

Sekisui House, Ltd.

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

Date: December 7, 2020, Monday 17:00 – 18:00 JPT

Participants: Hideyuki Kamijo, Managing Officer

Atsushi Yoshida, Chief Manager of Investor Relations Department

< Presentation >

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

[Sheet 1] Overview

Net sales rose chiefly due to the contribution of Konoike Construction Co., Ltd., which became a consolidated subsidiary on October 1, 2019, but profits fell due to the effects of COVID-19 pandemic on the Custom Detached Houses Business and the Remodeling Business and a review of the property sales plan in the United States. The margin, however, improved. The margin for the first nine months exceeded the full-year plan. Orders recovered sharply, reflecting exhaustive steps taken to address COVID-19 and the relaxation of restrictions on sales activities. We hope that results will recover next fiscal year.

Sales increased 1.9%, to ¥1,768.8 billion. Sales increased ¥146.8 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/Civil Engineering Business because of the addition of Konoike Construction Co., Ltd.

Sales in the Supplied Housing Business stood at ¥514.7 billion, which is on a par with the level of the previous year.

Sales declined in the Remodeling Business but increased in the Real Estate Management Fees Business. In the Development Business, sales fell 26.4%, to ¥204.8 billion. Sales fell in the Houses for Sale Business, Condominiums Business and Urban Redevelopment Business, but were in line with the full-year plan. Sales in the Overseas Business dropped 11.8%. While the delivery of condominiums in Suzhou made good progress, only two properties were sold in the multifamily business in the United States compared with seven properties in the previous fiscal year.

Gross profit decreased ¥10.6 billion to ¥342.5 billion, and the gross margin dropped 1.0p, to 19.4%. The gross margin fell 3.4p in the Built-to-Order Business as a result of the addition of the Architectural/Civil Engineering Business, fell 0.1p in the Supplied Housing Business, but improved 2.9p to 19.9% in the Development Business. In the Overseas Business, the gross margin dropped 1.2p.

SG&A expenses rose 4.8%, to ¥207.6 billion. The SG&A ratio increased 0.3%, to 11.7%. Personnel expenses climbed ¥8.5 billion. A ¥4.0 billion increase in retirement benefit expenses is included in this. The rise in SG&A expenses as a result of the the addition of Konoike Construction Co., Ltd. as a consolidated subsidiary was ¥9.8 billion.

Operating income decreased 13% to ¥134.8 billion. The operating margin fell 1.3p to 7.6%, but was good compared with the planned full-year operating margin, 7.2%. The operating margin fell in the Built-to-Order Business, despite a rise in sales, due to an increase in retirement benefit expenses and smaller sales in the Custom Detached Houses Business. In the Supplied Housing Business, operating income declined ¥2.7 billion, to ¥46.6 billion and the operating margin fell 0.5p, to 9.1% due to a decrease in profit in the Remodeling Business. In the Development Business, operating income decreased ¥6.4 billion, to ¥22.9 billion. The operating margin improved 0.6p, to 11.2%. The operating margin in the Urban Redevelopment Business and the Condominiums Business improved. In the Overseas Business, operating income fell ¥10.6 billion, to ¥30.6 billion. Operating income increased in China and Australia and declined in the United States.

The balance of non-operating income/expenses decreased ¥9.1 billion year on year, to -¥3.1 billion. Equity in earnings of affiliates dropped ¥7.5 billion to ¥0.3 billion, reflecting the absence of ¥5.8 billion equity in Konoike Construction Co., Ltd., which has been made a consolidated subsidiary, in the previous fiscal year. The impact of foreign exchange included foreign exchange losses of ¥3.8 billion.

Extraordinary income decreased ¥9.0 billion, to ¥3.1 billion, chiefly due to the absence of extraordinary income of ¥8.5 billion associated with the addition of Konoike Construction Co., Ltd., to the consolidated subsidiaries in the previous fiscal year. Extraordinary income in the current fiscal year includes the sale of strategic shareholdings. Extraordinary loss increased ¥0.8 billion, to ¥2.0 billion. The extraordinary loss included a loss on sales and retirement of non-current assets of ¥0.8 billion and a loss on valuation of investment securities of ¥0.5 billion.

Orders received decreased 5.0% year on year. However, orders in the third quarter alone (August to October) rose 17%, to ¥643.5 billion, which indicates a sharp recovery. The order backlog increased 0.7% from the end of the previous fiscal period, to ¥1,418.5 billion.

[Sheet 2] Financial Position

Current assets decreased ¥62.0 billion, to ¥1,753.9 billion. A major item was a decrease of ¥65.1 billion in cash and deposits. Factors for this included the payment of income taxes, consumption taxes and dividends. Real estate for sale was ¥958.2 billion, reflecting an increase of ¥24.3 billion in Japan and a decrease of ¥45.0 billion overseas. Noncurrent assets increased ¥17.6 billion, to ¥836.3 billion. Of noncurrent assets, property, plant and equipment rose ¥22.5 billion. Capital expenditures climbed ¥7.3 billion, to ¥65.1 billion, of which investment in real estate for lease was ¥52.4 billion. The full-year plan remains unchanged at ¥90.0 billion.

