

Question

- **Regarding the impact of COVID-19 on the financial results for the current fiscal year, what is the amount in sales to be posted in the current fiscal year from the backlog as of the end of the first quarter?**
- **Regarding the progress of the full-year plan in the Urban Redevelopment Business and the multifamily business, will the multifamily business in the United States progress after only the impact of the postponement to the next term, or is there a higher risk that even the market conditions will collapse?**

Answer

- The Custom Detached Houses Business contributes to sales for almost six months against the order backlog, and the Rental Housing Business contributes to sales for nearly a year. In the Custom Detached Houses Business, we will lead the early recovery of orders received so that it will contribute to sales in the second half. In the Rental Housing Business, the impact of COVID-19 is small because the order backlog is abundant.
- In the Urban Redevelopment Business, the progress rate is about 50% in operating income. In the multifamily business in the United States, five properties are to be sold, and the sale of one property has been completed. The remaining four properties are currently under negotiation. Because we conduct the business based on the policy of concluding a contract early, it is possible to decide by the end of the first half whether the posting of sales will be postponed. We expect that situation in the United States, etc. will recover due to low interest rates, in addition to the economic recovery. Regarding the real estate market conditions in Japan, we have not heard about a price decline, and there is no issue with the leasing of offices, although hotel business is tough.

Question

- **Describe why you did not withdraw the full-year results forecasts.**
- **Regarding the factors for the small decline in monthly orders received in May amid the impact of COVID-19, is there any impact or delay in the delivery of housing due to parts procurement?**

Answer

- As of this moment, we have not judged that operating income will decline by more than 30%. We intend to announce a message in some form in the announcement of financial results for the six months based on our judgment made by looking at trends of orders received in June and July after confirming the situation of the multifamily business in the United States, taking into account our sales outlook based on the order backlog at the beginning of the period.
- We have focused on digital marketing (online sales activities) for some time, and this effort facilitated

certain achievements during the period of the voluntary suspension of sales activities. Online requests for information materials are increasing about twofold. Regarding the delivery of houses, there has been almost no delay caused by parts procurement.

Question

- **When will sales activities in May have an impact?**
- **What is the relationship between orders received and sales during the period in the Custom Detached Houses Business, the Rental Housing Business and the Remodeling Business?**

Answer

- Because the sales style is different from before, we cannot clearly state at this moment that sales activities in May will lead to the business performance in June.
- Because we use the percentage-of-completion method, we make an earnings plan based on the assumption that an expected increase in orders received will be reflected positively in the second half. However, given that orders received continue to fall below the assumption, we are closely examining the earnings plan.

Question

- **In the sales activities, how do you facilitate receiving orders in place of face-to-face sales activities amid the impact of COVID-19?**
- **Did the gross margin in the Built-to-Order Business remain in line with the plan in the first quarter? Will the fall in material costs associated with the decline in steel prices contribute to financial results for the current fiscal year?**

Answer

- We are reducing the contact risk by conducting sales activities online and remotely. However, because the situation is different in Tokyo and local regions, we are conducting sales activities according to local government measures.
- The gross margin remains as planned. We had set the plan at a lower level for the Custom Detached Houses Business.
- Material costs will have an impact slightly later, but we will respond to parts produced at the factory and factory gains promptly because we check them every month.

Question

- **The Japan Federation of Housing Organizations has also issued a variety of guidelines on measures against COVID-19. Will homebuilders resume sales activities by aligning their policies for housing exhibitions?**

- **Other companies provide rent subsidies and exemption from rent for apartment buildings. What is your response?**
- **What is the situation of the Michi-no-Eki Stations Project?**

Answer

- Homebuilders implement customer services based on the relevant guidelines issued by the Japan Federation of Housing Organizations. While the number of visitors to housing exhibitions is smaller than before, visits to the exhibitions under the current environment shows that visitors are seriously considering purchasing a house. Therefore, we follow up with them hospitably.
- Sekisui House Real Estate manages about 650,000 units in an integrated manner, but COVID-19 has had little impact.
- The Michi-no-Eki Stations Project will open after this fall as planned.

Question

- **What is your outlook for the Architectural and Civil Engineering Business, which has already posted more than half of its operating income in the full-year plan, for the current fiscal year?**
- **Is there any change in the pipeline of the Michi-no-Eki Stations Project or your forecast after the next fiscal year?**

Answer

- The Architectural and Civil Engineering Business is progressing as planned. The profit margin will improve toward the end of March in the Architectural and Civil Engineering Business, which has posted profits of Konoike Construction Co., Ltd. for January to March.
- There is no change in the pipeline. Because the Michi-no-Eki Stations Project is a regional revitalization project, we are proceeding with it steadily.

Question

- **Between Sekisui House noie and Shawood, which shows stronger sales in terms of orders received in April and May?**
- **What was the impact of the delay in the construction period due to the suspension of on-site construction in April and May?**
- **Regarding the homebuilding business in the United States, will detached houses that you were unable to sell in April result in a risk of postponing the posting while potential demand is strong and rapidly recovering?**

Answer

- Sekisui House noie started business in February, but orders received for affordable houses are increasing from the previous year. In that sense, Sekisui House noie is stronger.

- At the construction site, we took measures such as suspending construction on Saturdays in April, and earnings are not affected significantly because we use the percentage-of-completion method.
- In the United States, potential demand is strong. While the number of houses sold is declining due to the impact of COVID-19, demand is strong because mortgage interest rates are at the lowest-ever level, and house prices are pushed up. Given that new housing starts show positive movements in April, we expect the number of houses sold to rebound going forward.