Sekisui House, Ltd.

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

Date	:	Thursday, December 9, 2021, 5:00 p.m. to 6:00 p.m.	
Participants	:	Yosuke Horiuchi	Representative Director, Vice Chairman & Executive Officer
		Atsushi Yoshida	Executive Officer, Chief Manager of Investor Relations Department

< Presentation Summary>

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

Sheet 1: Results Overview

The third quarter financial results can be broadly summarized into two main points. First, net sales and operating income hit record highs for a third quarter. The operating income achieved 76% of the 220 billion yen target set by the full-year plan, which provides a high level of certainty in reaching the full-year goal. Second, orders increased year on year in every business segment. In Japan, the impact from the end of 13-year 1% housing loan tax exemption remained limited, and Sekisui House has steadily increased order backlog which should contribute to earnings in the next fiscal year.

When considering the financial result by business model, net sales declined 1.3% in the Built-to-Order Business. The Custom Detached Houses and Rental Housing Businesses increased sales backed by a raise in orders received from the second half of fiscal 2020 and stable construction progress. The reason for a decline in net sales is due to a reaction to sales from large project posted in the Architectural/Civil Engineering Business in the previous year. The Supplied Housing Business showed 6.7% growth. The Remodeling Business achieved more than a double-digit increase in sales, while the Real Estate Management Fees Business contributed to stable growth. The Development Business generated 33.5% more sales. Net sales in the Houses for Sale and Urban Redevelopment Businesses also rose significantly. Net sales in the Overseas Business fell by 7.6%. Homebuilding as well as master-planned community businesses in the United States remained strong. However, a decline in condominium deliveries in China impacted the sales.

The gross profit rose 12%. The gross margin improved 1.4p. Sekisui House enhanced the gross margin in every business segment, except Urban Redevelopment Business. The Built-to-Order Business heightened gross margin by 2.3p, and the Custom Detached Houses and Rental Housing Businesses continued their upward trends. The Supplied Housing Business improved gross margin 1.1p. The gross margin of the Development Business dropped 1.4p due to a difference in the ratio of profit margin driven by properties sold for urban redevelopment business. The Overseas Business improved 3.3p thanks to a higher profit margin of businesses in the United States.

SG&A expenses rose 3.8%. 5.1 billion of the 7.7 billion yen was due to higher personnel expenses. The SG&A ratio was almost equivalent to the previous year at 11.7%.

Operating income rose 24.8% with the operating margin increasing 1.5p. In the Built-to-Order Business, operating margin improved 2.1p. In the Supplied Housing Business, operating margin rose 1.2p. In the Development Business, operating margin dropped 0.6p. In the Overseas Business, operating margin increased 2.4p.

Non-operating income/expenses increased 3.5 billion yen. Equity in earnings/losses of affiliates declined 1.2 billion yen due to lower profits in Singapore. However, the foreign exchange gain/loss improved 5.0 billion yen thanks to depreciation in the Japanese yen.

The extraordinary income of 3.0 billion yen in earnings from the liquidation of SPC and 2.2 billion yen from the sale of shares of subsidiaries and affiliates came from business in China. Approximately 36.0 billion yen returned to Japan in cash from China through liquidation of the Suzhou Condominium Project. Extraordinary losses primarily came from losses on sales of fixed assets.

Orders in every segment rose with an overall increase of 11.2%. Every business model also saw a stronger order backlog.

Sheet 2: Financial Position

Total assets rose to 125.0 billion yen compared to the end of the previous fiscal year. Current assets increased 114.8 billion yen, of which cash and deposits fell 3.6 billion yen while real estate for sale increased 127.9 billion yen. The increase in real estate for sale was due to 44.0 billion yen increase, including effects from transfer of non-current assets to current assets, in Japan and 83.4 billion yen increase, including a 42.4 billion yen increase from foreign exchange gain, in overseas. Non-current assets rose 10.1 billion yen. Capital expenditures were 67.3 billion yen, up 2.2 billion yen, of which investments in rental real estate made up 53.5 billion yen.

