Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the Third Quarter of FY2018 (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

Net sales decreased 0.4% year-on-year. In the Built-to-Order Business, both Custom Detached Houses and Rental Housing segments saw declines in sales. In the Supplied Housing Business, sales increased in both the Remodeling and Real Estate Management Fees segments. The Development Business recorded increased sales, attributable to a rise in sales in both the Condominiums and Urban Redevelopment segments which more than offset falls in sales in the Houses for Sale segments. In the Overseas Business, although sales decreased, the business progressed in line with the full-year plan. In Australia, sales declined as handovers of condominium units were in the off-crop period. In China, sales were down due to the decline in sales of condominium units in Taicang. In the United States, sales climbed thanks to Woodside Homes homebuilding business.

The gross margin dropped 0.4p year-on-year. The profitability of the Built-to-Order Business fell 1.3p, of which approximately 1.0p was due to a rise in expenses at construction sites, including design and construction costs, caused by a decrease in sales volume. The Supplied Housing and Development Businesses saw improvements in profitability of 0.7p, respectively. The profitability of the Overseas Business fell 0.5p due to a decline in sales.

Of the increase of ¥5.3 billion in general administrative expenses, ¥1.7 billion were incurred in the Overseas Business, and ¥3.6 billion were incurred in the domestic businesses. Labor expenses increased ¥4.2 billion.

Operating income decreased 10.2% year-on-year, and the OP margin fell 0.8p. While the OP margin of the Built-to-Order Business declined 1.9p because of a fall in the gross margin and a rise in labor and other expenses, the profit margin is expected to recover in the next fiscal year as a result of a raised volume due to a recent increase in accumulated orders. The OP margin of the Supplied Housing Business improved by 0.8p, to 9.0%, and the OP margin of both the Remodeling and Real Estate Management Fees segments also advanced. The OP margin of the Development Business improved by 1.2p to 13.1%, thanks to profit increases in Condominiums and Urban Redevelopment segments. In the Overseas Business, profit declined in Australia and China, while profit rose in the Unites States.

Of the non-operating income and losses of ¥4.3 billion, equity in earnings of affiliates was generated mainly by Singapore projects and Otori Holdings (Konoike Construction Co., Ltd.), which increased by ¥0.4 billion, to ¥5.2 billion. Non-operating income decreased ¥1.1 billion year-on-year as foreign exchange gains or losses decreased ¥1.4 billion and interest on loans increased.

Extraordinary loss improved by ¥8.9 billion in the absence of an allowance for doubtful accounts and a loss on valuation of investment securities.

[Sheet 2] Financial position

Of current assets, cash and deposits decreased ¥159.3 billion from the end of the previous fiscal year. Real estate for sale increased ¥99.3 billion, of which ¥28.4 billion increased in Japan and ¥70.8 billion increased overseas. Property, plant and equipment decreased, and noncurrent assets totaled ¥824.9 billion. Of capital expenditure of ¥42.9 billion, investment in rental real estate amounted to ¥35.5 billion.

Total liabilities decreased, mainly due to a fall in notes and accounts payable. Net assets declined ¥5.8 billion. Profit attributable to owners of parent totaled ¥82.9 billion; whereas payments of dividends amounted to ¥54.5 billion, translation adjustments declined ¥16.1 billion associated with the appreciation of the yen, and net unrealized holding gain on securities diminished ¥10.2 billion yen.

Looking at cash flow, that from operating activities declined ¥84.9 billion, due to an increase in real estate for sale and a decrease in notes and accounts payable. Despite having invested in Umekita Phase II in Osaka and other projects, cash flow from investing activities improved by ¥28.3 billion due to the absence of the expenses for the acquisition of Woodside Homes recorded in the previous fiscal year. Free cash flow for the fiscal year under review is expected to be positive while being supported by the planned property sale and other activities in the fourth quarter, despite a decrease of ¥131.2 billion in the first nine months.

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

Sales of the Custom Detached Houses segment declined due to a fall in orders received from the previous fiscal year, and the gross margin declined 1.3p. The primary cause was an increase in the portion of expenses at construction sites, including those for design and construction, due to a decrease in sales volume. The OP margin declined 1.6p, reflecting a fall in gross margin and a rise in labor expenses. Meanwhile, orders received grew 16.8% year-on-year in the three months of the third quarter alone, exceeding the targeted year-on-year increase of 6.9% for the second half of the fiscal year under review. Orders received in November 2018 grew 11% year-on-year, steadily to help achieve income growth in the next fiscal year.

