Sekisui House, Ltd.

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

Date	:	Thursday, September 8, 2022, 5:00 p.m. to 6:00 p.m. (JST)	
Participants	:	Yosuke Horiuchi	Representative Director of the Board, Vice Chairman, Executive 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

Record highs were achieved for both net sales and operating income in the current second quarter. The full-year plan has been revised upward, reflecting the strong progress of each business.

Interim and year-end dividends both increased by ¥5, with the full-year dividend forecast to exceed 100 yen.

Net sales increased by 16.3% year on year to ¥1,423.6 billion. Sales grew for all business models. Contributing factors include sales in the Built-to-Order Business of ¥46.9 billion, ¥19.8 billion in the Supplied Housing Business, ¥38.8 billion in the Development Business, and ¥92.1 billion in Overseas Business, as well as the strong performance in the domestic and international housing business and progress in property sales.

Gross profit increased by 19.4% to ¥301.6 billion. Gross margin improved by 0.5p to 21.2%. Despite the impact of the sharp rise in the price of raw materials, the volume effect and cost reduction contributed to the Built-to-Order Business, while increased profit in the Development Business and Overseas Business contributed significantly to the improvement.

SG&A expenses increased by 8.5% to ¥155.2 billion. Personnel expenses increased by ¥5.9 billion due to increase in overseas subsidiaries. The SG&A ratio decreased 0.8p to 10.9%, partly due to the increase in net sales.

Operating income increased by 33.5% to ¥146.4 billion. Operating margin improved by 1.3p to 10.3%.

Non-operating income/expenses decreased by ¥0.4 billion from the previous fiscal year to ¥1.2 billion. Foreign exchange gain/loss increased by ¥1.1 billion from the previous fiscal year to ¥2.3 billion due to the ongoing depreciation of the yen.

Equity in earnings/losses of affiliates decreased by ¥1.7 billion from the previous fiscal year to a loss of ¥1.8 billion. This includes the investment valuation loss of ¥1.7 billion in connection to the liquidation of a partially-owned company in the United Kingdom included in the first quarter. As a result, ordinary income increased by 32.6% year on year to ¥147.6 billion.

Extraordinary income was ¥8.3 billion after calculating the liquidated profit from the liquidation of a condominium project in Suzhou, China.

Including provision of allowance for doubtful accounts in the United Kingdom business of ¥1.9 billion and loss on sales of fixed assets, etc., extraordinary losses were ¥2.7 billion.

Quarterly net profit attributable to the owners of parent increased by 43.4% (¥31.5 billion) to ¥104 billion. EPS increased by ¥48 to ¥155.

[Page 4] Financial Position

Total assets increased by ¥249.1 billion from the end of the previous fiscal year. Assets from the acquisition of Chesmar Homes in July will be included in the current earnings results. Profits will be included from the third quarter. Current assets increased by ¥209.8 billion. Cash and deposits decreased by ¥42.2 billion. Real estate for sale increased by ¥216.9 billion to ¥1,393.6 billion. Domestic real estate increased by ¥24.2 billion and overseas real estate increased by ¥192.6 billion. In addition to the increase relating to the consolidation of Chesmar, there was an increase of ¥137.4 billion in effects of foreign exchange rates. Non-current assets increased by ¥39.5 billion. Property, plant and equipment increased by ¥8.8 billion. ¥3.2 billion in goodwill from the consolidation of Chesmar was included in intangible fixed assets.

Total liabilities increased by ¥109.4 billion due to an increase in borrowings, despite a decrease in accrued income taxes payable. Interest-bearing debt increased by ¥139.8 billion. Of the addition of approximately ¥36.6 billion in Japan and ¥103.1 billion at overseas subsidiaries, the effects of foreign exchange rates were ¥67.1 billion. D/E ratio increased by 5.6p from previous fiscal year to 42.9%. Hybrid bonds of ¥120 billion do not currently require replacement, and amortization took place on August 18 as scheduled.

Net assets increased by ¥139.7 billion. In addition to the increase in quarterly income, there was an increase of ¥83 billion due to cumulative foreign currency translation adjustments as depreciation of the yen continued. Equity ratio increased by 0.2p to 52.8%.

[Page 5] Cash Flow, Investment Status

Cash flow generated by operating activities decreased by ¥13.7 billion due to the increase in corporate tax payments, etc. Cash flow generated by investing activities decreased by ¥59.2 billion due to the purchase of Chesmar as well as the addition in investment in rental real estate. As a result, free cash flows decreased by ¥72.9 billion. While dividend payments and the repurchase of company shares moved forward, cash used for financing activities increased ¥39.4 billion due to the addition in borrowings and the redemption of bonds last year. Cash and cash equivalents at the end of the second quarter amounted to ¥472.8 billion.