Total liabilities declined ¥58.5 billion from the end of the previous fiscal period, to ¥1,269.3 billion, mainly reflecting decreases in accounts payable and accrued income taxes and the redemption of bonds. Interest-bearing debts decreased ¥9.0 billion, to ¥577.7 billion. The D/E ratio fell 1.2p, to 45.2%.

Net assets increased ¥14.1 billion from the end of the previous fiscal period. Translation adjustments declined ¥10.1 billion, reflecting the appreciation of the yen. The equity ratio increased 1.3p, to 49.4%.

Looking at cash flows, cash flows from operating activities dropped ¥197.6 billion, to ¥70.4 billion, chiefly due to

weak sales of real estate for sale. Cash flows from investing activities declined ¥13.5 billion year on year, to -¥66.4 billion due to investment in real estate for lease. As a result, free cash flows fell ¥211.1 billion. Cash and cash equivalents at the end of the period fell ¥63.8 billion from the end of the previous fiscal period, to ¥519.4 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 rose 0.1p, to 25.1% owing to a high value-added strategy, despite an increase in retirement benefit expenses, which reduced the margin by 0.5p. Operating income was 90% of the full-year plan. Orders received decreased 11.1% year on year. However, orders in the third quarter alone rose ¥7.7 billion, or 10%, to ¥83.5 billion, which shows a recovery trend. The order backlog increased ¥3.6 billion.

ASP per building rose ¥1.09 million to ¥41.02 million, and ratio of Green First Zero was 87%.

The Rental Housing Business recorded an increase in sales due to the abundant order backlog at the end of the previous fiscal period. The gross margin fell 0.5p, of which the negative impact of the increasing burden of retirement benefit expenses was 0.4p. The operating margin fell 0.9p but was in line with the full-year plan. Orders decreased 10.3%. Orders for non-housing buildings, primarily hotels and medical and nursing care facilities, were weak, but the year-on-year change in orders for Sha-Maison (rental housing) moved into positive territory.

ASP per building increased ¥12.99 million from the end of the previous fiscal period, to ¥115.40 million, and the ratio of three- and four-story houses to 76.3%.

The Architectural/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 ¥199.6 billion in net sales and an increase of ¥15.1 billion in operating income. This segment made progress as expected in the full-year plan.

[Sheet 3] Segment Information (Supplied Housing Business)

The Remodeling Business recorded falls in sales and profits, but orders were on a recovery trend. In the third quarter, orders rose 14% year on year. The order backlog increased ¥6.5 billion. Housing is attracting increasing attention. The fields that we are focusing on, such as large-scale remodeling projects of ¥5 million or more and the installation of insulation, performed well.

The Real Estate Management Fees Business achieved growth in both sales and profits. The number of units under management increased approximately 14 thousand units compared to the end of the previous fiscal period, and the occupancy ratio improved 0.1p, to 97.8%. We will strive to promote the penetration of the Sha-Maison brand and continue to provide high-quality service to maintain a high occupancy rate.

[Sheet 4] Segment Information (Development Business)

The Houses for Sale Business recorded declines in sales and profits. Sales fell, reflecting the absence of the sale of commercial land in large building lots for sale in the previous fiscal year. Like orders for the custom detached houses business, orders for houses for sale increased 36% year on year in the third quarter alone. The order backlog

increased ¥14.7 billion.

The Condominiums Business posted a decrease in sales and an increase in profits. The operating margin improved 1.2p, to 13.2%. Good progress was made in the delivery of properties for which a contract was concluded. Completed inventory fell 24 units from the end of the previous fiscal period, to 54.

The Urban Redevelopment Business registered decreases in sales and profits. Net sales from property sales decreased ¥42.6 billion year on year. Sales in the current fiscal year are from the sale of part of the stake in the Ritz-Carlton Kyoto. Certain properties are planned to be sold in the fourth quarter, and sales are in line with the plan.

[Sheet 4] Segment Information (Overseas Business)

In Australia, both sales and profits increased. Sales of housing land were favorable in Sydney and were in line with the plan. Orders received rose ¥14.0 billion. The order backlog increased ¥20.0 billion from the end of the previous fiscal period. The investment balance climbed ¥15.4 billion, to ¥155.7 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. The order backlog dropped ¥60.9 billion and the investment balance decreased ¥47.6 billion, to ¥69.2 billion.

In the United States, both sales and profits fell due to a change in the timing of the sale of properties in the multifamily business. Sales in the multifamily business stood at ¥56.0 billion, chiefly reflecting sales of properties in Denver and Seattle. Sales came to ¥36.3 billion in the community development business and ¥87.8 billion in the housing sales business. Operating income was ¥10.1 billion in the multifamily business, ¥1.8 billion in the community development business and ¥6.2 billion in the home sales business. Orders received declined ¥76.6 billion but increased ¥30.5 billion in businesses other than the rental housing development. In the multifamily business, five properties were initially planned to be sold, but three properties will be sold in the current fiscal year and two properties will be sold from the next fiscal year or thereafter due to a delay in leasing and a decline in investor confidence. The two properties were sold in the first nine months, and the remaining property will be sold in the fourth quarter. Performance in the community development business and the housing sales business was favorable owing to the historically lowest level of interest rates on housing loans. In the third quarter, a valuation loss of ¥3.2 billion was posted in a project in the community development business. Development approval has been obtained for the remaining projects, and there is no other risk of valuation losses.

