Sekisui House, Ltd.

Transcript for Earnings Results Briefing for FY2021
(Telephone Conference)

Date	:	Thursday, March 10, 2022, 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 financial results of FY2021 can be broadly summarized into two main points. First, net sales and operating income hit record highs, exceeding the upward revisions made to the forecast in September. Second, our annual dividend increased by ¥6 from the previous year to ¥90. This was an increase of ¥2 from the revision made in September.

Net sales were ¥2,589.5 billion, up 5.8% from the previous fiscal year. Net sales in the Built-to-Order Business increased 1.4%. Against a background of increased orders and steady progress in construction, sales in the Custom Detached Houses Business and Rental Housing Business exceeded the full-year plan, covering for the Architectural/Civil Engineering Business. Net sales in the Supplied Housing Business increased 6.1%. Net sales also increased in the Remodeling Business and Real Estate Management Fees Business. Development Business sales increased 19.8%. Net sales rose significantly in the Houses for Sale Business, and were in line with plans in the Condominiums Business and the Urban Redevelopment Business. Net sales in the Overseas Business increased by 4.9%. The multifamily business in the United States sold three development projects as planned, while the homebuilding business and master-planned community business performed well.

Gross profit increased by 11.7%. Gross margin improved in all segments except the Urban Redevelopment Business. In the second half, material prices rose for orders before price pass-through, but the impact was absorbed. In the Built-to-Order Business, the gross margins of the Custom Detached Houses Business and Rental Housing Business continued to improve, leading to an increase of 1.7p. The gross margin of the Supplied Housing Business improved by 0.9p. The gross margin of the Development Business dropped by 0.5p due to a difference in the ratio of profit margin driven by properties sold in the Urban Redevelopment Business. The gross margin of the Overseas Business improved by 1.5p.

SG&A expenses increased by 4.1%. The SG&A ratio declined 0.2p year on year to 11.5%.

Operating income increased by 23.4% while operating margin improved by 1.3p. In the Built-to-Order Business, operating income increased by ¥4.6 billion from the full-year plan and operating margin improved by 1.7p. In the Supplied Housing Business, operating margin improved by 1.1p. In the Development Business, operating income increased by ¥2.3 billion from the full-year plan, while operating margin decreased by 0.3p. In the Overseas Business, operating income increased by ¥7.6 billion from the full-year plan, while operating margin improved by 2.2p.

Non-operating income/expenses improved by ¥1.7 billion from the previous year. Equity in earnings/losses of affiliates declined by ¥1.8 billion due to lower profit in Singapore. However, non-operating income/expenses improved due to an exchange gain of ¥1.1 billion for the year thanks to depreciation in the Japanese yen, compared with an exchange loss of ¥3.5 billion in the previous year.

Extraordinary income consisted of ¥2.2 billion in earnings from the sale of shares of subsidiaries and affiliates and ¥3.0 billion in earnings from the liquidation of subsidiaries and associates in our business in China. Extraordinary losses were ¥1.6 billion, primarily from losses on sales of fixed assets.

Orders rose 13.3% overall. Order backlog rose 10.9% from the end of previous fiscal year to ¥1,512.5 billion. Order backlog increased by ¥78.4 billion in the Built-to-Order Business and ¥60.8 billion in the Overseas Business.

Sheet 2: Financial Position

Total assets increased by ¥175.3 billion from the end of the previous fiscal year. Current assets increased by ¥172.0 billion, which includes a decrease of ¥85.0 billion in cash and deposits. Real estate for sale increased by ¥252.7 billion, which includes an increase of ¥114.4 billion domestically and an increase of ¥138.2 billion overseas due to increase of ¥64.1 billion from effects of foreign exchange rates as well as conversion of Holt Homes into a consolidated subsidiary. Non-current assets increased by ¥3.3 billion. Capital expenditures were ¥89.5 billion, of which investments in rental real estate accounted for ¥67.9 billion. Investment of ¥80.0 billion is planned for FY2022, including ¥60.0 billion in investments in rental real estate.

