Sekisui House, Ltd.

Transcript for Question and Answer Session of the Overseas Business Briefing

Date:	Thursday, January 18th, 2024, 21:30 to 22:30 (JST)
Participants:	Yoshihiro Nakai, Representative Director of the Board, President, Executive Officer, CEO
	Yosuke Horiuchi, Representative Director of the Board, Vice Chairman, Executive Officer
	Toru Ishii, Director of the Board, Senior Managing Officer
	Toru Fujita, Executive Officer, In Charge of Account and Finance, Head of Finance Department
	Hiroyuki Kawabata, Head of Investor Relations Department

< Summary of Question and Answer Session >

Note: Matters previously described in the Overseas Business Briefing and documents subject to timely disclosure are omitted.

Question

Q.1 What is M.D.C. Holdings' competitive edge? In addition, what is M.D.C. Holdings' business scale in Florida, which Sekisui House was considering as a new business area?

Q.2 What is the size of M.D.C. Holdings' balance sheet? Could you also provide details on the amortization method of goodwill and expected size?

Answer

A.1 M.D.C. Holding's average price range is around US$560,000. There are differences depending on the area, however, the price is generally slightly lower than our existing group builders. We believe their ability to efficiently sell their product to first-time buyers and second-time buyers is their competitive edge. M.D.C. Holdings has established a solid organization structure and we understand they have a simple product development structure to achieve cost reduction and efficiently sell ready-to-build homes while focusing on the turnover rate. With regards to Florida, we found it appealing as M.D.C. Holdings has over 1,000 home deliveries and we believe its one of the states where SHAWOOD will gain popularity.

A.2 M.D.C. Holdings' competitive edge is showcased by their ability to acquire land at a fast pace and its strong relationship with sellers, as well as its ability to rotate land at a high turnover rate.

Total assets stood at US$5.3bn, US$2.2bn in total debt, and US$3.0bn in shareholder equity as of FY2022. Cash on hand stood at US$1.2bn, US$1.5bn in interest-bearing debt and US$3.5bn in real estate inventories.

The total acquisition value will be $4.9bn (approximately JPY680bn according to the conversation rate at JPY140 for US$1) and we expect the goodwill to be around JPY200bn, or 1.4 times the net asset, based on the estimated net asset as of closing. As for amortization method, while we cannot give a definitive answer on the amortization period at this moment as we will take necessary procedures for purchase price allocation (PPA) in the future, we plan to amortize goodwill excluding those allocated to inventory, in 5 years, which is in line with past acquisitions.

Question

Q.1 What is your view on the 19% premium (vs previous closing day). Can you elaborate on your thoughts on the likelihood of the transaction going through and pre-requisites for completion?

Q.2 How should we think about the profit after adjusting goodwill?

Answer

A.1 With regards to the premium, we currently believe the price is appropriate based on various analysis we have conducted considering past homebuilder transactions, etc. Having said, as the final decision will be made at M.D.C. Holdings' shareholder meeting to be held in several months ahead from now, we understand there are still risks of counterparties interloping.

As stated in disclosure materials (joint press release), 21.2% of the shares are currently held by the founder, CEO and their affiliates. We expect the resolution to be passed at the shareholder meeting considering the 41% premium to 90-day volume weighted average trading price.

A.2 Goodwill will be allocated to inventory, goodwill, trademark rights, etc., however, we will not be able to finalize this until we go through a PPA procedure, which will be completed within one year from transaction closing. We will allocate a reasonable proportion for provisional process before finalizing, though we cannot give a definitive answer at this moment. We have disclosed procedures for past acquisitions, which we believe will be a reference point.

Question

Q.1 You mentioned you will not be conducting share buyback in the next fiscal period. When do you plan to resume share buyback?

Q.2 Considering the deterioration of D/E ratio, are there possibilities this may hinder other businesses? Would there be any impact such as restraining investment in real estate-related business such as domestic urban redevelopment?

Answer

A.1 We do not plan to change our shareholder return policy. Given this is a large transaction, we will flexibly conduct share buyback after careful consideration as the timing of share buyback recommencement will significantly change depending on financial strategies such as financing plans and the speed of U.S. business growth and recovery.

A.2 Our plan to invest JPY3tn in real estate during the 6th mid-term plan period is progressing in line with the plan. We aim to add this transaction while making progress as planned.

Question

Q.1 What is your view on the appropriateness of the valuation?

