Sekisui House, Ltd.

Transcript for Earnings Results Briefing for FY2022
(WEB Conference)

Date	:	Thursday, March 9, 2023, 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 sales and operating profits in the final year of the Fifth Medium-Term Plan. With this increase in profits, dividend per share increased by ¥20 year on year to ¥110.

Net sales increased by 13.1% year on year to ¥2,928.8 billion. Sales grew for all business models. Contributing factors include sales in the Built-to-Order Business of ¥78.6 billion, ¥44 billion in the Supplied Housing Business, ¥79.6 billion in the Development Business, and ¥132.1 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 10.5 % to ¥584.2 billion. Gross margin decreased by 0.5p to 19.9%. This was due to high material costs, but was within expectations. Increased profit in the Development Business and Overseas Business contributed to the increase in gross profit.

SG&A expenses increased by 8.1% to ¥322.8 billion. Personnel expenses increased by ¥13.2 billion due to increase in overseas subsidiaries. The SG&A ratio decreased 0.5p to 11%, partly due to the increase in net sales.

Operating income increased by 13.6% to ¥261.4 billion. Operating margin was 8.9%, staying at the same level as the previous fiscal year.

Non-operating income/expenses decreased by ¥4.1 billion from the previous fiscal year to -¥4.2 billion. Foreign exchange gain/loss decreased by ¥1.8 billion from the previous fiscal year to a foreign exchange losses of ¥0.7 billion.

Equity in earnings/losses of affiliates decreased by ¥0.8 billion from the previous fiscal year to a loss of ¥2 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 11.8% year on year to ¥257.2 billion.

Extraordinary income was ¥17.2 billion after calculating the liquidated profit from the liquidation of a condominium project in Suzhou and Wuxi in China.

Including impairment loss on the Shenyang hotel of ¥2.1 billion, 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 ¥6.7 billion.

Yearly net profit attributable to the owners of parent increased by 19.9% (¥30.6 billion) to ¥184.5 billion. EPS increased by ¥49.21 to ¥276.58.

[Page 4] Financial Position

Total assets increased by ¥206.3 billion compared to the end of the previous fiscal year, due to the acquisition of Chesmar Homes in July last year, among other factors.

Current assets increased by ¥141.1 billion. Of current assets, cash and deposits fell ¥182.3 billion. Real estate for sale increased by ¥258.7 billion to ¥1,435.4 billion. Domestic real estate increased by ¥51.6 billion and overseas real estate increased by ¥207 billion. In addition to the increase relating to the consolidation of Chesmar as a subsidiary, there was an increase of ¥102.9 billion in effects of foreign exchange rates.

Non-current assets increased by ¥65.1 billion. Of noncurrent assets, property, plant and equipment rose ¥13.8 billion. Goodwill from the consolidation of Chesmar and Maruhon as subsidiaries was ¥31.4 billion.

Despite the decrease in corporate bonds, total liabilities increased by ¥59.7 billion due to increase in borrowings, etc. Interest-bearing debt increased by ¥57.3 billion. Of the decline of approximately ¥80.6 billion in Japan and increase of ¥137.9 billion at overseas subsidiaries, the effects of foreign exchange rates were ¥50.7 billion. D/E ratio decreased by 0.1p from previous fiscal year to 37.2%.

Net assets increased by ¥146.5 billion. Retained earnings and cumulative translation adjustments increased by ¥52.4 billion. Equity ratio increased by 1.7p to 54.3%.

[Page 5] Cash Flow, Investment Status

Cash flow generated by operating activities increased by ¥7.4 billion. While the corporate tax payments, etc. increased, increase in inventory during the period declined. Cash flow generated by investing activities decreased by ¥51.7 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 ¥44.2 billion. Cash used for financing activities decreased ¥44 billion due to redemption of hybrid bonds of ¥120 billion, dividend payments and the repurchase of company shares. Cash and cash equivalents at the end of the year amounted to ¥332.7 billion.

As for the investment situation, capital expenditures were ¥95.3 billion. Of this, investment in rental real estate comprised ¥78.3 billion.

Capital expenditures for FY2023 is ¥85 billion. Of this, ¥65 billion is planned for rental real estate.