Total liabilities increased by ¥23.2 billion from the end of the previous fiscal year. Although redemption of bonds totaling ¥30.0 billion was carried out in July, borrowings increased as well. Interest-bearing debt declined by ¥13.1 billion from the end of the previous fiscal year, taking into account a decline in Japan and an increase of ¥32.3 billion at overseas subsidiaries due to exchange rate effects. The D/E ratio improved by 5.1p to 37.3%.

Net assets increased by ¥152.0 billion from the end of the previous fiscal year. Factors included the recording of net profit and an increase in translation adjustments.

Cash flow generated by operating activities decreased by ¥73.9 billion despite an increase in profit, due to an increase in real estate for sale in Japan and the United States. Cash flow used for investing activities was ¥113.7 billion due to the acquisition of tangible non-current assets as well as the acquisition of Holt Homes in the United States. As a result, free cash flow decreased by ¥92.1 billion. Cash used for financing activities was ¥111.7 billion, which include redemption of corporate bonds, repayment of debts, etc. Cash and cash equivalents at the end of the fiscal year amounted to ¥515.1 billion.

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

The Custom Detached Houses Business strengthened sales and profit through steady construction progress and favorable orders. Gross margin increased to 26.5%, its highest-ever value, due to active added-value proposals despite the effects of increasing material prices. Operating margin also improved by 2.0p due to volume effects. Recovery continued in orders, which increased by 9.6%, or an increase of 4.2% compared to the second half of the previous year, which the bar is high. Order backlog maintained the level at the end of the previous fiscal year. Family Suite and other lifestyle design proposals continued to have a strong appeal. We also worked to attract visitors to the Tomorrow's Life Museum experience-oriented facility, which underwent renewal in August 2021. As a result, price per housing also increased by ¥1.27 million from the previous year to ¥42.65 million.

In the Rental Housing Business, sales and profit increased. Gross margin improved significantly by 1.1p, similar to the increase seen in the Custom Detached Houses Business. Operating margin improved by 1.5p. Orders increased by 9.9%, and the order backlog increased by ¥6.1 billion. Sales of ZEH Rental Housing grew steadily. Compared to the target of 2,500 units set for the final year of the Fifth Mid-Term Management Plan, sales for the fiscal year were 8,501 units, with the ratio of ZEH growing rapidly to about 30%. ZEH has won high marks for the many merits it offers residents and for its contribution to companies' ESG management.

The price per housing was ¥126.56 million, up ¥8.6 million from the previous year. The ratio of three- to four-story buildings increased to 79%.

Sales in the Architectural/Civil Engineering Business declined, due in part to the delivery of several large projects in the previous fiscal year and to postponed construction caused by the COVID-19 pandemic and other external factors. At the same time, gross margin improved by 1.4p due to additional construction and other factors. Orders increased by 19.7% due to sales efforts, resulting in the order backlog increasing by ¥71.7 billion from the end of previous fiscal year.

Sheet 3: Results by Segment—Supplied Housing Business

Sales and profit increased in the Remodeling Business, and operating margin improved by 1.9p. In remodeling of custom detached houses, we focused on Family Suite Renovation and other large-scale remodeling, connecting a growing interest in comfortable lifestyles to the receipt of orders. Remodeling for rental housing also grew strongly, propelled by remodeling proposals essential to long-term stable management. Orders received increased by 13.6%.

The Real Estate Management Fees Business achieved growth in sales and profit. From the end of the previous fiscal year, the number of units under management increased by 16,935 and the occupancy rate rose 0.2p to 97.9%, maintaining a high occupancy rate through the supply of high-quality rental housing in favorable locations. Rents rose as well. Measures such as remodeling work, rent increases, and other measures taken at the time of changing tenants proved successful in increasing the profit. Residents in a total of about 111 thousand units changed during the fiscal year, and monthly rents increased ¥187 million.

Sheet 4: Results by Segment—Development Business

Sales and profit increased in the Houses for Sale Business, with the sales increase stemming from first-time buyers, relocations from condominiums, etc. We continued making purchases of superior land and increased land inventory by about ¥30.0 billion. Orders increased by 38.9%.

