Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the First Quarter FY2022 (WEB Conference)

Date	:	Thursday, June 9, 2022, 5:00 p.m. to 6:30 p.m. (JST)	
Participants	:	Yosuke Horiuchi	Representative Director of the Board, Vice Chairman, Executive Officer
		Toru Ishii	Director of the Board, Senior Managing Officer
		Atsushi Yoshida	Executive Officer, Head 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".

[Page 2] Results Overview

Net sales increased by 22.2% year on year to ¥743.6 billion. Sales grew for all business models. Factors contributed to the sales growth are: sales increase in the overseas business by ¥77.9 billion and ¥24.2 billion in the Built-to-Order Business, strong performance in the Housing Business and progress in property sales. Gross profit increased by 30.4% to ¥163.1 billion. Gross margin improved by 1.3p to 21.9%. Despite slight declines in the Built-to-Order Business and the Supplied Housing Business, increased profit in the Development Business and Overseas Business contributed to significant improvement. SG&A expenses increased by 7.0% to ¥75.4 billion. Due to the increase in overseas subsidiaries, personnel expenses increased by ¥2.8 billion. However, the SG&A ratio declined by 1.5p to 10.1% due to increased sales. Operating income increased by 60.5% to ¥87.7 billion. Profit increased for all business models. Operating margin improved by 2.8p to 11.8%. The overall rate of progress of operating income against the full-year plan was favorable at 37.2%, compared to 23.8% in the previous fiscal year.

Non-operating income/expenses decreased by ¥2.6 billion from the previous fiscal year to a loss of ¥ 1.6 billion. Foreign exchange gain/loss decreased by ¥0.7 billion from the previous fiscal year to ¥0.3 billion. Equity in earnings/losses of affiliates decreased by ¥1.6 billion from the previous fiscal year to a loss of ¥ 1.7 billion. As Urban Splash House Holdings, an investment by the Company's United Kingdom Business, entered into liquidation proceedings, an investment valuation loss of ¥1.5 billion was recorded. An extraordinary loss of ¥1.8 billion was recorded as provision of allowance for doubtful accounts.

Including provision of allowance for doubtful accounts, losses on sales of fixed assets, etc., extraordinary losses were ¥2.5 billion.

Overall orders received increased by ¥92.1 billion (14.3%) to ¥736.6 billion. Orders received were strong both in Japan and overseas, increasing in all business models and marking a strong start toward achieving the full-year plan.

[Page 4] Financial Position

Total assets increased by ¥49.4 billion from the end of the previous fiscal year. Current assets increased by ¥48.7 billion. Cash and deposits increased by ¥5.0 billion during the fiscal year due to the contribution of income in the United States, despite the occurrence of notes and accounts payables, income tax and consumption tax, and dividend payments in the first quarter of every year. Real estate for sale increased by ¥16.1 billion. Of this, domestic real estate for sales decreased by ¥10.2 billion while overseas real state for sales increased by ¥26.4 billion, which included ¥50.9 billion in effects of foreign exchange rates. Non-current assets increased by ¥0.7 billion. Of this, property, plant and equipment increased by ¥11.9 billion.

Total liabilities increased by ¥2.8 billion due to an increase in borrowings, despite a decrease in accrued income taxes payable. Interest-bearing debt increased by ¥57.2 billion. This included approximately ¥25.0 billion in Japan and ¥25.0 billion due to effects of foreign exchange rates at overseas subsidiaries. D/E ratio increased by 2.7p to 40.0%. The Company also made a decision to redeem hybrid corporate bonds. The Company deemed replacement to be unnecessary based on its sound financial status and balanced revenue structure, even taking into account M&A and other growth investments.

Net assets increased by ¥46.5 billion. Comprehensive income increased by ¥37.6 billion due to cumulative foreign currency translation adjustments as depreciation of the yen continued. Equity ratio increased by 0.7p to 53.3%.