Total liabilities rose 37.7 billion yen. Although redemption of bonds of 30.0 billion yen was made in July, interest-bearing debts rose 25.4 billion yen. Interest-bearing debts declined in Japan but borrowings increased at overseas subsidiaries, of which approximately 23.0 billion yen was from the effects of foreign exchange rate. The D/E ratio was 41.7%, improving 0.7p.

Net assets increased from cumulative translation adjustments climbing 27.6 billion yen in addition to net profit, while acquiring roughly 15.0 billion yen in the repurchase of company shares.

Cash flows generated by operating activities rose 37.0 billion yen thanks to higher profit and other such factors, even while furthering the purchase of land for real estate. The cash flow generated by investing activities increased 9.5 billion yen due to primarily rental real estate investments. As a result, Sekisui House improved its free cash flow by 46.6 billion yen to 50.6 billion yen. Cash used in financing activities amounted to 71.2 billion yen due to the redemption of corporate bonds, repayment of debts, and dividend payments. Cash and cash equivalents at the end of the third quarter amounted to 596.5 billion yen.

Sheet 3: Results by Segment—Built-to-Order Business

The Custom Detached Houses Business strengthened sales backed by steady construction progress as well as favorable order trends from the second half of the previous fiscal year. The gross margin rose 1.4p due to active added-value proposals, even while tackling a business environment with high material costs. The price per housing was 41.91 million yen, up 530 thousand yen from the previous year. Partly driven by a volume effect, operating margin climbed 2.4p. Orders rose 13.1%. The third quarter alone showed strong results with an 8% increase, which had a high bar set in the previous year. Order backlog rose 15.3 billion yen. Family Suite and other lifestyle design proposals continued to have a strong appeal with customers. Orders in November declined by 4%, but this was due to the high bar set in the previous year and the figures itself continues to be at a high standard. As the COVID-19 pandemic subsides, Sekisui House foresees the possibility of restaurant and tourist consumption impacting future orders.

The gross margin of the Rental Housing Business rose 1.5p, showing the same tremendous recovery as the Custom Detached Housing Business. The operating margin also increased 2.0p. Orders for ZEH rental housing have reached the 2,500 unit target set for the final year of the mid-term management plan in the first half of the fiscal year under review. Therefore, Sekisui House set a new target of 6,000 units. The strong trend of orders has already reached 5,600 units as of the third quarter. The price per building was 124.54 million yen, up 6.58 million yen. Three- to four-story buildings shifted to a higher ratio of rental properties at 77.7%. Despite non-residential orders declining year on year, hospitals and clinics are showing some recovery with a total 41.5 billion yen made up of 27.0 billion yen in factory shipping materials and 14.5 billion yen in RC. Sekisui House is focused on recovering orders quickly even in non-residential sectors through various measures including preparations for a second stage of the Trip Base *Michi-no-Eki* Stations Project, a project on regional revitalization.

The Architectural/Civil Engineering Business delivered several large projects during the previous fiscal year, which resulted in lower sales this year. The gross margin rose 1.9p through additional construction and other such factors. Orders increased 5.9% after receiving large projects and other sales efforts. This resulted in order backlog increasing by 41.4 billion yen compared to the end of previous year.

Sheet 3: Results by Segment—Supplied Housing Business

The Remodeling Business increased net sales by 13.4%, operating income by 34.8% and the operating margin by 2.5p.

It also increased orders for remodeling detached homes due to our initiatives focusing on large scale remodeling matching the increase of interest in comfortable lifestyles. Remodeling for rental housing made up 34.7 billion yen of the sales in the Remodeling Business with strong growth propelled by remodeling proposals essential to long-term stable management. The orders received increased by 15.1%.

Real Estate Management Fees Business grew net sales by 5.1%. The number of units under management rose by roughly 12,300 and the occupancy rate climbed 0.3p compared to the end of January, maintaining the high occupancy rate. Operating income rose 5.5 billion yen year on year. The operating margin also improved 0.9p. Sha Maison Rental Housing expanded sales and profit beyond expectations mainly due to increased sales through measures such as installing package lockers and other new amenities and receiving renovation orders when changing tenants as well as increasing rents. Residents in a total of about 87,000 units changed by the third quarter, generating an additional 145 million yen in monthly rental fees.