Equity in earnings of affiliates posted in Singapore decreased ¥0.9 billion, and investment balance of Singapore business totaled ¥45.3 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 ¥0.6 billion.

[Sheet 5] Full-Year Plan For FY2020

Although profits fell significantly due to the COVID-19 pandemic, profit margins were relatively good and orders recovered. First, we will strive to achieve the full-year plan. If profit exceeds the plan, we will examine the year-end dividends. We will focus on receiving orders for growth in the next 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

- What is the probability of achieving the full-year plan for the Urban Redevelopment Business and what is your plan for the sale of properties from the next fiscal year?
- Could you explain the environment surrounding the receiving of orders?

Answer

- Contracts for an office building in Nagoya and a hotel in Fukuoka that are planned to be sold in the fourth quarter have been signed and are included in the order backlog in the third quarter. From the next fiscal year, we will steadily make progress in construction and sell these properties. We are actively purchasing real estate for lease, primarily for Sekisui House REIT, Inc. Meanwhile, we will transfer part of properties for sale to real estate for sale. We will examine the balance between investment and return to develop a plan for the next fiscal year.
- Orders have started recovering in the third quarter. We think that the recovery reflects not only changes in the impact of COVID-19 but also the effects of the sales efforts we made.

Question

- What is your outlook for the Overseas Business in the next fiscal year?
- What are the reasons for the strong orders in the Custom Detached Houses Business?

Answer

- In China, we are making progress in deliveries. In Australia, the order backlog is increasing. In the United States, orders are strong in Woodside Homes's homebuilding business. In the multifamily business, we have heard that rents for some properties have fallen, but we have not changed rents. Our properties are valuable in terms of location and quality. The cap rate remains flat, taking falling interest rates into consideration. Investors are taking a wait-and-see attitude. In this environment, we will monitor the situation toward the end of this fiscal year to formulate a plan for the next fiscal year.
- The situation in the Custom Detached Houses Business continues to be challenging due to the COVID-19 pandemic. The number of people visiting housing exhibitions is falling. The situation is unpredictable. Meanwhile, the digital marketing we have been engaged in over the past few years is producing results. We think the trust-based relationships we have established with customers are resulting in orders received. In addition, measures supporting home purchases are expected to expand. In this environment, we think there is potential demand.

Question

- Overall, your business appears to be making good progress against the plan. Could you explain the progress by segment?
- Is it still difficult to predict next year's performance in the multifamily business in the United States?

Answer

- Operating income has made good progress overall against the plan. Progress against the plan has been a bit slow in the Remodeling Business and the Real Estate Management Fees Business. In the other businesses, however, there are no concerns.
- The properties in the multifamily business in the United States are in good locations, and we believe the business will be healthy. We will formulate a plan for the next year depending on earnings. We are not overly optimistic but believe that the business will go in a good direction.

Question

- Can we expect that performance of the Overseas Business in the next fiscal year will be in line with the 5th Medium-Term Management Plan?
- What will the D/E ratio be at the end of the fiscal year and in the next fiscal year?

Answer

- The fall in sales of properties in this fiscal year will definitely result in the creation of sources of sales in the next fiscal year. Results in the multifamily business may exceed the 5th Medium-Term Management Plan, and Woodside Homes is performing well. Operating income may exceed the plan in the 5th Medium-Term Management Plan.
- We expect that the year-end D/E ratio will be around 0.47. We want to lower it to 0.44 to 0.45, but we will not stop growth investments to achieve the target. We will control the D/E ratio so that it will not exceed 0.45.

Question

- Orders received in the Rental Housing Business fell short of the plan. What is your outlook for the Rental Housing Business in the next fiscal year?
- You said in the second quarter that you will reduce share repurchases, assuming that COVID-19 will continue to have an impact until August next year. Is it possible that you will increase share repurchases if the situation is likely to recover earlier than expected?

Answer

- In November, orders for Sha-Maison rose 22%, while orders for non-housing buildings fell 65%. It is difficult to achieve a sharp recovery in the leasing of non-housing buildings, such as hotels and nursery schools, but we do not think that the rental of housing will deteriorate based on the current order situation, because the time from

the receiving of orders to the posting of sales is becoming longer.

- We will keep the payout ratio at 40% or higher and maintain flexible share repurchases. We will examine share repurchases, taking into consideration the ROE target and the situation surrounding the COVID-19 pandemic.

Question

- I have heard that in the Rental Housing Business, many of your customers are elderly people amid the COVID-19 pandemic and investment sentiment has fallen. Why is Sha-Maison performing well?

Answer

- We are now focusing on the CRE business for corporate customers as well as individual customers. For individual customers, we are establishing human relationships with customers who have repeatedly placed orders. Those, we believe, are the reason for the strong performance.