[Page 5] Cash Flow, Investment Status

Cash flow provided by operating activities increased by ¥28.1 billion due to an increase in net profit and a decrease in real estate for sale associated with progress in the sale of properties. Cash flow provided by investment activities improved by ¥9.2 billion. As a result, free cash flows improved by ¥37.4 billion. Cash used for financing activities was ¥17.6 billion due to dividend payments and the repurchase of company shares. Cash and cash equivalents at the end of the first quarter amounted to ¥520.2 billion.

[Pages 6, 7] Segment Information (Built-to-Order Business)

Net sales in the Built-to-Order Business overall increased by 10.2% to ¥262.3 billion. Operating income grew by 9.4% to ¥30.1 billion. Sales and profit increased, driven by custom detached houses and rental housing.

Net sales in the Custom Detached Houses Businesses increased by 13.4% to ¥84.6 billion. Sales and profit increased due to robust receipt of orders continued from the previous fiscal year. Gross margin decreased by 0.4p to 26.4%. This breaks down to -1.4p due to effects of soaring material prices, and +1.0p due to increased price per building and volume effects. This remained within the range of the initial plan, which incorporated the effects of ¥13.0 billion in material price increases for the full year. At the same time, as material prices are expected to continue to rise for the market as a whole, prices were revised for contracts from June onward in custom detached houses and rental housing. Operating margin decreased by 0.2p to 12.3%. Order receipts remained strong, increasing by 6.3% to ¥87.6 billion. The order backlog increased by ¥2.9 billion. The ZEH ratio for the most recent April was 93%, with adoption by over 90% of customers. Cumulative units through the previous year reached 69,163. As a result, price per building also increased by ¥1.29 million from the previous fiscal year to ¥43.94 million.

Net sales in the Rental Housing Businesses increased by 17.9% to ¥105.3 billion. Both sales and profit increased significantly in line with strong progress in construction. Gross margin decreased by 0.1p to 25.7%, covering for effects of soaring material prices through increased sales and higher added value, as in detached houses. Operating margin improved by 1.6p to 14.3%. Orders received decreased by 0.4% to ¥95.7 billion. Orders for non-housing, including hotels and offices etc., decreased year-on-year due to the COVID-19 pandemic, but orders for Sha Maison rental housing were up from the previous year. The adoption rate for Sha Maison ZEH is 57%, setting a pace that exceeds the target of 50% for the fiscal year. As of the first quarter, 3,401 units were built, with cumulative orders received through the previous fiscal year reaching 12,307 units. The unit price per building is ¥139.64 million, an increase of ¥13.08 million from FY2021. The ratio of three-to-four-story houses also remained high at 85.7%.

In the Architectural/Civil Engineering Business, both sales and profit declined. In addition to a decrease from the previous fiscal year in the number of civil engineering projects, reasons for decreased profit include lower gross margin due to competition for orders in the industry. Orders received decreased by ¥0.8 billion to ¥83.3 billion. Amid soaring steels prices, commercialization of projects ordered by developers is difficult under a severe cost environment. Accordingly, the Company is focused on the acquisition of projects with a strong propensity for ordering even under rising prices, such as government offices, schools, factories, and warehouses.

[Page 8, 9] Results by Segment—Supplied Housing Business

Net sales in the Supplied Housing Business as a whole increased by 5.5% to ¥191.1 billion. Operating income increased by ¥0.2 billion to ¥20.5 billion.

The Remodeling Business recorded increases in sales and profit. Operating margin improved by 0.6p to 15.8%. Orders received increased by 3.5% to ¥41.4 billion, with strong performance continuing from the previous fiscal year. Remodeling remained strong in custom detached houses and rental housing. In addition to large-scale remodeling such as Family Suite Remodeling, stable growth continued atop a strong customer foundation, including the rental housing remodeling proposals that are vital to long-term stable management. At the same time, as in the Built-to-Order Business, there is a need to closely watch movements in material prices.

In the Real Estate Management Fees Business, sales increased but profit decreased. Operating margin decreased by 0.7p to 9.6%. Due to the establishment of Sekisui House Real Estate Holdings, Ltd., profit decreased under increased personnel expenses and temporary cost impacts associated with changes in business operation systems. However, profit is expected to recover from the second quarter. In the first quarter, tenants changed in 37,639 units, monthly rental fees increased by ¥7.8 billion, and sales from rental housing remodeling were ¥12.8 billion. The number of units under management is about 680,000 with an occupancy rate of 98.4%, an increase of 0.5p from the end of January.

