Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the First Quarter of FY2021 (Telephone Conference)

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Participants : Yosuke Horiuchi, Representative Director, Vice Chairman & Executive Officer

Atsushi Yoshida, Executive Officer, 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

Both net sales and operating income achieved record highs in the first quarter amid the COVID-19 pandemic. The housing business has been strong both in Japan and overseas due to the success of the Company's high value-added proposals, reflecting increasing interest in housing as a result of longer hours spent at home and the emergence of the new normal created by the COVID-19 pandemic.

Net sales increased 1.8% year on year. In the Built-to-Order Business, net sales fell 3.1%. Sales in the Custom Detached Houses Business rose, reflecting an increase in orders from the second half of the previous fiscal year. Sales in the Rental Housing Business have remained flat year on year, reflecting progress in housing construction work despite weak performance in the non-residential facilities. The main factor for the fall in net sales was a reaction to sales from large projects posted in the Architectural / Civil Engineering Business in the previous fiscal year. Sales in the Supplied Housing Business climbed 5.7%. In the Remodeling Business, sales increased significantly. The Real Estate Management Fees Business grew steadily. Sales in the Development Business rose 11.4%. Sales in the Houses for Sale Business increased significantly. In the Condominiums Business, sales fell due to a difference in the delivery of properties. In the Urban Redevelopment Business, sales rose, reflecting good progress made in the sale of properties. Sales in the Overseas Business fell 2.5%. In the United States, sales remained flat. A decrease in the delivery of condominiums in China was offset by an increase in the sale of condominiums in Australia.

Gross profit rose 3.5%. The gross margin improved 0.4p. In the Built-to-Order Business, the margin improved 1.8p, reflecting an improvement in the margin in Custom Detached Houses Business and Rental housing Business. In the Supplied Housing Business, the margin was 1.2p higher. In the Development Business, the margin fell 4.6p due to a difference in the profit margin in the sale of properties in the Urban Redevelopment Business. In the Overseas Business, the margin was 0.1p higher.

SG&A expenses rose 0.6%. The SG&A ratio fell 0.1p, to 11.6% partly due to an increase in sales. There was no impact from the increase in retirement benefit expenses this fiscal year.

Operating income increased 7.5%. The operating margin improved 0.5p. In the Built-to-Order Business, the operating margin was 2.0p higher, reflecting a rise in margin in the Custom Detached Houses Business and the Rental Housing Business. In the Supplied Housing Business, the margin rose 1.5p. In the Development Business, the margin fell 4.5p. In the Overseas Business, the margin was 1.2 p lower. Operating income in the first quarter accounted for 27.3% of the full-year plan. The progress was good at the same level as the previous fiscal year.

The balance of non-operating income/expenses increased ¥4.2 billion year on year. Equity in earnings (losses) of affiliates declined ¥0.6 billion year on year, reflecting a decrease in earnings in Singapore and a cost burden in the United Kingdom business. Non-operating income/expenses improved due to foreign exchange gains of ¥1.0 billion as opposed to foreign exchange losses of ¥3.3 billion in the previous fiscal year.

Extraordinary losses were mainly related to a loss on sales or disposal of fixed assets.

Orders received increased 12.7%. Orders rose in all segments except in the Architectural/Civil Engineering Business and the Urban Redevelopment Business. The order backlog increased 2.6% from the end of the previous fiscal year, to ¥1,399.2 billion.

[Sheet 2] Financial position

Total assets increased ¥42.2 billion from the end of the previous fiscal year. Current assets rose ¥22.7 billion. Of current assets, cash and deposits fell ¥42.6 billion. Factors for this included notes and accounts payables and the payment of income taxes, consumption taxes and dividends. Real estate for sale in Japan dropped ¥9.1 billion. Real estate for sale overseas increased ¥57.6 billion, including an increase of ¥42.9 billion due to foreign exchange rates. Noncurrent assets climbed ¥19.5 billion. Of noncurrent assets, property, plant and equipment rose ¥15.7 billion. Capital expenditures climbed ¥5.4 billion, to ¥25.1 billion, of which investment in real estate for lease was ¥19.8 billion. The full-year plan remains unchanged at ¥100.0 billion.

Total liabilities declined ¥1.9 billion from the end of the previous fiscal year, mainly reflecting decreases in notes and accounts payables and accrued income taxes payable. Interest-bearing debts increased ¥25.2 billion chiefly due to effects of foreign exchange rates of ¥21.9 billion at overseas subsidiaries. The D/E ratio rose 0.6p, to 43.0%.