As for the investment situation, capital expenditures were ¥36.2 billion. Of this, investment in rental real estate comprised ¥27 billion. The full-year plan has been changed to ¥100 billion.

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

Net sales in the Built-to-Order Business overall increased by 9.6% to ¥534.2 billion. Operating income was ¥57.9 billion. The increase in profit in custom detached houses and rental housing covered the decrease from architectural/civil engineering.

Net sales in the Custom Detached Houses Businesses increased by 7.3% to ¥179.2 billion. Sales increased due to robust receipt of orders continued from the previous fiscal year. Gross margin decreased by 1.3p to 25.4%. In comparison to the initial plan, which incorporated the effects of ¥13 billion in material price increase for the full year, there was a negative impact of ¥7 billion by the second quarter. The revised plan will assume an increase to ¥19 billion for the full year. Operating margin decreased by 0.7p to 11.5%. Orders received totaled ¥177.7 billion, a high level that match the previous year. The order backlog decreased by ¥1.5 billion. The ZEH ratio was 91%. ASP per building also increased by approximately 6% year on year to ¥45.42 million.

Net sales in the Rental Housing Businesses increased by 14.1% to ¥208.9 billion. Sales increased significantly in line with strong progress in construction. Gross margin decreased by 0.6p to 25.2%. Operating margin improved by 0.2p to 14.3%. Orders received increased by 5.2% to ¥202.7 billion. Strong performance in Sha Maison rental housing covered the decline in non-residential areas. The adoption rate for Sha Maison ZEH exceeded 60%, setting a pace that exceeds the target of 50% for the fiscal year. The unit price per building is ¥136.76 million, an increase of ¥10.2 million from FY2021. The ratio of three-to-four-story houses also remained high at 84.8%.

Net sales in the Architectural/Civil Engineering Business increased by ¥8.9 billion to ¥145.9 billion. Operating income decreased by ¥4.1 billion. Reason for decrease in profit includes competition for orders in the industry and the rise in prices. Orders received decreased by ¥0.9 billion to ¥156.8 billion.

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

Net sales in the Supplied Housing Business as a whole increased by 5.3% to ¥391 billion. Operating income increased by ¥0.4 billion to ¥40.3 billion.

The Remodeling Business recorded increases in sales and profit. Operating margin also improved by 0.4p to 17.0%. 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 remodeling proposals that are vital to long-term stable management of rental housing. As with the Built-to-Order Business, there is a need to closely watch movements in material costs but profit is continuing to improve based on additional orders for large-scale remodeling. Orders received increased by 6.7% to ¥86.5 billion. Government policies have also had an impact, including the project to support child-rearing families to acquire housing, and there has been strong growth in proposal-based and environment-based remodeling for custom detached houses. Net sales in Rental Housing reached ¥26.7 billion after actively making remodeling proposals when tenants change.

In the Real Estate Management Fees Business, sales increased but profit decreased. Operating margin decreased by 0.6p to 8.5%. Despite the decrease in profit due to temporary increase in costs associated with the establishment of Sekisui House Real Estate Holdings, with the high occupancy maintained, it is expected that cost issues will be eliminated and profit will increase for the full year.

The number of units under management is about 680,000 with an occupancy rate of 98.0%. In the second quarter, tenants were replaced in 63,914 units and monthly rental fees increased by ¥138 million as rental fees continued to increase.

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

Net sales for the Development Business overall increased by 21.8% to ¥217 billion. Operating income increased by ¥9.6 billion to ¥26.1 billion. Profit increased in all segments.

Sales and profit increased in the Houses for Sale Businesses. Gross margin decreased by 0.9p to 18.3%. Orders received increased by 25.2% year on year to ¥128.2 billion. Effort was put into ongoing purchases of land in prime areas. Land inventory increased by about ¥24.1 billion from the end of the previous fiscal year.

Sales and profit increased in the Condominium Business. Operating margin improved by 4.1p to 18.9%. Delivery of the residential tower completed at the end of the previous fiscal year in the Umeda area of Osaka significantly contributed to the profit. The rate of progress against the full-year sales plan is 98%. Orders received increased by 0.5% to ¥41.1 billion. Completed housing stock decreased by 94 units from the end of the previous fiscal year to 71 units.

Sales decreased and profit increased in the Urban Redevelopment Businesses. Sales from the sale of properties were ¥32.2 billion. The sale of properties to REIT and the sale of development properties also progressed. 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 due to the impact of the seventh wave of COVID-19 pandemic.

[Page 12] Results by Segment—Overseas Business

Net sales increased by 61.6% to ¥241.6 billion. Operating income increased by ¥28 billion to ¥46.1 billion. Operating margin improved by 7.0p to 19.1%. Sales and profit increased in the United States, Australia and China. Orders received increased by ¥61.1 billion to ¥250.7 billion.