[Page 10, 11] Results by Segment—Development Business

Net sales for the Development Business overall increased by 20.0% to ¥123.3 billion. Operating income increased by ¥8.9 billion to ¥19.8 billion. Profit increased in all segments.

Net sales and profit increased in the Houses for Sale Businesses. Gross margin decreased by 0.7p to 18.6%. Orders received increased by 39.0% to ¥65.3 billion. Interest in housing purchase remains high. Land inventory increased by about ¥16.0 billion from the end of the previous fiscal year due to ongoing purchases of land in prime areas.

Sales and profit increased in the Condominium Business. Operating margin increased by 7.8p to 23.7%. Orders received increased by 6.1% to ¥21.4 billion. Delivery of the residential tower completed at the end of the previous fiscal year in the Umeda area of Osaka made progress, significantly contributing to profit. Deliveries in this fiscal year are concentrated in the first quarter, and the rate of progress against the full-year operating income plan is 78%. Completed housing stock decreased by 45 units from the end of the previous fiscal year to 120 units.

Sales decreased and profit increased in the Urban Redevelopment Businesses. Sales from the sale of properties were ¥25.2 billion, through sales of properties to REITs and sales of development properties. Despite a decrease in sales, profit increased due to a difference in gross margin. In the Hotel Business, many hotels have just opened, and recovery of profit will take time.

[Page 12] Results by Segment—Overseas Business

Net sales increased by 114.2% to ¥146.3 billion. Operating income increased by ¥21.5 billion to ¥28.6 billion. Operating margin improved by 9.2p to 19.6%. Despite a large contribution from the United States, sales and profit also increased in Australia and China. Orders received increased by ¥59.5 billion to ¥156.2 billion.

[Page 13] Overseas Business—Details by Country

In the United States, net sales increased by ¥52.1 billion to ¥101.4 billion. By business model, the Multifamily Business sold properties from two project orders received in the previous fiscal year. Profit from Holt Homes will be added to profit in homebuilding businesses from this fiscal year. Operating income increased by ¥14.4 billion to ¥20.9 billion. Profit increased in all three businesses. In the homebuilding businesses, Holt Homes and improvement in gross margin due to strong sales contributed to profit. Orders received increased by ¥26.4 billion to ¥104.2 billion. In the new houses market, entry-level sales are depressed under soaring housing prices and rising mortgage interest rates. Steady demand is continuing, however, and orders received remain strong in regions and price ranges in which the Company engages in business. At the same time, prices are increasing under high inflation and prolonging of supply chain turmoil amid high interest rates, requiring close attention to the outlook.

In Australia, net sales increased by ¥18.9 billion to ¥32.9 billion. Operating income increased by ¥4.2 billion to ¥4.8 billion. The delivery of condominiums in Sydney, which had been delayed by the COVID-19 pandemic in the previous fiscal year, made a contribution. Profits from the sale of Sydney-area development land to local developers were also recorded. Orders received increased by ¥38.2 billion to ¥50.9 billion. Despite concerns over rising prices of custom detached houses and rising interest rates, profits are currently progressing as planned.

In China, net sales increased by ¥7.0 billion to ¥11.8 billion. Operating income increased by ¥3.0 billion to ¥3.2 billion. Delivery of properties in the city of Taicang was recorded. The order backlog is ¥8.7 billion. Progress is strong toward the completion of all projects during this fiscal year.

In Singapore, equity in earnings of affiliates remained flat at ¥0.1 billion.

[Page 15] Full-year Plans

Full-year plans remain unchanged based on steady orders in Japan and overseas. At the same time, the Company plans to carefully assess the impacts of soaring materials prices on profit, and will disclose figures checked in the second quarter.

[Discussion of Overseas Business]

<United States Business>

The acquisition of Chesmar Homes was decided today. With the acquisition of Holt Homes at the end of the previous fiscal year, business expansion in six western states was firmed up. The acquisition of Chesmar Homes enables expansion into the southern region, a volume zone. In addition to the state of Texas, through this acquisition the Company is aiming for the southeastern region, with a focus on Florida.

