Sekisui House, Ltd.

Transcript for Question and Answer Session of the Sixth Mid-Term Management Plan Briefing

Date:	Friday, March 10, 2023, 1:30 p.m. to 3:00 p.m. (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
	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.

Question

Q.1 What are your assumptions for unit prices, cost and gross margin in the U.S. business during the period of the Sixth Mid-Term Management Plan? Are the SHAWOOD business and M&A factored into the plan?

Q.2 The plan states that "Regarding share repurchase, we utilize flexible share repurchase based on the status of cash flow allocation." Could you tell us how this approach will work as M&A efforts progress? Could it be affected when demand for capital arises within the ¥200 billion of investment in new business and M&A that is forecast in the Sixth Mid-Term Management Plan?

Answer

A.1 We have not factored any M&A into our plan. In the SHAWOOD business, our pilot project was successful and we have now begun construction at Sommers Bend in California on about 50 prototype homes for sale. Through these efforts, we will deliver 150 homes in 2024 and 300 in 2025. Sales have been strong, and we plan to grow this business while carefully studying the market.

For the current fiscal year, we plan for sales to reach approximately 80% of the previous year's on a USD basis. We plan for operating profit to be about 50% of the FY2022 level in FY2023, 70% in FY2024 and 90% in FY2025. On a yen basis, unit prices in FY2022 were up 30% year on year, of which about 15% was due to foreign exchange rate fluctuations, indicating a 15% USD-basis increase. Furthermore, the decrease in the operating profit margin is due partly to goodwill.

A.2 We plan to do a share repurchase of ¥40.0 billion in FY2023, but we have not made any decisions regarding a share repurchase in FY2024. We are planning to invest ¥200.0 billion in new businesses and M&A and to invest in real estate during the new mid-term plan period, so we seek to respond flexibly with a share repurchase in light of the timing of major investments. I cannot say anything specific about M&A in the United States, but we are making steady progress.

Question

Q.1 Considering that it could take until the second half of the year to reach sales agreements for properties to be sold this year in the U.S. multifamily business, if revenue is lower than planned, could the urban redevelopment business shore up results? Please tell us your thoughts on business development with new partners in the multifamily business and standards for recording loss on valuation of portfolio properties.

Q.2 How sensitive is the U.S. homebuilding business to interest rates? Did interest rate fluctuations affect sales in January and February?

Answer

A.1 In the U.S. multifamily business, we plan to sell four properties this year. Of these, we have yet to reach sale agreements for three. In line with a policy of maximizing property value, we are taking a hard line in negotiations, so it could take until the second half to reach agreements for these properties. In the urban redevelopment business, we plan to sell five properties this year. We reached an agreement today regarding the property among these that will contribute most to profit, so I think that we have built up an adequate base of support for overall results.

In the multifamily business, we plan to continue and expand our business with Holland, which is an excellent partner. At the same time, we will work with new partners to move into the East Coast region, where we do not yet have a presence. Until now, we have worked in high-rise property development with Holland, which operates on a long timescale, and in the homebuilding business, which has high turnover. Going forward, we will also target turnover rates and internal rate of return (IRR) that are between these two by developing low- to mid-rise projects with new partners. We have shared these plans with Holland, and they are on board.

To date, we have sold 23 properties working with Holland, all with an IRR of more than 10%. The loss on valuation we recorded was mainly due to a drop in the occupancy rate of offices in San Francisco and the corresponding plummet in rental housing demand in the neighboring city of Oakland. However, according to a report from a research firm, Oakland is forecast to see some of the steepest rent increases this year, and we have in fact already seen signs of recovery since the start of the year.

A.2 Home sales in January were about 65% of the previous year's and recovered to around 80% in February, rising to about 30% higher than what we planned for. Prices bottomed out in December 2022 and rose in January and February. We have also begun to back off of the moderate price reductions we were making to promote sales. Furthermore, in February, the cancelation rate fell back to pre-interest rate hike levels and, as of the preliminary report in March, has declined even further. Given the uncertainty going forward, we are conservatively planning for annual operating profit to be down about 50% year on year, but we believe that the risk of it falling even further is low.

Question

Q.1 Could you give us a breakdown of the ¥3.0 trillion in real estate investment planned under the Sixth Mid-Term Management Plan? In particular, how much do you plan to invest in the development of residential land for detached houses, which Sekisui House Real Estate is aggressively advancing? What are your plans for investment by country?

Q.2 Please tell us about property sales and profit in the urban redevelopment business in FY2024 and beyond.