Sales and profit increased in the Condominiums Business. Delivery of a residential tower in Osaka, completed in the fourth quarter, has progressed to about the halfway mark, contributing to net sales in the fiscal year. Sales activities for luxury and other properties remain strong, and orders increased by 3.7%. The completed housing stock was 165 units. We further made the decision to make all condominiums sold from 2023 ZEH-compatible, accelerating our contribution to a decarbonized society through multiple-dwelling complexes.

Sales resulting from the sale of properties in the Urban Redevelopment Business were ¥70.1 billion, including contributions from the sale of some shares in Grand Front Osaka and W Osaka as well as the sale of properties to Sekisui House Reit, Inc. Earnings from hotels remained difficult due to the renewed spread and prolonging of the COVID-19 pandemic.

Sheet 4: Results by Segment—Overseas Business

Net sales in Australia decreased by ¥3.5 billion. Operating income resulted in a loss of ¥3.9 billion. Severe conditions continued, including delays in construction progress due to the COVID-19 pandemic and the recording of some valuation losses. Recovery continued in the condominium market despite constrained investment from overseas. Orders increased by ¥20.6 billion and the investment balance increased by ¥15.3 billion. We forecast a significant increase in sales and profit in FY2022, with net sales of ¥66.9 billion and operating income of ¥6.7 billion based on an accumulating order backlog.

In China, sales and profit declined from levels in the previous fiscal year, which had benefitted from concentrated delivery of condominiums in Suzhou. During the fiscal year, we recorded deliveries of properties in Wuxi, Shenyang, and Taicang. Contracts for all housing units had already been completed, and deliveries will proceed in line toward the goal of approximately 6,700 units. Orders decreased by ¥9.6 billion, with an order backlog of ¥19.4 billion. The investment balance declined by ¥30.6 billion from the end of previous fiscal year to ¥21.5 billion, due to factors including the sale of factories and the liquidation of local SPC. In FY2022, we forecast net sales of ¥22.0 billion and operating income of ¥5.0 billion.

In the United States, net sales increased by ¥56.7 billion from the previous fiscal year. Breaking down results by business model, the multifamily business sold three projects during the year as scheduled, generating ¥62.3 billion. The master-planned community business and homebuilding business (Woodside Homes) were strong at ¥75.5 billion and ¥157.8 billion, respectively. Operating income increased, yielding ¥14.1 billion in the multifamily business, ¥16.5 billion in the master-planned community business, and ¥16.5 in the homebuilding business. Of ¥337.6 billion in orders received, the homebuilding business recorded an increase of 10% from the previous fiscal year to achieve ¥167.6 billion. In December, Holt Homes was converted to a subsidiary. Order backlog increased by ¥57.2 billion, including two projects scheduled to be sold during the current fiscal year for the multifamily business and Holt Homes. The order backlog was ¥32.1 billion in the multifamily business, ¥51.8 billion in the master-planned community business, and ¥91.3 billion in the homebuilding business. The investment balance increased by ¥152.9 billion from the end of the previous fiscal year to ¥581.3 billion. In business in the United States in FY2022, we forecast net sales of ¥325.9 billion and operating income of ¥43.6 billion. In the multifamily business, we plan to sell four projects against a backdrop of a favorable sales environment. In the homebuilding business, despite a seeming pause in the housing market, steady demand centered on millennials continues under shortages of supply, and we expect continued robust sales and business performance. At the same time, in the master-planned community business, we forecast a decline in sales other than sales of commercial land, due in part to a decline from the large number of builders acquiring land ahead of schedule in FY2021. Breaking down results by business model, we forecast net sales of ¥70.2 billion and operating income of ¥13.6 billion in the multifamily business, net sales of ¥58.2 billion and operating income of ¥10.8 billion in the master-planned community business, and net sales of ¥196.2 billion and operating income of ¥20.0 billion in the homebuilding business.

In Singapore, equity in earnings of affiliates, primarily from rents on commercial facilities, declined by ¥1.1 billion. The investment balance stood at ¥36.3 billion.

In the United Kingdom, a ¥1.7 billion loss of equity in earnings of affiliates occurred due to delayed sales and construction brought on by the COVID-19 pandemic.

