

Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the Second 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

When earnings were announced on March 5, we did not expect the declaration of a state of emergency following the spread of Covid-19. Considering the spread of the coronavirus even in July and subsequently, we revised the full-year forecasts for the fiscal year ending January 31, 2021 when earnings for the first six months were announced.

Orders are on a recovery trend at the Company because the Company has been taking steps to promote telework, including the provision of iPads to employees, before the spread of the coronavirus, and salespeople are gradually becoming accustomed to non-face-to-face negotiations with customers.

The Japan Federation of Housing Organizations has requested the government to give 2 million points maximum in a new point rewards system to the acquisition and renovation of houses, including houses for rent, expand home mortgage tax breaks and raise the gift tax exemption limit.

Looking at earnings results, net sales fell ¥39.8 billion, to ¥1,167.9 billion. In the first three months, net sales rose in all four businesses, but in the first six months, net sales decreased in the Custom Detached Houses Business, the Remodeling Business, the Houses for Sale Business and the Condominiums Business. Property sales declined in the Urban Redevelopment Business and the Overseas Business. In the Built-to-Order Business, sales fell in the Custom Detached Houses Business, but sales rose significantly in the Architectural and Civil Engineering Business because Konoike Construction Co., Ltd. became a subsidiary. In the Supplied Housing Business, sales declined in the Remodeling Business due to the coronavirus, but increased steadily in the Real Estate Management Fees Business. In the Development Business, large properties decreased in the Houses for Sale Business, and property sales in the Urban Redevelopment Business fell. In the Overseas Business, sales were favorable in China, but the number of properties sold in the multifamily business in the United States fell to one property, down from six properties.

Gross profit decreased 6.1%, or ¥14.9 billion due to a fall in net sales. The gross margin fell 0.6p.

SG&A expenses increased ¥5.4 billion, of which ¥4.8 billion was an increase in personnel expenses, including retirement benefit expenses. SG&A would have fallen ¥0.9 billion except for ¥6.3 billion at Konoike Construction, which has become a consolidated subsidiary. Travel expense was reduced due to increasing telework and online meetings.

Operating income dropped 18%, or ¥20.3 billion. The operating margin declined 1.5p, to 7.9%. Operating income in the Built-to-Order Business rose 3.3%, or ¥1.5 billion, and the operating margin fell 2p, to 9.8%. Operating income decreased significantly in the Custom Detached Houses Business and declined slightly in the Rental Housing Business. In the Architectural and Civil Engineering Business, operating income increased substantially due to the addition of income at Konoike Construction, which has become a subsidiary. In the Supplied Housing Business, operating income decreased 2.3%, or ¥0.7 billion. The operating margin fell 0.3p, to 9.4%. In the Remodeling Business, both sales and operating income declined due to COVID-19. In the Real Estate Management Fees Business, both sales and operating income rose with an increase in the number of units under management and a high occupancy rate. In the Development Business, operating income decreased 18.2%, or ¥4.2 billion, and the operating margin rose 1.9p, to 12.7%. In the Overseas Business, operating income fell 48.2%, or ¥14.5 billion, and the operating margin dropped 3.3p.

The balance of non-operating items decreased by ¥5.4 billion year on year, to -¥1.9 billion. Equity in earnings of affiliates fell ¥4.8 billion chiefly due to a decrease of ¥4.1 billion attributable to Konoike Construction becoming a subsidiary. An extraordinary loss of ¥1.4 billion was posted, which include a fixed cost of ¥0.6 billion mainly due to the suspension of hotel operations during the state of emergency caused by Covid-19 and a loss of valuation of investment securities of ¥0.4 billion.

Orders received decreased 14.3%, or ¥189.9 billion, to ¥1,135.4 billion due to a fall of ¥96.9 billion in the Development Business and a decrease of ¥125.5 billion in the Overseas Business. The order backlog declined 2.3%, or ¥32.5 billion.

[Sheet 2] Financial position

Total assets decreased ¥47.4 billion, to ¥2,587.2 billion. Real estate for sale fell ¥8.3 billion, to ¥970.6 billion. Cash and deposits dropped ¥39.5 billion, to ¥545.1 billion. Net assets increased ¥12.5 billion, to ¥1,319.4 billion.

Interest-bearing debts fell ¥8.0 billion, to ¥578.8 billion. The D/E ratio improved 1.1p, to 45.3%. The equity ratio increased 1.3p, to 49.4%. The financial position improved as planned.