Answer

A.1 The ¥1.3 trillion in real estate investment in Japan will, as in the past, go toward the urban redevelopment business, condominiums business, and acquiring land for detached houses. We plan to invest nearly ¥700.0 billion through Sekisui House Real Estate, including in the development of residential land for detached houses. Overseas, we plan to invest ¥1.7 trillion in real estate, of which about 90% will be in the United States, with the multifamily business accounting for the majority as we steadily begin construction on our rich pipeline of projects.

A.2 Of the planned FY2023 profit in the urban redevelopment business, ¥21.0 billion is gain on property sales, meanwhile, rent operations are projected to result in a deficit. We will consider plans to sell properties in FY2024 and FY2025 in light of progress in overall portfolio performance. Going forward, we seek to maintain profit at a minimum of around ¥7.0 billion to ¥8.0 billion, and we will flexibly advance property sales in the urban redevelopment business in light of economic recovery in the United States.

Question

Q.1 How many homes were sold in FY2022 in the U.S. homebuilding business? Could you give us a breakdown of the 10,000 homes you aim to supply annually overseas by 2025?

Q.2 Under the Skelton and Infill (SI) business model (one of the initiatives in the detached houses business under the Sixth Mid-Term Management Plan), about how much revenue do you expect per home?

Answer

A.1 We sold 3,753 units in FY2022 (see page 18 of the Financial Factbook). The FY2022 results included the contribution of Chesmar Homes only in the latter half of the year, so sales in the third and fourth quarter would come to just under 5,000 homes when annualized. Under the Sixth Mid-Term Management Plan, we envision sales of 4,000 homes in the first year, 5,000 in the second, and 6,000 in the third. Reaching 10,000 homes will require additional M&A.

A.2 As we mentioned, the SI business will be a joint operation with local builders. Specifically, in the SI business model, the local builders will be the prime contractors, and Sekisui House Construction companies will be the subcontractor, handling the construction of building foundations and framing. A key feature of this business is that the foundation and framing that the Group provides will come with a Sekisui House Group guarantee, just as Sekisui House or Sekisui House noie housing would. We assume a home sale price of around ¥25 million, and revenue for foundation and framing construction contracting will be a portion of that.

Question

Q.1 Please tell us your policy on business in Australia, Singapore and the UK going forward, including your thoughts on whether or not it makes sense to continue your business in these countries.

Q.2 Please tell us about your policy going forward for cash flow allocation and shareholder returns. In particular, is there any possibility of increasing the speed of M&A and aggressiveness of investment, or of further increasing the shareholder payout ratio?

Answer

A.1 We are promoting middle- and high-end lines in the overseas business, so the crucial thing about this business is that overseas populations in our target income bracket are expected to grow. A certain level of environmental awareness is another important point for our business, and considering this, the countries it makes sense to enter are naturally limited. From that perspective, the United States and Sydney, Australia are especially promising. In Singapore, the land is owned by the government, and growth opportunities are only accessible when we can acquire land by bid. Nevertheless, given that we have successfully completed around 10 projects in Singapore to date, I think there is no reason for us to withdraw from the country. The United Kingdom, meanwhile, is facing such social issues as an aging and declining construction workforce and shortage of housing. Against this backdrop, interest in pre-engineered housing is on the rise. Although we are still developing construction methods for such housing, we believe this is a promising market in which to apply our pre-engineered housing technologies in the future. We are not presently considering entering any other countries or regions, because they do not present the right conditions for our businesses.

A.2 As we increase investment in real estate and the growth foundation, we will need to improve the turnover rate to maintain financial discipline. Last year demonstrated that Sekisui House Real Estate's business in the development of residential land for detached houses has an extremely high turnover rate, so we will proactively develop this business going forward. In the U.S. multifamily business, meanwhile, we will raise ROA through collaboration with Holland Partner Group and other partners. While we ultimately aim to raise the payout ratio, it will be important to maintain a balance with investment. In the final fiscal year of the Sixth Mid-Term Management Plan, the development business will have a greater weight within the overall business portfolio, so we will need to reconsider appropriate financial leverage and financial indicators in light of portfolio changes.

Question

Q.1 Could you tell us about the geographic areas and development scale of the Sekisui House Real Estate's business in the development of residential land for detached houses?

Q.2 Please tell us your thoughts about base pay increases for employees, and whether this has been factored into the earnings plan.

Answer

A.1 Like the 1st (¥30 million), 2nd (¥30 million to ¥50 million) and 3rd (¥50 million and above) ranges of the detached houses business, the development of residential land for detached houses will be nationwide. Using data from our existing brokerage and other businesses, we plan to proactively acquire land. Project scale will vary, but we are not looking at anything like reshaping entire mountains to create new usable land.

A.2 We are considering ways to increase compensation, including increasing base pay, regular raises and bonuses. Details will be announced once they have been decided.