Sheet 5, 6: Full-year Plans

We seek to increase net sales in all segments to achieve ¥2,787 billion, an increase of 7.6% from the previous fiscal year. Operating income is planned to increase by 2.5% to ¥236.0 billion. Effects of soaring material prices will be significant during the fiscal year and are expected to reach a total of ¥13.0 billion, primarily in custom detached houses business, rental housing business, and houses for sale business. At present, we are addressing these effects through increased added value and cost reductions without price pass-through, and plan to secure increased profit despite a decline in profit margin.

Net sales of custom detached houses are planned to increase by ¥15.2 billion from the previous fiscal year to ¥368.0 billion. Operating income will increase by ¥1.0 billion to ¥43.5 billion. Net sales and profit are expected to increase under the current increase in orders. We plan an increase in orders of 4.2% under firm housing demand and continued strengthening of lifestyle design proposals. In Rental Housing business, net sales will increase by ¥21.9 billion to ¥406.0 billion, and operating income will increase by ¥1.9 billion to ¥58.0 billion. Net sales and profit will increase due to order backlog conditions and favorable performance of Sha-Maison ZEH. Orders for the fiscal year are planned to increase by 4.6%. In the Architectural/Civil Engineering Business, we expect net sales to increase by ¥65.0 billion to ¥327.0 billion and operating income to increase by ¥0.5 billion to ¥15.7 billion as major projects move forward. Orders will be near the level of the previous year. For Built-to-Order Business overall, net sales will increase by 10.2% and operating income will increase by 3.1% to ¥117.2 billion. We forecast continued strong performance of proposal-based remodeling and environmental-based remodeling sales in the Remodeling Business, and growth centered on Family Suite Renovation. Net sales will increase by 5.0% to ¥164.0 billion. Gross margin will be close to the level of the previous year, while operating income will increase by ¥0.9 billion to ¥26.5 billion. The Real Estate Management Fees Business will maintain high occupancy and stable growth. Operating income will increase by ¥2.0 billion to ¥52.5 billion. In the Development Business, net sales of houses for sale business will increase by 8.6% to ¥208.0 billion in response to strong demand from first-time buyers. Operating income will increase by ¥0.4 billion to ¥15.0 billion. We expect net sales of condominiums to be close to the level of the previous year, but have a reserved outlook for the operating income. In the Urban Redevelopment Business, net sales will be ¥117.2 billion and operating income will be ¥10.0 billion. Of this, sale of properties will account for about ¥85.0 billion and gain on sales will account for ¥15.0 billion. Recovery of earnings from hotels is expected to take time. In the Overseas Business, we expect net sales to increase 6.6% to ¥414.8 billion. Operating income will increase by ¥3.8 billion to ¥54.0 billion. We expect the significant decline in sales in China to be covered by sales in the United States and Australia. Sales by Holt Homes will also make a contribution.

We expect ordinary income of ¥234.0 billion. We further expect a net extraordinary income of ¥4.0 billion, the same as in the previous fiscal year. Net profit will be ¥158.0 billion. We plan EPS of ¥237 and ROE of 10.5%. We plan to increase dividends per share by ¥4 to ¥94, the 11th consecutive year of increases.

In FY2022, the final year of the Fifth Mid-Term Management Plan, we will take new lifestyles as opportunities to promote growth and will carry out appropriate growth investments aimed at sustainable growth as we head into the Sixth Mid-Term Management Plan, which starts in the next fiscal year. We also hope to increase shareholder returns through continued dividend growth and flexible repurchase of company shares.

<Summary of Question and Answer Session>

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

Question

- What is the background to the ¥30 billion limit for repurchase of company shares and your thoughts on early redemption of hybrid bonds?
- What is the environment for the detached housing business in the United States?