Looking at cash flows, cash provided by operating activities fell ¥193.3 billion, to ¥39.7 billion, reflecting a decrease in property sales and a decrease in advances received on construction projects in progress because of a fall in orders. Cash used for investing activities improved ¥2.5 billion, to -¥40.8 billion. The free cash flow status decreased ¥190.8 billion to -¥1.0 billion. Cash flow used in financing activities increased to ¥33.2 billion, reflecting cash dividends paid of ¥28.0 billion, purchases of treasury stock of ¥3.0 billion and a

reduction in interest-bearing debt, etc. of ¥24.1 billion. Cash and deposits fell ¥39.2 billion, to ¥544.0 billion. Of capital expenditures of ¥34.0 billion, investment in real estate for lease was ¥26.2 billion. Depreciation and amortization came to ¥10.4 billion. Capital expenditures and investment in real estate for lease in the full year were planned to be ¥90.0 billion and ¥75.0 billion, respectively, and the plan remains unchanged.

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

The effect of a rise in retirement benefit expenses in the Custom Detached Houses Business was 0.4% in the gross margin and 0.8% in the operating margin. Orders remained weak, falling 19.5%, due to the coronavirus, but were recovering gradually. ASP per building exceeded ¥40 million for the first time. The ratio of Green First Zero was 88%, remaining high. In the full-year, orders are expected to be ¥48.0 billion less than the plan, although orders are expected to rise 6.1% year on year in the second half. Net sales will be ¥41.0 billion less than the plan. Operating income will be ¥2.5 billion less. The gross margin will fall 0.8p but will be 0.5p more than the initial plan. The operating margin will drop 3.6p but will be 0.3p more than the plan. We aim to achieve orders exceeding the plan in the second half and increase sales and income significantly in the next fiscal year.

Retirement benefit expenses affected the Rental Housing Business as the Custom Detached Houses Business. The effect on the gross margin was 0.5%, and the impact on the operating margin was 0.8%. Orders received were relatively solid but fell 12.1%. ASP per building was ¥113.6 million. The ratio of three- and four-story houses rose favorably to 77.8%. Orders for ShaMaison ZEH were approximately 1,000 units, which is twice as many as in the full previous fiscal year. Orders are expected to increase 7.7% year on year in the second half and will be ¥28.0 billion less than the plan in the full year. Net sales are expected to be ¥18.0 billion less than the plan in the full year. Operating income will be ¥5.0 billion less. The gross margin and operating margin will fall short of the plan. As in the Custom Detached Houses Business, we aim to increase orders to achieve more sales and income in the next fiscal year.

Net sales in the Architectural and Civil Engineering Business were ¥160.1 billion, of which ¥142.6 billion was sales at Konoike Construction. Orders received increased ¥110.9 billion, to ¥136.3 billion. In the full year, net sales, operating income, and orders will fall ¥13.0 billion, ¥1.0 billion, and ¥47.0 billion, respectively, from the plan. The major factor is difficulty in receiving orders for RC (reinforced-concrete) structures partly due to COVID-19. We are promoting cooperation with Konoike Construction in condominium construction work, soil improvement, demolition work and the construction of medium-rise buildings.

[Sheet 3] Segment information (Supplied Housing Business)

In the Remodeling Business, interior work was suspended due to COVID-19, which made it impossible to look at interiors in activities for receiving orders. That had a significant impact on net sales, orders and income. In the full year, orders, net sales, and operating income are forecast to decrease ¥20.5 billion, ¥18.0 billion,

and ¥4.5 billion, respectively, from the plan. Margins will fall year on year and from the plan.

In the Real Estate Management Fees Business, the gross margin and operating income will improve. On February 1, Sekiwa Real Estate changed its trade name to Sekisui House Real Estate, which added more than ¥1.0 billion to expense. The number of units under management increased by 10 thousand units from the end of January, to 650 thousand units. The occupancy rate was high at 97.7%. The full-year forecast has not changed.

[Sheet 4] Segment information (Development Business)

The Houses for Sale Business recorded declines in sales and profits due to the absence of the sale of commercial land in large building lots for sale and public housing for disaster victims in the previous fiscal year. Although orders received rose more than 70% in August, in the full year, orders will be ¥12.0 billion less than the plan. Net sales and operating income will fall ¥12.0 billion and ¥2.0 billion, respectively, from the plan.

The Condominiums segment posted increases in sales and profits. Orders fell 21.1%. Model rooms were temporarily closed due to COVID-19, and an appointment system for viewing properties and online sales activities have been introduced. Completed inventory was 84 units at the end of July. Contracts have been concluded for more than 90% of sales planned in the second half. In the full year, orders will be ¥12.0 billion less than the plan. That is the only change in the full-year forecasts.

The Urban Redevelopment Business recorded decreases in sales and profits partly due to strong sales in the same period of the previous fiscal year. Income from leasing declined significantly because the hotel business moved into the red due to COVID-19. In the full year, sales of properties are forecast to be ¥73.0 billion, and income is forecast to be around ¥18.0 billion. Net sales, operating income and orders will fall due to a decrease in earnings in the hotel business.