Sales in the Rental Housing segment decreased due to the longer preparation period required before construction as a result of growing sizes of buildings such as three- and four-story housing units and non-residential properties. The gross margin declined 1.4p on factors similar to those affecting the Custom Detached Houses segment. The order environment remained weak in regional areas despite strong orders in the three major metropolitan areas. The volume decreased 6.8% in the three months of the third quarter alone, falling below the targeted year-on-year decrease of 1% for the second half of the fiscal year under review. Orders received increased 3% in November, however, and a trend of recovery and signs of bottoming out are seemingly appearing, not only in orders for non-residential properties, but in orders for rental housing received. Orders for non-residential properties received were strong, with a year-on-year rise of 21%, to approximately ¥55 billion. The accumulated orders are building up, which will facilitate growth in the next fiscal year.

[Sheet 3] Segment information (Supplied Housing Business)

The Remodeling segment achieved growth both in sales and profit by focusing on remodeling proposals for the amount of orders received exceeding ¥5 million, including proposal-based remodeling and environment-based remodeling. Both the gross margin and OP margin improved. .

The Real Estate Management Fees segment achieved growth in both sales and profit. The OP margin increased 0.9p, thanks largely to reduced vacancy periods. The occupancy rate remained high, at 97.8%.

[Sheet 4] Segment information (Development Business)

Both sales and profit in the Houses for Sale segment declined, given the absence of sales of post-disaster public housing (Tohoku region) posted in the previous year. Meanwhile, orders received turned to year-on-year growth in the third quarter.

Both sales and profit increased in the Condominiums segment. Orders received decreased 27.3% as sales were made ahead of schedule in the previous fiscal year. The completed property inventory at the end of the third quarter was 210 unit of the Grande Maison Egota No Mori. The number of visitors to the site has doubled since the town was opened in September, and we will continue our sales activities. Accumulated orders amounted to slightly more than ¥120 billion, a value equivalent to sales for approximately a year and a half.

In the Urban Redevelopment segment achieved growth in sales and profit thanks to property sales to Sekisui House Reit, Inc. and funds. Both gross margin and the OP margin improved. The fall in orders received was caused by posting the orders for properties sold to the REIT in May this year at the end of the previous fiscal year.

[Sheet 4] Segment information (Overseas Business)

Sales in Australia declined substantially after the delivery of a large condominium in Wentworth Point in the previous fiscal year. The investment balance remained at the same level from the end of the previous fiscal year. We are currently examining the valuation loss on the complex development project in Queensland and plan to post it at the end of the current fiscal year.

In China, sales decreased as the Taicang project, which had been successful since the previous fiscal year, was sold out. An operating loss resulted from the fall in sales and depreciation expenses for a hotel in the Heping District of Shenyang. The accumulated orders rose ¥12.1 billion to ¥21.7 billion, and the investment balance decreased ¥16.2 billion from the end of the previous fiscal year, to ¥176.7 billion. The Company plans to hand over a condominiums in Suzhou in the fourth quarter of the fiscal year under review, and the result in China progressed in line with the full-year plan.

In the United States, both sales and profits climbed. Of the sales, ¥71.5 billion was generated from Woodside Homes and no sales were recorded from the sale of multifamily properties in the first nine months of the current fiscal year. While the non-consolidated operating income of Woodside Homes was ¥6.0 billion, the consolidated operating income was ¥3.9 billion including amortization of goodwill, etc. The orders received dropped ¥65.1 billion. This is because the orders for the sale of multifamily properties (sales were posted in the fourth quarter of the previous fiscal year) and the order backlog of Woodside Homes amounting to approximately ¥20 billion at the time of the acquisition were included in the orders received for the previous fiscal year. The investment balance increased ¥86.4 billion from the end of the previous fiscal year., mainly due to the progress of construction for multifamily property development.

As in the first six months of the fiscal year, the Singapore segment posted equity in earnings of affiliates through rental income from the commercial facilities held in Punggol and the progress of condominium construction.

As a whole, both sales and profit declined in the Overseas Business, but the result progressed in line with the Company’s plan.

[Sheet 5] Full−Year Forecasts

No revisions were made to the full-year forecasts. In the meantime, EPS forecast rose ¥0.2 in consideration of the 2 million shares of buybacks conducted during the third quarter of the current fiscal year.