Sheet 4: Results by Segment—Development Business

The Houses for Sale Business increased net sales by 42.2%, gross margin by 0.7p, and the operating income by 5.1 billion yen. This segment has accumulated about 20.0 billion yen in land inventory since the end of the previous fiscal year through ongoing purchases in excellent areas. Orders rose by 41.5% compared to the previous fiscal year as well. Orders remained strong in November with 6% growth.

The Condominiums Business increased net sales by 6.1% with operating income up 800 million yen and the operating margin 1.0p higher than the previous fiscal year.

The delivery of major condominium projects mainly in Tokyo, Osaka, and Fukuoka progressed on schedule. Marketing initiatives for luxury and other properties proved successful, such as the sale of every condominium in the 871-unit residential tower in Umeda, Osaka. Orders increased 19.3% with 30 units completed housing stock.

The Urban Redevelopment Business increased net sales by 41.7% while sustaining a steady operating income. This segment has almost fully achieved its 11.0 billion yen full-year plan. Property sales generated 63.6 billion yen in earnings. This consisted of some of its shares in Grand Front Osaka sold in the first half of the fiscal year as well as some properties sold to Sekisui House Reit, Inc. and some of its shares in W Osaka luxury hotel developed in Osaka sold during the third quarter. The sale of properties held by Sekisui House Real Estate companies also contributed. Earnings from hotels are still recovering but are expected to trend upward with the return of domestic tourists beginning in November.

Sheet 4: Results by Segment—Overseas Business

In Australia, an additional 8.1 billion yen of net sales was generated year on year but saw a 400 million yen decline in operating income. Condominium delivers progressed on schedule, but profits dropped due to a decline in the number of houses sold during the off season for detached housing projects in Sydney. With investments being regulated overseas, the condominium market is still on the recovery. Orders rose 10.3 billion yen compared to the previous fiscal year. The investment balance also increased 2.6 billion yen compared to end of the previous fiscal year.

In China, sales declined due to concentrated deliveries of condominiums in Suzhou during the previous fiscal year. The financial results for this quarter include the delivery of properties in Wuxi, Shenyang, and Taicang. Almost all units of the properties have been sold when including provisional sales agreements. Orders fell 4.1 billion yen with 42.6 billion yen in order backlog. The investment balance declined by 12.0 billion yen compared to the previous fiscal year due to various factors, including factory sales and the liquidation of local SPC.

In the United States, net sales increased by 10.8 billion yen compared to the previous fiscal year. Breaking down the financial results by business model, the Multifamily Business built off its second quarter results in Portland with third quarter project sales in Denver. This generated 28.1 billion yen in net sales. The sales climate is improving with projects moving forward as planned. The master-planned community business continued to show favorable results with sales of 52.1 billion yen, up 15.7 billion yen, alongside the Woodside Homes Company, LLC homebuilding business which increased sales by 23.1 billion yen to 111.0 billion yen. Operating income in this segment was driven by the detached housing business with 6.4 billion yen from the Multifamily Business, 12.8 billion yen from the master-planned community business, and 11.0 billion yen from the homebuilding business. Orders reached 205.3 billion yen, up 7.7 billion yen compared to the previous fiscal year, with the homebuilding business increasing 26% to make up 126.7 billion yen. Order backlog rose 12.8 billion yen compared to the previous fiscal year to 131.0 billion yen. The order backlog consists of 50.4 billion yen from the master-planned community business and 80.2 billion yen from the homebuilding business. The Multifamily Business plans to sell one more property with negotiations progressing favorably. The master-planned community business sold roughly 3,200 plots of land by the end of the third quarter and is on track to deliver roughly 4,000 by the end of the fiscal year. The homebuilding business delivered 2,006 homes as of the end of the third quarter and is on pace with its plans to deliver approximately 2,700 homes by the end of the fiscal year. The demand in the new houses remains robust. Sekisui House is regaining its construction capabilities, and the situation which it has been strategically controlling its sales volume thus far will improve over the next fiscal year. The investment balance rose 88.6 billion yen compared to the previous fiscal year to 517.1 billion yen.

The equity in earnings of affiliates declined 800 million yen in Singapore. This was mainly due to rental fees of commercial complexes. The investment balance stood at 36.3 billion yen.