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

Net sales in the Built-to-Order Business overall increased by 7.9% to ¥1,077.3 billion. Operating income was ¥109.9 billion. Custom Detached Houses Business and Architectural/Civil Engineering Business decreased in income, while Rental Housing Business increased in income.

Net sales in the Custom Detached Houses Businesses remained flat at ¥352.4 billion. Gross margin decreased by 1.4p to 25.1%. Operating margin decreased by 1.1p to 10.9%. Orders received was ¥344 billion. The order backlog decreased by ¥8.4 billion. The ZEH ratio was 90%. ASP per building increased by ¥3.54 million year on year to ¥46.19 million.

The impact of increase in material costs affected the detached housing, rental housing, and houses for sale businesses, totaling ¥27 billion during the Fifth Medium-Term Plan period. The affected segments covered the factors constraining the earnings and achieved a cumulative increase of ¥20 billion (total of detached housing and rental housing) over the three years.

Net sales in the Rental Housing Business increased by 11% to ¥426.1 billion. Sales increased significantly in line with robust receipt of orders and strong progress in construction. Gross margin decreased by 1.1p to 24.6%. Operating margin decreased by 0.9p to 13.7%. Orders received increased by 9.3% to ¥426.4 billion. Sha Maison rental housing continued to show favorable results. The adoption rate for Sha Maison ZEH increased to 65%. ASP per building also increased by 11% year on year to ¥141.61 million. The ratio of three-to-four-story houses also remained high at 87.1%.

Net sales in the Architectural/Civil Engineering Business increased by ¥36.8 billion to ¥298.7 billion. Operating income decreased by ¥1.9 billion. Although the profit margin decreased due to competition for orders in the industry and rise in material costs, recent improvement in profit margin was better than the revised plan. Orders received decreased by ¥31.9 billion to ¥301.6 billion. The architectural business remained flat but the public works orders in the civil engineering business decreased.

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

Net sales in the Supplied Housing Business as a whole increased by 5.9% to ¥785.1 billion. Operating income increased by ¥2.1 billion to ¥78.2 billion.

Net sales in the Remodeling Business increased by 6.2% to ¥165.9 billion. Operating margin also improved by 0.2p to 16.6%. Remodeling remained strong in custom detached houses and rental housing. This strong growth was due to large-scale remodeling such as Family Suite Remodeling for detached housing performing well with the increased use of subsidies. Remodeling proposals that are vital to long-term stable management of rental housing showed continued stable growth atop a strong customer foundation. Sales of remodeling for rental housing increased by 10% year on year to ¥51.7 billion, accounting for one-third of the net sales and we recognize this as a business with high potential demand. Orders received increased by 5% to ¥169 billion.

Net sales in the Real Estate Management Fees Business increased by 5.9% to ¥619.2 billion. Operating margin decreased by 0.4p to 8.2%. Despite the impact of temporary increase in costs associated with the establishment of Sekisui House Real Estate Holdings, high occupancy was maintained and rent level increased.

The number of units under management is about 691,000 with an occupancy rate of 97.8%.

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

Net sales for the Development Business overall increased by 20.7% to ¥464.4 billion. Operating income increased by ¥10.9 billion to ¥49.2 billion. Sales and profit increased in all segments.

Net sales in the Houses for Sale Business increased by 24.4% to ¥238.2 billion. Gross margin improved by 0.1p to 18.1%. Orders received increased by 23.7% year on year to ¥249.6 billion. Effort was put into ongoing purchases of land in prime areas. Land inventory increased by about ¥53.6 billion from the end of the previous fiscal year.

Net sales in the Condominiums Business remained flat from previous fiscal year at ¥90.8 billion. Operating margin also improved by 0.9p to 14.7%. 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. Orders received were at the same level as the previous year, at ¥84.2 billion. Completed housing stock increased by 80 units from the end of the previous fiscal year to 245 units. Multiple properties were completed in January this year, resulting in a temporary increase in inventory, but sales progressed smoothly.