Answer

- The decision was made in line with our past policy concerning flexible repurchase of company shares. While investment for growth and cash reserves will be given priority, we have judged the scale to be appropriate at a total of ¥50 billion over the three years of the Fifth Mid-Term Management Plan, including the portion scheduled for implementation. Regarding hybrid bonds, early redemption on each interest payment date from August 2022 is one option, but we will continue considering options that include replacement, taking into consideration the situation of cash, etc. associated with M&A, etc.
- Holt Homes owns about 4,000 lots of land in the states of Oregon and Washington, equivalent to about four years of supply. Together with Woodside Homes, we have prepared a supply base in the western and northwestern United States. Our target is to supply 10,000 units globally by 2025, including 7,000 to 8,000 units in the United States. At present, we anticipate about 4,000 units for Woodside Homes and Holt Homes, and will continue considering alliances and M&A with builders in the southern and eastern regions who understand our strategies and thinking.

Question

- Looking ahead, what is your thinking regarding shareholder returns, including dividends and repurchase of company shares?
- Could you explain the balance of profit plans in countries in which the Overseas Business operates?

Answer

- One factor behind the setting of a ¥30 billion scale on the repurchase of company shares is the ongoing selling of strategic share crossholdings in the market. Total return ratio, too, is not decided on the basis of numbers, and as a result is 50% or more.
- Of four multifamily business projects scheduled for sale in FY2022 in the United States, two have been contracted for sale. We have received many inquiries from investors, and hope to advance to sales contracts in the first half of FY2022. In Australia, we expect a rebound during the fiscal year, but even if plans undergo change, overseas business in the United States and elsewhere will make up for it.

Question

- To what extent has the recording of current fiscal year sales been finalized for the homebuilding business in the United States? What impact will soaring material prices have? Please also touch on the state of the supply chain.
- Could you provide a breakdown of the ¥13 billion (domestic) in effects of material prices increases? Also, please note whether there are timber imports from Russia, and what the outlook is for timber procurement.

Answer

- Woodside Homes and Holt Homes have a combined order backlog of about half of the fiscal year's sales. Turmoil in the supply chain has not had a major impact, but we must closely watch the potential for further turmoil.
- The breakdown of the ¥13 billion has not been disclosed. While we do not have direct imports from Russia, considering cost increases for procurement of North Europe and North American timber, including soaring fuel prices and changes in transportation routes, there could be impacts in the future. However, our recognition is that there are no significant impacts in terms of overall import volume.

Question

- Is the ¥13 billion in effects of soaring material costs limited to the Built-to-Order Business? Could you provide a breakdown by segment?
- Should the officially announced approach to shareholder returns be understood as an average payout ratio of 40% and flexible repurchase of company shares? Also, is there a possibility of change in the next Medium-Term Management Plan?

Answer

- As the Custom Detached Houses Business and the Rental Housing Business produce the same materials at the same factories, this can be pictured in terms of order rate or sales ratio.
- That understanding is correct. Shareholder returns under the Sixth Mid-Term Management Plan are currently under deep consideration.

Question

- What is the background behind of the growth of ZEH Sha-Maison to 8,501 units? Is there room for further growth, and what will be the impact of government subsidies, etc.?

Answer

- ZEH Sha-Maison is popular for allowing residents to sell electricity and reduce utility costs, and for letting corporations contribute to the "S" (Society) in ESG by having employees live in ZEH Sha-Maison housing. ZEH rental housing is increasingly being actively chosen. At the same time, corporate residents are well received by owners as stable, high-quality residents. Regarding government subsidies, there was a FY2021 subsidy but it ended in one month in April. Even with no effect from subsidies, customers are increasingly choosing ZEH rental housing.

Question

- Could you explain your thinking on price pass-through in Japan to address soaring material prices?
- Overseas, looking only at Woodside Homes in the United States, what sort of changes have you factored into business results for FY2022 compared to FY2021?
- What is the status of orders for platform houses?

Answer

- The order backlog extends to around the third quarter of FY2022, and we will have to shoulder the increase in material prices for orders for which order contracts have already been completed. Regarding price pass-through in the future, we will carefully consider this with an eye toward effects on orders.
- We have determined that forecasting Woodside Homes' earnings is difficult in light of geopolitical risks, interest rate movements, the possibility of supply chain disruptions, soaring material costs, etc., and so have planned for profit at about the same level as the previous year.
- Regarding platform houses, proof-of-concept trials are underway for HED-Net. We have begun sales of PLATFORM HOUSE touch, with a positive reception that includes adoption by 35% of customers in the second range and 47% in the third range.