In the United Kingdom, with its scale of business currently yet limited and from the effects of the sluggish sales and construction delays brought on by the COVID-19 pandemic, break-even point could not be reached. This resulted in a 600 million yen loss of equity in earnings of affiliates.

Sheet 5: Full-year Plans

The full-year plans were not changed from the plans revised during the second quarter. The profit margin should continue to improve as high raw material costs and other factors constraining earnings subside. We project our financial performance will achieve the targets set in its full-year plan and will focus on securing more orders to foster further growth in during 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.

Question

- What are the factors enhancing profit margin in the Built-to-Order Business and how are the very high material costs impacting it?
- Would you also provide a forecast of the operating income in the Urban Redevelopment Business and the reason for selling some of its shares in W OSAKA?

Answer

- We have already undergone a cost pass-through for wood materials in June and steel materials in July. Sekisui House bore the costs for contracts before the pass-through, which equated to 5.0 billion yen for wood materials and 2.0 billion yen for steel materials. Despite such environment, the profit margin rose thanks to the added value proposals on site.
- Urban Redevelopment Business may slightly exceed the plan as rental income will generate in the fourth quarter as well. The Company decided to sell some of its shares in W OSAKA after receiving strong purchasing inquiries. Although occupancy is currently low, it seems many investors making inquiries believe the future of hotel businesses in Japan is easy to project.

Question

- How will reforms to tax policies, such as mortgage tax exemptions and a reduction in income requirements, affect future orders?
- How is the Multifamily Business in the United States doing with the sale of their third property?

Answer

- In general, tax reforms largely affect people who take out a mortgage to buy land when building a house. However, the impact on our custom detached houses in the Built-to-Order Business as well as the volume zone demographic of our customers earning an annual income of 9 million yen should be minimal.
- Sales negations have been moving forward smoothly. Whether or not the sale of the property will be on the books this fiscal year or the next is still unclear, but there is no doubt the properties be sold.

Question

- Could you provide a forecast for the next fiscal year? I am particularly interested in the Architectural/Civil Engineering and Australian businesses.
- Would you also give us some insight about the future of Woodside Homes Company, LLC in the United States?

Answer

- In general, there is no doubt receiving orders and making a profit through construction in the current general contractor industry is difficult. However, we believe the civil engineering work expertly handled by Konoike Construction Co., Ltd. will be able to secure orders and be highly profitable. Order backlog have climbed to almost 41.0 billion yen, which makes a favorable outlook for the next fiscal year highly likely. The future of the Australian market remains uncertain due to the omicron variant, travel restrictions returning, and other circumstances. Therefore, we will review its original plan.
- Woodside Homes Company, LLC has had a fabulous reception of houses with lifestyle options incorporating our added-value proposals. The price of each building is rising, but there is room for future growth.

Question

- Will the Condominiums Business include Grande Maison Shin-Umeda Tower THE CLUB RESIDENCE (871 units) in the financial results for this fiscal year?
- Could you also please explain the pipeline and sales policies of the Multifamily Business in the United States?

Answer

- We plan to split the financial results from the Grande Maison Shin-Umeda Tower THE CLUB RESIDENCE between this fiscal year and the next because deliveries start in January.
- Currently, the Multifamily Business is in the process of acquiring land set to be sold between fiscal 2026 to fiscal 2027. We have already secured properties to sell in fiscal 2022 and fiscal 2023. The leasing business is also performing well. Investors are highly motivated to buy land, but details about the number of properties to sell and the timeline has not been set because our policy is to sell when the price is at its highest.

Question

- How profitable is the architectural business in the Architectural/Civil Engineering Business?

Answer

- It is hard to make a sufficiently large profit in construction. Competition in private construction is becoming particularly fierce. The business climate does not lend to orders, even through approaches such as joint ventures.

Question

- How do sales of PLATFORM HOUSE touch currently stand?

Answer

- PLATFORM HOUSE touch is our unique proposal and was on pre-sale in some areas in the Kanto and Kansai regions. In those areas, 30% of custom detached houses came equipped with this smart home service as of November. Sekisui House has expanded this optional service throughout Japan as of December. PLATFORM HOUSE touch is raising the order value and improving the profit margin. We expect these types of lifestyle design proposals to become a new strategic strength.