[Sheet 4] Segment information (Overseas Business)

In Australia, sales increased ¥2.4 billion, reflecting the sale of detached houses for sale in the suburbs of Sydney and Brisbane and the sales of condominiums in Brisbane. Operating income and orders received rose ¥0.6 billion and ¥5.0 billion, respectively. Despite the effect of COVID-19, the housing market is on an upward trend thanks to a record-low interest rate and subsidies and stamp duty exemptions for home buyers. In the full year, sales will be ¥6.7 billion less than the plan. The sale of part of Melrose Park has been postponed to the next fiscal year, and operating income will fall ¥1.1 billion from the plan.

In China, sales and operating income rose ¥19.3 billion and ¥5.0 billion respectively. The investment balance declined ¥32.0 billion. Sales recovered in the second quarter. The number of units for which contracts are yet to be completed fell to 722 at the end of July. The business has not been affected by COVID-19 and has made steady progress. More than 70% of sales came from the Suzhou project, where all condominiums

were sold in August. The liquidation of an SPC in Taicang I was completed in August, and ¥24.7 billion was sent to Japan. Sales and delivery are making steady progress and sales are expected to be ¥6.0 billion more than the plan. Operating income will rise ¥2.0 billion from the plan.

In the United States, the housing market is favorable due to lower interest rates, among other factors. However, certain areas are affected by lockdowns. In the multifamily business, investor sentiment has fallen temporarily. Looking at results in each business, sales, operating income, orders, and the investment balance in the multifamily business stood at ¥17.4 billion, ¥3.3 billion, ¥35.9 billion and ¥225.8 billion, respectively. The results were lower than in the same period of the previous fiscal year because only one property was sold in the fiscal year under review compared with six properties in the previous fiscal year. In the community development segment, sales, operating income, orders, and the investment balance came to ¥19.1 billion, ¥2.3 billion, ¥30.0 billion, and ¥132.3 billion, respectively. In the homebuilding business, results were favorable. Sales, operating income, orders, and the investment balance were ¥51.7 billion, ¥2.7 billion, ¥65.1 billion, and ¥101.4 billion, respectively. In the multifamily business, five property sale projects were planned. However, because there are strong requests for discounts, reflecting a decline in investor sentiment due to COVID-19, the business has decided that only three projects will be sold in the fiscal year under review, considering it is better to raise occupancy rates and maximize the value of properties in the remaining two projects and sell them in the next fiscal year. In the community development segment, valuation losses may be posted in projects for which development approval has not been obtained due to opposition from neighboring residents, and full-year forecasts have been revised downward. Net sales will be ¥59.3 billion less than the plan, and operating income will be ¥12.0 billion less than the plan.

[Sheet 5] Full-Year Forecasts

Net sales will fall ¥170.0 billion from the plan. Gross profit will decrease ¥44.0 billion. The gross margin will be 0.5p less than the plan. SG&A expenses will be ¥13.0 billion lower. Operating income will be ¥31.0 billion lower. The operating margin will be 0.8p lower. The decline from the plan in non-operating income (loss) will expand ¥1.5 billion. Ordinary income will be ¥32.5 billion lower. Profit will be ¥23.0 billion lower. EPS will be ¥167.22. ROE will be 8.9%.

With regard to shareholder returns, we plan to leave the total return ratio at 53.4% even after the full-year forecasts are changed. We will change the annual dividend per share to ¥82, up ¥1 from the fiscal year. The payout ratio will be 49%. The limit for share repurchases will change to ¥5.0 billion, but we plan to leave the return ratio and the total return ratio unchanged at 4.4% and 53.4%, respectively.

< Summary of Question and Answer Session >

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

Question

- **I have a question about shareholder returns. In the revised plan, the payout ratio is 49%. Have you changed the payout ratio from 40% or more? Or do you just state that the payout ratio is 49%, taking into consideration the total return ratio and the dividend increase?**
- **When did you prepare this revised plan? I have the impression that orders are favorable now and imagine that actual results may exceed the revised plan. What is your response to that?**

Answer

- The payout ratio is 40% or more. There is no change. We did not want to cut dividends when we revised the plan. We have kept the total return ratio at 53.4%.
- We created the revised plan for the fiscal year ending January 31, 2021 in late August. The plan may appear conservative when you look at the current trends of orders. We have lowered the plan to the level that we are sure to achieve. We think there are risk factors, including a second wave of coronavirus and declarations of a state of emergency.