Net assets increased ¥44.2 billion from the end of the previous fiscal year. In comprehensive income, foreign currency translation adjustment increased ¥32.4 billion due to the weaker yen.

Looking at cash flows, cash flows from operating activities improved ¥21.1 billion chiefly due to an increase in profit. Cash flows from investing activities declined ¥1.7 billion year on year chiefly due to investment in real estate for lease. As a result, free cash flows improved ¥19.3 billion. Cash used in financing activities was ¥30.6 billion, reflecting dividends paid and the repurchase of company shares. Cash and cash equivalents at the end of the first quarter stood at ¥557.5 billion.

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

The Custom Detached Houses Business recorded increases in sales and profit, reflecting strong orders from the second half of the previous fiscal year. The gross margin improved 2.7p due to active added value proposals. The operating margin improved 4.9p, reflecting the effect of sales quantities, among other factors. Orders remained strong and increased 4.5%. The order backlog increased ¥7.7 billion. As hours spent at home increased, interest in living a more comfortable, happier life is increasing. In this environment, the added value that the our proposed in response to new lifestyles was well received. Green First ZERO houses accounted for 91% of houses in the previous fiscal year. They were provided to more than 90% of customers. Lifestyle proposals, including Family Suite, and new proposals, including SMART-ECS, which proposes greater ventilation and air cleaning features, were accepted well. As a result, ASP per building rose ¥530 thousands year on year, to ¥41.91 million.

In the Rental Housing Business, there was good progress in construction, and sales remained flat from the same quarter in the previous year. The gross margin improved 2.6p, a significant increase as in the Custom Detached Houses Business. The operating margin improved 2.9p. Orders received rose 5.3%. The Company is focusing on the sale of ZEH rental housing from FY2020. Orders for ZEH were positively affected by Prime Minister Suga's carbon neutrality declaration. ZEH earned high marks from many corporate customers in urban areas in terms of their ESG evaluation regarding two aspects: building and homes for employees. The employees of corporations have been praised by individual customers (owners). ASP per building increased ¥10.25 million from the previous fiscal year, to ¥128.21 million. The ratio of three-to-four-story houses remained high, 77.2%.

The Architectural / Civil Engineering Business was added in the previous fiscal year. The business consists of the construction of reinforced concrete (RC) structures other than properties using materials shipped from the factory and Konoike Construction Co., Ltd. In the previous year, many large properties were completed and additional construction projects worth large amounts were recorded. In reaction to that, both sales and profit fell this fiscal year. Orders decreased ¥11.5 billion. The order backlog increased ¥10.0 billion from the end of the previous fiscal year. It is difficult to determine quarterly performance because of the large scale of each project, but we believe that we are making good progress in logistics, factory equipment at profitable companies, and housing and public infrastructure renovation even amid the COVID-19 pandemic.

[Sheet 3] Segment Information (Supplied Housing Business)

The Remodeling Business recorded increases in sales and profit. The operating margin rose 2.6 p. Orders for the remodeling of custom detached houses reflected increasing interest in a new lifestyle and a comfortable life. The remodeling of rental housing grew steadily owing to active remodeling proposals, which are indispensable for stable management in the long term. Orders received rose 25.6%.

The Real Estate Management Fees Business achieved growth in both sales and profits. The number of units under management increased 5,000 from the end of the previous fiscal period, and the occupancy ratio rose 0.7 p, to 98.4%. Both remained at a high level. In the sub-lease business in Japan, the vacancy rate generally rises as the building age increases, and rent is lowered to maintain the occupancy rate. However, because Sekisui House Real Estate's Sha-Maison rental housing has locational advantages, we recommend renovating the apartment and raising rent when the tenant changes. In the first quarter, the tenants of 37,116 units changed, and monthly rents rose ¥56 million. Sales from rental housing remodeling were ¥11.3 billion.

[Sheet 4] Segment Information (Development Business)

The Houses for Sale Business recorded increases in sales and profits. The results show high interest in the purchase of houses as in the purchase of custom detached houses. The results reflected our efforts to purchase high-quality land for customers who are looking for land, including first-time buyers and those considering moving from condominiums to detached houses. Orders received climbed 52.4%.