[Page 13] Overseas Business—Details by Country

In the United States, net sales increased by ¥56.8 billion to ¥176.6 billion. To break this down, the multifamily business is scheduled to sell four properties this year in contrast to the sales of properties in two projects in the first quarter, making net sales of ¥36.3 billion. The master-planned community business increased sales by ¥4.5 billion to ¥38.8 billion. Profit from Holt Homes has been added to profit in homebuilding businesses from this fiscal year, with an increase of ¥31.1 billion to ¥100.7 billion. Operating income increased by ¥16.4 billion to ¥34.8 billion. There was an increase in all three businesses, with ¥8 billion in the multifamily business, ¥12.3 billion in master-planned community business, and ¥13.8 billion in the homebuilding businesses due to improved profit from favorable sales and the contribution to profit from Holt Homes. Orders received increased by ¥50 billion to ¥196.7 billion. Of this, the homebuilding businesses increased by ¥41.6 billion to ¥135.3 billion. In addition to the net increase from Holt Homes, there was an increase in orders received at Woodside Homes. Order backlog increased by ¥74.5 billion from the end of the previous year to ¥249.9 billion. The master-planned community business reached ¥69.5 billion while the homebuilding businesses reached ¥180.4 billion, including the order backlog from Chesmar. There was a continued rise in unit prices and an improvement in the gross profit margin. In the immediate future for sales, along with the rise in mortgage interest rates, even if sales slowdown, sales will gradually recover backed by the lack of available pre-owned homes and the stable demand from Millennials. Based on thorough PMI, including the recent acquisition of Chesmar, we are continuing to optimize the supply chain and to respond to the rise in prices. The investment balance increased by ¥251.7 billion against the end of the previous year to ¥833 billion, which includes Holt Homes and Chesmar.

In Australia, net sales increased by ¥24.1 billion to ¥43.7 billion. Operating income increased by ¥5.5 billion to ¥5.6 billion. The delivery of condominiums in Sydney, which had been delayed by the COVID-19 pandemic in the previous fiscal year, and the sale of properties made a contribution. Orders received increased by ¥21.3 billion to ¥50.4 billion. Custom detached houses will continue to be in adjustment phase while mortgage rates continue to rise. Regarding condominiums, it is expected that there will be an economic recovery due to the mitigation of entry restrictions, as well as the recovery of sales due to inflation and the ongoing gradual rise in prices. The investment balance increased by ¥2.8 billion against the end of the previous year to ¥167.3 billion.

In China, net sales increased by ¥11.1 billion to ¥21.2 billion. Operating income increased by ¥6.4 billion to ¥6.6 billion. Delivery of properties in the city of Taicang was recorded. The order backlog is ¥1.7 billion. The investment balance decreased by ¥12.5 billion against the end of the previous year to ¥9 billion. Progress is steady toward the completion of all projects, including the liquidation of Suzhou Condominium Project company.

In Singapore, equity in earnings of affiliates remained flat at ¥0.3 billion.

[Page 15] Full-year Plans

Full-year plans have been revised upward, taking into account steady orders in Japan and overseas as well as the contribution to profits from Chesmar.

Net sales increased by 13.1% year on year to ¥2,930 billion. A ¥143 billion increase to the initial plan. Operating income increased by 13.0% to ¥260 billion year on year, an upward revision of ¥24 billion to the initial plan.This is due to factors including favorable sales of houses in the United States, and steady performance of Rental Housing and the Houses for Sale Businesses in Japan. An upward revision was made that covers the impact of the high price of raw materials. Ordinary profit was ¥260 billion.

Net profit was ¥174 billion, an increase of ¥16 billion against the initial plan. EPS increased by 14.7% to ¥260.83. ROE of 11.2% is planned. Dividends are scheduled to be ¥104, which is ¥14 higher than the previous year. Planned orders were accumulated, including in the Houses for Sale Businesses that is strong primarily in the overseas business.

<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 estimate of Chesmar's profitability in the current revised plan and the forecast for the United States custom detached house market?
- What is the outlook on the profitability of domestic custom detached houses from the next fiscal year and thereafter?

Answer

- Operating income for Chesmar in the current fiscal year is expected to be approximately ¥2 billion. The current environment includes a mortgage interest rate of 5.5% that may continue to rise, and while there may be a temporary impact on orders received in the current fiscal year, which contribute to sales in the next fiscal year. From next year onward, we believe there will be an improvement in the business environment due to population increase and a lively demand for housing, an increase in rental fees of rental housing, and because our customer base tend to be in the price range of customers that buy as replacement rather than first-time buyers. Orders related to sales in the current year have generally been completed, and the revised plan is formulated including partial cancellations.
- At present, while we cannot reveal the forecast figures, we hope to improve profit through leveling the load of construction work for detached housing and rental housing, and lower transportation fees and other costs.