Q.2 What is the impact of the M&A on ROE? What is the target going forward?

Answer

A.1 With regards to valuation, we applied a price to tangible book value multiple of 1.4 times considering the 1.47 times average for past listed homebuilder transactions. We believe our valuation is appropriate considering the price is within our DCF range and our analysis of two other large-sized comparable transactions.

A.2 The impact on FY2024 will also depend on the timing of completion, however, given the impact will contribute in full from FY2025 onwards, we expect ROE to exceed 11% level, which is the target of our sixth mid-term plan. We expect to achieve ROE of high 12% or higher than 13% in the next mid-term plan period, through realizing synergies from the acquisition.

Question

Q.1 Can you share details on the business synergy to be achieved through M&A, such as the acceleration in transfer of Sekisui House Technologies, etc.

Q.2 What is the interest cost of interest-bearing debt to be procured associated with the M&A? In addition, what is the impact of goodwill and increased interest cost on net income?

Answer

A.1 With regards to the transfer of Sekisui House Technologies, we have been discussing the transfer of various technologies closely, with main focus on Woodside Homes. As M.D.C. Holdings has a solid home base of operations including its product development team, we believe we will be able to promptly roll out technologies and accelerate the transfer once we have decided on which technology to transfer.

A.2 M.D.C. Holdings' existing interest-bearing debt is mainly comprised of corporate bonds. It was issued at a relatively low interest rate before the interest rate hike, averaging around 4%. While we cannot give a definitive answer on the financing cost for the funds associated with the acquisition, we aim to lower the financing cost to the extent possible through mixing JPY and USD denominated bridge loan, while managing currency fluctuation risk.

With regards to the impact on our net income, we are currently reviewing the impact on FY2024 as this will depend on the timing of completion and one-time cost. We expect a positive impact from FY2025 onward despite the impact of goodwill and interest costs related to the funds procured for the acquisitions.

Question

Q.1 Given there are areas that overlap with existing group builder's business area, what is your expansion strategy going forward? Can you also share your thoughts on future growth, including increase in number of house closings.

Q.2 Are there any specific plans for the permanent financing of the funds associated with this M&A?

Answer

A.1 There will be four group builders under Sekisui House Residential Holdings post-acquisition. We plan to initiate discussions on organizational structure, area strategy and product strategy with the executives of four builders immediately after the transaction completion. In the U.S., there is limited geographic overlap between M.D.C. Holdings and Sekisui's existing builders, which is only about 8% on per project basis. We will maintain the current operational structure for the timing being and plan to discuss and establish the optimal structure after transaction completion.

We aim to further expand and grow our supply capacity while strengthening the organizational structure consisting of 4 companies. We plan to pause large-scale acquisitions for now. Going forward, we will consider potential M&A transactions on a case-by-case basis, as we will continue to receive information on potential M&A transactions including small-scale transactions.

A.2 With regards to permanent financing, we plan to mainly utilize bank loans, corporate bonds including foreign currency denominated bonds and other financial instruments such hybrid finance including hybrid bonds and hybrid loan. We are mainly considering hybrid bond as we issued a JPY120bn hybrid bond in 2017 in relation to the acquisition of Woodside Homes.

Question

Q.1 What is the background of M.D.C. Holdings' sale?

Q.2 How do you plan to implement governance post-acquisition?

Answer

A.1 We understand their decision for the sale is related to the age of the founder and CEO. In addition, given they are a highly ESG conscious company, they were seeking for a company with similar vision, and we understand our vision aligned with theirs.

A.2 Regarding governance, we believe we will be able to further improve our governance structure through the addition of M.D.C. Holdings to our existing group builders, as M.D.C. Holdings possessed a solid platform and comprehensive home base of operations. We will establish a committee to discuss the optimal structure consisting of 4 companies upon transaction completion.

Question

Q.1 Can you please elaborate on how fluctuation in mortgage interest rate has impacted and is expected to impact M.D.C. Holdings' business environment and any difference to other existing group builders, given the unit price is slightly lower in comparison to existing group builders

Answer

A.1 As explained on page 10 of the briefing presentation, number of house closings continues to grow steadily. We understand M.D.C. Holdings has been flexible in responding to changes in the business environment, which is showcased by their solid management strategy to promptly adjust to changing environment including the compression of inventory during rising interest rates and their focus on turnover rate.