Net sales in the Urban Redevelopment Business increased by ¥32.5 billion to ¥135.3 billion. Sales from the sale of properties were ¥94.8 billion. Operating income increased by ¥3.7 billion to ¥15 billion. Sales of Prime Maison to Reit, sales of development properties such as Akasaka Garden City stakes and sales of properties owned by Sekisui House Real Estate progressed, securing profits exceeding the plan. In addition, in the Hotel Business, occupancy is recovering thanks to mitigation of entry restrictions.

[Page 12] Results by Segment—Overseas Business

Net sales increased by 34% to ¥521.1 billion. Operating income increased by ¥23.7 billion to ¥73.8 billion. Operating margin also improved by 1.3p to 14.2%. Orders received decreased by ¥14.2 billion to ¥418.5 billion.

[Page 13] Overseas Business—Details by Country

In the United States, net sales increased by ¥137.1 billion to ¥434.5 billion. To break this down, the multifamily business completed sales of four properties this year as planned, making net sales of ¥80.5 billion, an increase of ¥18.1 billion from the previous fiscal year. The master-planned community business decreased sales by ¥1.3 billion from the previous fiscal year to ¥74.1 billion. The homebuilding businesses increased net sales by ¥121.1 billion to ¥279.9 billion through consolidating the Holt Homes from the first quarter and Chesmar from the third quarter. Operating income increased by ¥16 billion to ¥63.4 billion. The multifamily business conducted a review of property evaluations due to the delayed recovery of the office environment in San Francisco, resulting in profit of ¥6.8 billion. The master-planned community business recorded a significant increase in profits with ¥23.1 billion due to strong sales. In the homebuilding businesses, Woodside Homes showed significant increase in profit. With Holt and Chesmar, profit totaled ¥34.2 billion.

Orders received increased by ¥1.7 billion to ¥339.4 billion. In the Multifamily Business, orders received was ¥65.5 billion, including one property planned to be delivered during this period. The homebuilding businesses increased by ¥32.9 billion to ¥200.6 billion with the addition of two consolidated subsidiaries. Of this Wodside Homes show decrease of approximately 20% due to slowdown of sales from June last year. The decrease was 44.3% in terms of units and 35.6% in terms of dollars. The order backlog is ¥66.4 billion. Sales status declined in the latter half of the previous year due to raise in mortgage interest rates but the rise in interest rates has stabilized recently. There are some months that result in a positive to the same months of the previous year. FY2023 is expected to be an adjustment phase but significant recovery is expected from the end of this period. Based on thorough PMI of the three companies in charge of housing sales, we are working to improve earnings as well as adoption of Sekisui House technologies. The investment balance increased by ¥264 billion against the end of the previous year to ¥845.3 billion due to M&A and other factors.

In Australia, net sales increased by ¥28.2 billion to ¥62.5 billion. Operating income increased by ¥9.1 billion to ¥5.1 billion. The increase was contributed to by the delivery of condominium and property sales in Sydney and the homebuilding businesses. Orders received increased by ¥8.6 billion to ¥74.5 billion. Custom detached houses and condominiums is expected to continue to be in adjustment phase while mortgage rates remain high. The investment balance rose ¥7.1 billion yen to ¥171.6 billion.

In China, net sales decreased by ¥33 billion to ¥23.9 billion. Operating income decreased by ¥0.9 billion to ¥6.9 billion. With the completion of all condominium project deliveries, the order backlog was zero. The investment balance decreased by ¥16.6 billion against the end of the previous year to ¥4.9 billion. Progress is steady toward the completion of projects in the Sixth Mid-term Management Plan, including the liquidation of project companies in Suzhou and Wuxi.

In Singapore, the equity in earnings of affiliates increased by ¥0.4 billion to ¥1 billion. The investment balance stood at ¥41.8 billion.

[Page 15] Full-year Plan

In FY2023, net sales increased by 5.2% year on year to ¥3,080 billion. Operating income is expected to increase by 1.3% to ¥265 billion. Ordinary profit is expected to be ¥259 billion. Extraordinary income and extraordinary losses are expected to be a net ¥16 billion. Yearly net profit attributable to the owners of parent is expected to be ¥193 billion. EPS is expected to be ¥295.05. ROE is expected to be 11.6%. The annual dividend per share is planned to be increased by ¥8 from the previous fiscal year to ¥118, marking a 12th consecutive period of dividend growth.