The Condominiums Business made progress as planned mainly in the delivery of tower condominiums completed towards the end of the previous fiscal year. Sales, including sales of expensive properties in the city center, were strong. Orders increased 41.8%. Contracts were already signed for most of the properties, and income was as planned. Completed inventory fell 28 units from the end of the previous fiscal year, to 24 units.

The Urban Redevelopment Business registered an increase in sales and a decrease in profits. Net sales from properties, including the sale of part of the stake in Grand Front Osaka, stood at ¥33.8 billion.

[Sheet 4] Segment Information (Overseas Business)

In Australia, both sales and profits increased. The delivery of condominiums in Sydney contributed to this. Orders received rose ¥8.4 billion. Government policy measures to help purchase homes are producing results gradually. Orders were received for more than 90% of the condominiums that are planned to be sold this fiscal year. The investment balance rose ¥5.6 billion from the end of the previous fiscal year chiefly due to foreign exchange rates (the appreciation of the Australian dollar).

In China, both sales and profits decreased in reaction to progress in the delivery of condominiums in Suzhou in the previous fiscal year. This fiscal year, the delivery of condominiums in Wuxi, Shenyang and Taicang was recorded. Orders increased ¥1.2 billion. The order backlog was ¥48.6 billion. Progress was made as planned toward the completion of all projects. The investment balance stood at ¥55.0 billion, reflecting progress in the building of condominiums in Taicang.

In the United States, both sales and profits increased in dollars. Due to a stronger dollar than in the first quarter of the previous fiscal year, sales fell in yen. In the Multifamily Business (Rental Residence Development), there were property sales in Denver in the previous fiscal year, but this fiscal year, property sales will be recorded from the second quarter. Sales increased, reflecting a strong housing market. Net sales in the Master-planned Community Business increased ¥7.2 billion. Net sales in the Homebuilding Business (Woodside Homes) rose ¥9.1 billion. In the Multifamily Business, an operating loss of ¥0.1 billion was recorded. Operating income in the Master-planned Community and in the Homebuilding, business was ¥3.7 billion and ¥2.6 billion, respectively. Of orders received of ¥77.8 billion, orders in the Homebuilding Business were ¥56.8 billion, up 76% year on year. The order backlog in Master-planned Community Business and Homebuilding Business stood at ¥56.5 billion and ¥89.4 billion, respectively. In the Multifamily Business, leasing is making steady progress and inquiries from investors are increasing. Thus, we think that two properties will be sold this fiscal year without any problems. Master-planned Community Business development and Homebuilding Business have secured a sufficient backlog. The new housing market remained strong, and we are in an environment where we can pass rising raw material prices on to housing prices. The investment balance stood at ¥478.2 billion.

In Singapore, equity in earnings of affiliates, mainly rents at commercial facilities, declined ¥0.5 billion year on year. The investment balance was ¥46.3 billion.

In the United Kingdom, we made an investment in 2019 to participate in a project for new homes using (proprietary) pre-engineered housing technology. The break-even point has yet to be reached, and equity in earnings of affiliates came to a loss of ¥0.1 billion.

[Sheet 5] Full-Year Plans

The full-year plans remain unchanged in consideration of steady orders in Japan and overseas.

< 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 are your views on the effects of rising materials prices on the domestic businesses? What is your outlook on the second half and thereafter?**
- **What do you think about the concerns over a possible fall in housing sales in suburban areas in the United States as people returning to city centers after there is progress in vaccination?**

Answer

- Of the raw materials we purchase, the prices of wood and steels are rising. We estimate that the effect of the increase of the cost of wood will be ¥1.5 billion for this year annually. We are considering passing the rising costs on through selling prices from July. We are also promoting the introduction of domestic premium lumber, an option whose price is at the same level, as the costs passed on through selling prices. We have inventories for about six months. We estimate a ¥2.9 billion increase in the cost of steels. Of that amount, we will absorb about ¥2.1 billion, an increase in the cost of the steels for which we have received orders, chiefly by improving capacity utilization at plants. We will pass the cost of steels for which orders will be received from July, on through a 0.8% to 1.2% increase in selling price depending on the size of properties.
- I have heard that inquiries about rental housing in city centers are increasing. The customers buying houses from Woodside Homes are shifting from baby boomers to millennials. There is demand from a wide range of customers. I believe there will be a certain level of demand for custom detached houses unless rates on home loans rise sharply. If interest rates rise, I believe that we will be able to deal with the situation if the rate rise is moderate. In the Multifamily Business (Rental Residence Development), we are purchasing good land not only in urban areas but in suburban areas.