Question

- **A deadline for a home mortgage tax break will come in September. Do you see any effects of that on your outlook or strategy for October and thereafter?**
- **Could you describe the revised plan for the Overseas Business in the fiscal year ending January 31, 2021?**

Answer

- The Japan Federation of Housing Organizations has submitted a request to the government. Public spending is now concentrated on countermeasures against COVID-19. We have heard that after COVID-19 subsidies, housing and automobiles will be keys to an economic recovery. We will continue to make requests.
- In the U.S. multifamily housing business, sales are forecast to be ¥64.4 billion and operating income is forecast to be ¥11.1 billion. We planned to sell five properties, but subsequently decided to sell only three. In the previous fiscal year, we sold seven. The change in number has increased. In the community development segment, sales and operating income are forecast to be ¥49.8 billion and ¥2.4 billion, respectively. We anticipate valuation losses related to projects for which development permission has not been obtained. We have not changed the initial plan for the homebuilding business. Sales are forecast to be ¥110.1 billion, and operating income is forecast to be ¥5.9 billion. Business conditions are definitely favorable, but we take rising timber prices and stagnant logistics into consideration. In the next year, we

plan to sell five properties in the multifamily business.

Question

- **Orders were weak in the Rental Housing Business in August. Could you describe your sales activities? You said salespeople are used to non-face-to-face sales activities. Are many people still resistant to face-to-face sales activities?**
- **Is the operating rate falling in the U.S. multifamily housing business? What is your outlook for Woodside Homes?**

Answer

- Orders in the Rental Housing Business fell 20% in August. However, we forecast that orders will increase 7.7% in the second half compared with a 12% drop in the second half of the previous fiscal year. Our expectations are that orders will recover from September onwards, when events, including ShaMaison Festa and *Sumaino Sankanbi*, will be held. It is true that customers prefer non-face-to-face meetings, but non-face-to-face negotiations are difficult without relationships of trust with customers.
- Our understanding is that rental housing market in the United States has not changed significantly and demand is always more than supply. However, big cities, where the multifamily housing business is operated, were affected by lockdowns and progress in attracting tenants was slow. As for Woodside Homes, we have heard that the housing market is strong. However, there is bad news too. Sacramento and Las Vegas, where profit margins are high, are significantly affected by COVID-19, including lockdowns. Logistics prices are at risk of rising sharply.

Question

- **The percentage of re-builders was 22% in the first half, falling from 28% in the same period of the previous fiscal year. What was the background? Will the percentage rise? What is the impact of the percentage of re-builders on earnings?**
- **What is your policy on dividends from the next fiscal year onwards?**

Answer

- Due to COVID-19, orders for houses for sale were good compared with orders for custom detached houses, and the change in the percentage of re-builders did not affect profit margins. (The volume of orders is more important.)
- We have a strong intention to continue to increase dividends. The financial situation will almost fully recover next fiscal year. We wish to continue to increase dividends and share buyback.

Question

- **In the market, young first-time buyers started to buy low-price suburban houses for sale from around May. Meanwhile, at the Company, orders for high-price houses recovered sharply in August.**

Why is that?

- **What is the effect of rising timber prices in the United States on the U.S. business? Do the rising prices have any effect on the housing business in Japan?**

Answer

- In the fifth medium-term management plan, we are implementing three-brand strategies. We are strengthening sales of the third range (high-end) products and are raising the unit price of the second range (medium to high-end) products, and that are producing results. We are promoting the use of *Sumaino Yumekojo* events, where 40% of the visitors conclude contracts. As the annual income of the owners of our detached houses is rising, we are promoting sales of higher-price products. We feel that affluent people are moving.
- Because Woodside Homes anticipated rising material prices to some extent, we think the effect of the rising timber prices on results is small this fiscal year. Material prices hardly changed in the first half, and we do not expect significant changes in the second half. The production volume at the plant has more impact on earnings than material prices. If the operating rate rises in the first half of the next fiscal year due to an increase in orders in the second half of this fiscal year, profit margins will rise.

Question

- **What is the background of the approval risk in community development in the United States? How much are provisions for losses?**
- **What is the progress of the *Michi-no Eki* Stations project? Will it expand earnings? How much will it contribute to sales and income?**

Answer

- We take steps for good local relations in development plans in the United States as in Japan. However, the government does not give permission if there is strong opposition. We have a number of options, including cutting the land price to the price before development and obtaining a new development permit. We need to carefully examine provisions for losses. The plan includes provisions of ¥3 billion to ¥4 billion.
- We will open hotels one by one at eight locations in four prefectures from October by the end of this year. We plan to provide 1,152 rooms by the end of 2021, about 1,000 rooms in 2022 and about 3,000 rooms in 25 prefectures by 2025. We posted sales of nearly ¥10 billion in the first half of this fiscal year. (Konoike Construction posted a certain amount of sales separately.)