< Summary of Question and Answer Session >

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

Question

- **Orders for the Custom Detached Houses have been strong and have been increasing year-on-year for four consecutive months. What are the contributing factors, and what are the Company's opinions about the last-minute surge in demand before the planned hike in consumption tax and the subsequent reactionary fall?**
- **It appears that the Overseas Business is behind schedule. How are sales in each country?**

Answer

- At present, we have not identified any last-minute surge in demand before the hike in consumption tax. We consider the revitalization of our sales activities through the reorganization implemented in April as the factor behind the strong order result. We do not expect a significant reactionary fall, since the government is expected to take measures to prevent reactionary falls.
- As for sales in the Overseas Business, in Australia, we are planning to hand over condominium units in West Village in Brisbane and Central Park in Sydney in the fourth quarter of the fiscal year under review. In China, too, we plan to hand over condominium units in the western and eastern blocks of Suzhou in the current fourth quarter. As in Australia, the progress has been in line with the Company's plan. In the U.S., sales of Woodside Homes have been strong. We are also planning to post earnings from multifamily business in the fourth quarter, and as of now, earnings in our Overseas Business have been consistent with the plan.

Question

- **It appears that the Built-to-Order Business is behind schedule. What is the process for achieving the targets?**
- **What are the future prospects based on demand for rental housing and non-residential properties in the Rental Housing segment?**

Answer

- Accumulated orders for Custom Detached Houses segment increased 9.1% from the end of the third quarter of the previous fiscal year to the end of the third quarter of the current fiscal year. Earnings will increase through steady construction based on the percentage of completion method.
- Although the environment for receiving orders for rental apartments has been improving gradually, we need to observe the situation for a while. Sales of non-residential properties have been increasing steadily, and we hope to raise the current percentage of non-residential properties (approximately 20%) to 30% at an early stage.

Question

- **What is the business scheme for the roadside hotels in Michi-no-Eki Stations Project and the Westin Yokohama? What are the contract values of the roadside hotels?**

Answer

- For the Michi-no-Eki Stations Project, a special-purpose company (SPC) will be established and we will receive contracts for hotel construction from the SPC. The Westin Yokohama will be developed by us, and we will own the property. We expect to post orders for roadside hotels from the next fiscal year, with approximately 1,000 rooms in 15 locations valued at about ¥20 billion.

Question

- **What is the Company's plan for the SPC and the recovery of capital invested in the Taicang project in China, in which the units were sold out?**
- **What is the management roadmap from now on?**

Answer

- We will make arrangements to dissolve the SPC for Taicang project. We are preparing to recover the funds in the form of capital reduction.
- While we are currently engaging in various activities for our business in and after the fiscal year 2020, we have yet to determine the management targets and will explain progress and other related matters at the time of announcing the financial results at the end of the current fiscal year.

Question

- **There have been some media reports such as the postponement of the energy-saving standard to be imposed in 2020, which may suggest the regression of the movement to impose the standard. Shouldn't you expand your strategies a little more, not only to the high end but also to the lower end?**

Answer

- While we must consider responses by including the possibility that the imposition of the standard will be postponed, we wish to continue being a leading company that provides high value-added housing. We hope to compete in the largest market segment with the nationwide standardized models (price range between ¥22 million and ¥23 million) of the second brand launched this year.

Question

- **Can you explain the decrease in the gross margin of the Custom Detached Houses and the Rental Housing segments since the second quarter only with an increase in indirect cost?**
- **Is a delay in acquiring loans due to the tightening of lending a factor that is contributing to the**

delay in posting sales from rental housing?

Answer

- Sales volumes of the Custom Detached Houses and the Rental Housing segments are usually lower in third quarters than in second and fourth quarters, causing a fall in the profit margin.
- There is no delay due to the tightening of lending or insufficient loans in our business.

Question

- **What is the status of the contracts for the condominiums in Suzhou, China, to be handed over in the fourth quarter? Are the condominium prices likely to be reduced?**

Answer

- Of the 480 units currently on sale in Suzhou, the formal contract covers 400 units and a provisional contract covers 10 units. We are not reducing the prices.

Question

- **Is the understanding that the factors for the decline in the gross margin of the Custom Detached Houses do not include an increase in the cost of building materials and labor expenses correct?**

Answer

- While labor expenses have increased somewhat due to salary rises, the fall in the profit margin was caused practically by a decrease in volume, and not by the increase in labor expenses.