In the Sixth Medium-term Management Plan, in addition to maintaining an average dividend payout ratio of 40% or more, we aim to further improve the stability of shareholder returns by setting a minimum dividend of ¥110, the same as the performance in FY2022. Additionally, repurchase of company shares will be carried out flexibly, with the Board of Directors resolving to increase the upper limit by ¥10 billion from the previous year to ¥40 billion for FY2023.

[Page 16] Full-year Plan (Revision of Segment Composition)

The four business models of Built-to-Order, Supplied Housing, Development, and Overseas businesses remain unchanged.

In the Detached houses businesses, Exterior Businesses that were previously included in the Other businesses have been added as it is part of a comprehensive proposal for Sekisui House's custom-built housings as well as for buildings in the Houses for sale Businesses. Also, the housing business handled by Sekisui House noie will continue to be included in this segment.

In addition to the Sha Maison rental housing and non-residential commercial properties built using factory shipping materials, the Rental housing and commercial buildings business now includes RC constructions handled by Sekisui House in the Architectural/civil engineering business. Similar to the Detached houses Businesses, this segment also includes exterior businesses related to buildings in this segment.

Architectural/civil engineering business has become a segment representing the architectural and civil engineering businesses handled by the Konoike Construction Group as the RC constructions handled by Sekisui House has been removed.

In the Supplied Housing Business, the conventional Real estate management fees business has been broken down into management and brokerage businesses and a new Rental housing management business has been added to represent the rental housing management segment of the Sekisui House Real Estate Group. There is no change in the Remodeling Business.

A new Real estate and brokerage business has been added to the Development Business. This segment will manage the sales of land for housings that were previously included in the Houses for Sale Businesses, the brokerage business that was recorded in the Real Estate Management Fees Business as well as condominium and real estate development of the Sekisui House Real Estate Group, which were previously included in the Condominiums Business and Urban redevelopment businesses. The Condominium Business will record Sekisui House's condominium and management businesses, while the Urban redevelopment businesses will mainly focus on Sekisui House's development projects.

As a result of the removal of the Exterior Business, the scale of the Other business segment has been reduced.

Various costs will be allocated to the appropriate segments, and efforts are being made to ensure that business management for sustainable growth is carried out, such as setting KPIs according to the financial structure of each business unit linked to the reporting segments.

[Page 17, 18] Full-year Plan (Segment Information)

Net sales of Detached houses business is expected increase by 1.2% year on year to ¥482 billion. Operating income is expected to increase by ¥2.5 billion to ¥44 billion. Combining the former detached houses and houses for sales, sales is expected to increase due to steady orders. Profit is planned to increase due to expected improvement of profit margins from last year's price revisions and the settling of rising material costs. The seemingly lower profit margin compared to the former segment is partly due to the inclusion of the Exterior Business. Orders received are planned to increase by 3.1% due to solid housing demand and continuation of efforts to strengthen lifestyle design proposals. In the Rental housing and commercial buildings business, sales are expected to increase by 5.7% to ¥535 billion. Operating income to increase by ¥7.5 billion to ¥82 billion. Significant profit growth is expected due to effects of increased sales and price revisions. Orders received for the current period are also planned to increase by 5.7%. In the Architectural/civil engineering Business, sales are expected to increase by 2.1% to ¥273 billion. In the current competitive environment for orders, profit is expected to decrease by ¥1.8 billion to ¥10 billion, with a challenging profit margin continuing. Orders received are planned to decrease by 3.4%. Orders received will be expanded through focusing on strengthening collaboration with Sekisui House and environmentally friendly technologies. For the entire Built-to-Order Business, a 3.2% increase in sales and an ¥8.2 billion increase in operating income to ¥136 billion are expected.

In the Supplied Housing Business, Rental housing management is expected to maintain high occupancy rates and stable growth. Operating income is expected to increase by ¥1.4 billion to ¥49 billion. In the Remodeling Business, proposal-based and environment-based remodeling will continue to perform well. Sales are expected to increase by 7.2% to ¥179 billion and operating profit is planned to increase by ¥1.5 billion to ¥24 billion. The seeming decrease in operating profit margin compared to the former segment is due to the change in after-sales department expenses, which were previously recorded in Custom Detached Houses Business, to the Remodeling Business.