In the United States homebuilding businesses, the current three companies are expected to sell about 7,000 units a year in 2025, part of the Company's steady progress toward its target of 10,000 units in overseas markets in the same year.

Chesmar Homes was founded in Houston in 2005, and has since expanded its market to San Antonio, Austin, and Dallas. It currently has 461 employees (including in-house architects), delivered 2,082 units in FY2021, and owns and operates approximately 6,500 lots of residential land.

Major factors behind the acquisition decision include the status of the south as the largest market, and the alignment of our corporate DNA with that of Chesmar, which values people's happiness.

Chesmar's limited track record in Dallas represents upside potential. By horizontally leveraging the experience accumulated through Woodside and Holt, we expect to build an effective and efficient operating structure in the United States and improve profitability.

Products cover a wide range, from about $300,000 for first-home buyers to high-range products exceeding $700,000. As with Woodside and Holt, it is possible to shift toward higher value orientation by adopting lifestyle proposal-type options. With regard to SHAWOOD, the Company believes that it is possible to develop products incorporating next-generation elements including environmental considerations that have a track record in Japan, focused on development in Dallas and Austin where a high-price-range market is foreseen in the medium to long term.

Woodside CFO Rick Robideau was appointed the CEO of SHRH in April. With CEO Robideau at the center together with a PMI manager from Sekisui House headquarters, the Company will facilitate cooperation, sharing of know-how, and horizontal communication among builders.

In the operation of SHAWOOD, design work will begin at Sommers Bend in California, which is being undertaken as a prototype with construction set to begin in fall of this year. While expanding scale through M&A, the Company will in parallel transplant Sekisui House technologies and will make efforts to achieve 10,000 units in overseas markets in 2025.

<United Kingdom Business>

In its United Kingdom Business, the Company has decided to liquidate United Kingdom-based Urban Splash House Holdings, in which the Company has been a minor investor since May 2019. Differences in opinions existed with the partner company in discussions on business restructuring, in addition to failure to raise factory productivity as expected and the inability to achieve originally scheduled growth due to business activity restrictions under the COVID-19 pandemic.

At the same time, the United Kingdom housing market remains attractive. With supply of housing as the highest priority, delayed payment of land costs is possible depending on discussions with government agencies, and high financial efficiency can be expected. The United Kingdom government is actively promoting pre-engineered housing and eco-friendly housing, and there is strong potential for the Company to utilize its pre-engineered housing technology and environmental technology. In future development in the United Kingdom Business, the Company plans to search for new partners and set specific directions.

<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 timing of recording profit from Chesmar after the acquisition?**
- **Should I understand that the acquisition price of Chesmar is appropriate and that you will consider M&A in areas where you aim to expand next?**
- **Has there been any change in your thinking concerning shareholder returns and growth investments following the decision to redeem hybrid corporate bonds?**

Answer

- We expect to record profit from Chesmar from July 1 (the third quarter) onward. At the time of consolidation, income after deduction of goodwill will be recorded.
- Regarding the validity of the acquisition price, we used the DCF method, also using examples of acquisitions by other companies in the industry as reference. With the acquisition, our EBITDA ratio became 6 times. In terms of future developments, we have our sights on Florida and are proceeding with M&A discussions with multiple companies.
- In the redemption of hybrid corporate bonds, too, there is no change in the policy of shareholder returns and growth investments under our fifth mid-term management plan. Our shareholder returns have a dividend payout ratio of 40% or more. For growth investments, our budget is ¥200.0 billion.