Question

- What is the current and outlook of the orders for the homebuilding businesses and master-planned community business in the United States where mortgage rates are currently rising?
- What is the current trend in domestic steel and lumber prices, and how much are they reflected on the prices of custom detached houses and rental housing?

Answer

- The reason why there were cancellations during the increase in mortgage rates in June and July was mostly due to the inability of customers looking for replacement to sell their homes at the desired price or the inability to borrow money. A revised plan for the current year is formulated taking in account partial cancellations. Regarding the master-planned community business, there has not been any cancellation of signed sales contracts with builders, and the contracts are settled as planned. Regarding the Sixth Mid-Term Management Plan, we are investigating the speed of housing development.

- Lumber prices are stable at the moment. Regarding steel prices, metal manufacturers and automobile manufacturers recently agreed on a high price. As price for the housing industry is decided after the automotive industry, we will subsequently be impacted.
  Rising costs were passed on in stages in June and August of current year for steel frame houses, with an overall price revision of around 2%. Prices are being revised for wooden houses due to the lumber shortage of last year.

Question

- Please comment on the cancellations caused by rising interest rates in the United States homebuilding businesses.
- Based on the approach to the sale of properties in the United States multifamily business, what is the outlook of business in the United States for the next year?

Answer

- As mentioned above, while there have been some cancellations, the canceled properties are quickly taken up by another customer in some cases, and we know from experience that there is a stronger demand than in Japan. In the future, as mortgage interest rates rise even higher, sales may be difficult for a time, but we are sure that the demand is strong and will continue to grow.
- Regarding sales of properties in the multifamily business, contracts for the two remaining properties in the current year have been completed. We are currently preparing for 2027 to 2028, but the Company enforces a policy of conducting sales at the best possible time, and during adjustment phase with low investment trend, we will own the property and use it to gain rent income. Also, we consider such situation to be actually an opportunity to stock up. In the next year, Holt Homes and Chesmar, which have become consolidated subsidiaries, will be included in the total, and we will continue growth.

Question

- What is the progress of M&A in the United States?
- What is the breakdown of Overseas Business in the full-year revised plan? Also, how much impact does exchange rate have?

Answer

- There is no information that we can disclose about the progress of M&A. What we can say is that we are searching for companies that resonate with our philosophy rather than looking for cheap acquisitions. We always investigate targets for M&A with an awareness of the smiling curve.
- The breakdown of the increase of ¥26 billion in operating income between the revised plan and the initial plan is as follows: ¥9 billion in effects of foreign exchange rates, ¥2 billion from Chesmar, ¥3.5 billion from Australia, ¥6 billion from housing development, and ¥5.5 billion from sales of houses to builders. While the foreign exchange rate in the initial plan was 114 yen to the dollar, in the revised plan, it is 129 yen.

Question

- Are the figures for Chesmar's contribution to profit only for the second half of the year? In addition, what is the impact of the consolidation of Chesmar on the next year?
- Please explain about the impact of rise in material prices on profits in detached and rental housing for the next year?

Answer

- Chesmar is included in assets from the second quarter but the contribution to profit is only from the second half. We have high expectations for the next year and thereafter.
- We hope to offset the increase in material costs after the initial forecast by price revisions and cost reductions. The initial expected impact of ¥13 billion is the impact on orders received before the price revisions. Orders received from June onwards are post-price revision, and they will contribute to sales from the first half of the next year. The lead time for detached housing is six months, while the lead time for rental housing is 10-12 months, so there will be some delay in the contribution to profits.

Question

- How are the hotel occupancy rate and the hotel property sales environment?

Answer

- While occupancy rate was favorable for some period such as during the summer holidays, we have not returned to pre-COVID levels yet. Despite this situation, there is strong interest in sales.

Question

- What is the current situation of domestic custom detached houses and rental housing orders?
- Is the ordering environment for custom detached houses weak?

Answer

- Custom detached houses integrates of technologies, lifestyle design and services, and we have built a sales system that is highly competitive. In addition to the change in sales style due to COVID-19, one of our strengths is the ability to make design proposals.
  We are successfully coordinating with Sekisui House Real Estate on rental housing, and the occupancy rate is at the very high level of 98%. For Sha Maison ZEH, which is receiving favorable orders, there has been an increase in pre-completion occupancy by giving advance notice to partner companies. Deliveries used to be concentrated in March and September, but by offering deliveries throughout the year, we have been able to level the load of construction work, leading to reduced costs.
- While all housing companies are reflecting increased costs on prices, there is a divide between those that their new price is being accepted by customers and those that are not. We believe we are among the former.