Question

- **When do you think you will sell properties in the Multifamily Business and the Master-planned Community Business in the United States?**
- **What are your views on full-year plans?**

Answer

- In the Multifamily Business, investor sentiment is forecast to recover from around summer this year. Based on the forecast, we have started negotiations from the beginning of this fiscal year. At present, inquiries are received from urban and rural areas. Demand is in a recovery phase. Property sales will start in the second quarter or later. In the Master-planned Community Business, the rate of progress is fast. Local homebuilders usually make plans towards the end of the fiscal year and purchase land. They are purchasing properties earlier than usual, while monitoring market conditions.

- We are making good progress. If raw materials prices rise within the range that the Company expects, there is no problem. We need to examine the risk of the price increases. There are signs of the COVID-19 pandemic ending, and interest rates are stable. We thus do not think that results will fall below the initial plan. We will strive to be able to revise the forecast upward when we announce first half results.

Question

- **Why did the gross margin improve in the Custom Detached Houses Business and in the Rental Housing Business?**
- **Are there any problems in Woodside Homes' land inventories, construction capabilities, or timber procurement in this environment in the strong market in the United States?**

Answer

- Added value proposals, particularly in the second and third ranges of custom detached houses under the Company's three brands strategies, will help increase the gross margin. In the Rental Housing Business, too, the gross margin has improved due to the Hotel Like Style design, an increase in the ratio of three-to-four-story houses in urban area centers, larger properties and a reduction of indirect costs.
- We need to carefully watch the supply chain, including timber procurement. In the United States, our goal is to sell 3,000 custom detached houses this fiscal year. For the achievement of this goal, there are no problems in procurement and construction.

Question

- **Could you explain why ASP per building increased for custom detached houses and rental housing and also explain the relationship between the rise in ASP per building and carbon neutrality initiatives?**
- **What is the situation in China?**

Answer

- In the Custom Detached Houses Business, the percentage of ZEH increased to 91% and orders from wealthy customers and an associated increase in prices in the third range contributed to the increase in ASP per building. In the Rental Housing Business, the number of ZEH Sha-Maison properties reached 2,900 units, exceeding the FY2022 target of 2,500 units, and we have revised the target up to 4,000 units. That boosted ASP per building. We expect that progress in carbon neutrality initiatives will increase ASP per building.
- We aim to sell all properties by the final year of the fifth mid-term management plan. We plan to reinvest in the United States, where business growth is expected. In China, we have sold approximately 6,700 units. We have 240 units to sell. Construction is almost finished, and there is no risk of the price of raw materials rising.

Question

- **Which segments are exceeding plans?**
- **Could you provide more information about orders received for rental apartment buildings and rental non-residential facilities in the Rental Housing Business?**

Answer

- The gross margin is improving significantly in the Built-to-Order Business, Supplied housing Business and Houses for Sale Business. In the Condominiums Business, Urban Redevelopment Business, and Overseas Business, we have made progress as planned. We will decide whether to revise the full-year plans when we announce first half results.
- In May, orders received increased 26%. Orders for pure apartment buildings rose 40%. Non-housing orders continued to fall more than 30%. Non-housing is a smaller percentage of materials shipped from the factory, and the decline was offset by apartment buildings.

Question

- **Why was the gross margin high in the Real Estate Management Fees Business?**

Answer

- There were three factors in the improvement: an increase in the number of units under management, a rise in rents and shorter vacancy periods

Question

- **How long will orders remain strong in the Custom Detached Houses Business?**
- **Could you provide more information about sales activities and customer trends during the COVID-19 pandemic in relation to orders for rental housing?**

Answer

- The biggest factor for strong orders was long hours spent at home amid the COVID-19 pandemic and increased opportunities to think about homes. The prices of condominiums, including used condominiums, in city centers remain high. That, I think, is a reason why an increasing number of people are moving from condominiums to custom detached houses. I expect that the situation will change after the COVID-19 pandemic subsides. We will continue the Company's digital transformation and continue to communicate information about the Company, regardless.
- Around 2015, apartments in suburban areas sold well to reduce inheritance taxes. At present, the Company is implementing a strategy focusing on areas where there is strong demand in city centers. In those areas, large portions of land are owned by companies. We propose buildings to them from the ESG perspective. They have been received well. Also, Sekisui House Real Estate cooperate with them in our relationships with tenants. We preferentially provide information on vacancies to them.