Question

- **What are the factors behind the increase in orders in the United States homebuilding businesses, and what is the outlook for the United States housing market?**
- **What are the reasons for the liquidation of Urban Splash House in the United Kingdom?**

Answer

- With regard to the order receipt environment, orders are strong for both Woodside and Holt, and order backlog has reached nearly 90%. We are feeling effects of the landing in this fiscal year. At the same time, we have to closely watch how much contract balance will accumulate for the next fiscal year. Regarding the outlook, demand remains solid. As costs continue to rise, however, gross margin may not grow as much as in the previous year or this year.
- The construction method that we had considered rolling out in the United Kingdom faced problems with high cost unless sales volume increased. A major point in liquidation was that aligning opinions on a solution did not go well with the local partner as the Company was a minor investor. However, based on what we have learned through the United Kingdom business over the past three years and the fact that our technology has been well received locally, we will search for a new partner and move forward on the initiative of the Company to continue our involvement in business in the United Kingdom.

Question

- **What management is used in the United States Business?**
- **When exactly did the Chesmar's M&A take form?**

Answer

- Regarding business management, there are daily meetings between sites and PMI managers dispatched locally. We take part in meetings once or twice a week. Our feeling is that by communicating closely with local management, we have recently been able to instill our way of thinking throughout the organization. As an example, by holding workshops on lifestyle proposals and increasing orders received for options, the homebuilding businesses improved operating margin by nearly 8% in the previous fiscal year. The local side is also becoming more active in selling SHAWOOD, which features high construction reproducibility locally. According to our in-house research, our Family Suite concept has been well received by Americans, so we have high expectations.
- We have been considering Chesmar's M&A for several years. Discussions took shape about six to ten months ago.

Question

- **Regarding the passing on of costs on to prices in custom detached houses and rental housing, what are the impacts on business performance and the timing of the passing on of costs?**
- **What is the status of progress toward plans, by segment? Does progress remain ahead of plans?**

Answer

- We expect prices to increase by about 2% at the shipping stage. The lead time from contract to delivery is 6 months for custom detached houses and 12 to 14 months for rental housing. If progress is good, this will enter into sales in the second half.
- Overall, progress is in line with the Company's plans. As of the first quarter, there are not strengths and weaknesses by segment.

Question

- **How will goodwill from Chesmar be amortized?**
- **What would you say is one of Chesmar's strengths? Also, do you expect a high price range in areas of expansion?**
- **Please comment on the mandatory installation of solar in Tokyo.**

Answer

- We have not disclosed goodwill amortization, but we plan amortization over five years.
- A strength of Chesmar is that every branch has an architect. This makes it easy to accept lifestyle proposals that capture the preferences of customers, and to transfer our know-how. The price range is not as high as that on the west coast, but we are aiming for a slightly higher spot than average area prices. Dallas in particular has room for expansion of SHAWOOD, and we see great growth potential.

- We will continue promoting ZEH housing to customers, as we have been doing. However, when the installation of solar is made a condition because of the obligation placed on business operators, we recognize that whether we can respect the wishes of customers is an issue.

Question

- **You had factored in ¥13.0 billion as the impact of rising raw materials prices for the full year. How much of this has been realized in the first quarter? What are the reasons for the decision to pass on costs on to prices?**
- **Please comment on tightness in supply chains in the United States and the circumstances of materials procurement.**

Answer

- We have remained on pace within that range of ¥13.0 billion. Regarding price revisions, we have based these on the fact that prices of raw materials and other items have risen due to the situation in Ukraine, which was not part of our initial plans. At the same time, as high raw materials prices are showing signs of prolongation, we believe that we must continue cost reductions.
- In the United States, extension of construction periods by about two months has become the norm. We are formulating profit plans with the construction period predicted. We are making progress in line with plans for this year.

Question

- **Regarding the *Michi-no-Eki* Stations Project, restrictions on entry into the country by overseas travelers are easing. Is the current situation improving, including for the Marriott Group and other partners in the project?**

Answer

- Hotel occupancy rates have not recovered, and there is still no connection to profit. At the same time, inquiries about buying hotels have begun to appear from overseas funds, and there is potential for an exit if profit can be secured. Regarding the fact that overseas travelers will increase as entry is eased, the limit per day is currently 20,000 visitors, while the average for 2019 was 140,000. As such, it is difficult to predict when recovery will take place.

Question

- **My impression is that construction is progressing in rental housing. What is the background to this?**

Answer

- Both construction and sales are proceeding nearly according to plans in rental housing, unrelated to any special factors.