In the Development Business, Real estate and brokerage sales are expected to increase by 26.2% to ¥279 billion. The sales of residential land will be strengthened and the brokerage business will grow, focusing on Sekisui House Real Estate. Operating income is expected to increase by ¥5.4 billion to ¥23 billion. In the Condominium Business, sales are expected to increase by 13.3% to ¥110 billion, with luxury properties in Tokyo and condominium deliveries in Fukuoka contributing to the increase. Operating income also expected to increase by ¥2.2 billion to ¥16 billion. In the Urban redevelopment business, sales are expected to increase by 44% to ¥124 billion. Operating income is expected to increase by ¥12.8 billion to ¥18 billion. Of which property sales are expected to be around ¥91 billion, with a sales profit of ¥21 billion. The hotel operation's balance is planned to be a break-even.

Total Overseas Business sales are expected to decrease by 7.4% to ¥482.5 billion. Operating income is expected to decrease by ¥24.8 billion to ¥49 billion. In the United States, a 40% decrease in profit is planned, assuming the recovery of housing demand by the end of the current fiscal year. In Australia, profit growth is planned, as the lump-sum sale of projects that had previously recorded valuation losses are expected.

<Summary of Question and Answer Session>

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

Question

- Can you give details about the minimum dividend setting in the Sixth Medium-Term Management Plan?
- What are the details of the net amount of ¥16 billion for extraordinary income in the FY2023 plan?
- What are the expected recovery and current situation of homebuilding businesses and multifamily business in the United Sates?

Answer

- It is to set the dividend of ¥110 for FY2022 as the minimum. We intend to achieve the planned increase in profits, but we would like you to understand that this is an expression of our commitment to pay at least ¥110, no matter what happens.
- The details are undisclosed, but it includes the sale of shares and the sale of policy-held shares in Singapore.
- Housing loan interest rates in the United States have been trending around 6.5 to 6.7% after peaking at 7% in November. Orders received in January and February increased by more than 20 to 30% compared to the expected amount and we have secured about 80% of orders received compared to the same months of the previous year. We had expected a 50% decrease in operating profit for the homebuilding businesses compared to the previous period, but we have had a good start in the past two months. As for the multifamily business, we have recorded valuation losses for three properties in Oakland. The background is that the office vacancy rate in San Francisco is around 20% at the moment, compared to about 6% last year and in Oakland. A nearby bedroom community, rent increases are slowing down and the free rent period is extending. However, we do not think that investors' appetite for investment is that bad and we plan to proceed with the sale as planned this term as well.

Question

- What is the reason for the large increase in orders received while operating income is expected to decrease by half in the FY2023 plan for the business in the United States?
- What is the background behind the increase of the repurchase of company shares to ¥40 billion, an increase of ¥10 billion from the previous year?

Answer

- There are three main factors contributing to the decrease in profit in the plan. The first is the decline in orders and order backlog due to the sharp rise in housing loan interest rates in the second half of previous year. The second is the assumption that the number of sales will drop in the first half of the current year.

The third is that adjustments in sales prices (5 to 10% based on USD sales prices) have been factored in. It is assumed that the number of sales will recover in the second half of 2023, and with the increase in number of contracts and improvement in cancellation rates, orders received are expected to turn positive.

- This was set with the intention of meeting the expectations of investors. While M&A is also planned, the timing and prices are yet to be determined and we believe that repurchase of company shares should be carried out flexibly, considering the balance between investment and funds.

Question

- What is planned for the Urban Redevelopment Businesses in FY2023? Are there any properties available for sale?
- What is the status of recent housing sales, sales price adjustments, etc. in the United States?

Answer

- Although information about individual properties are not disclosed, properties remain available for sale. The pipeline amounts to approximately ¥350 billion in total. Among this, ¥150 billion is for office and hotel properties, while ¥200 billion is for rental housing.
- While there are differences among the three builders, it was difficult to offer discounts while they had contract balances. However, as inventory decreased by the end of the year, some properties became eligible for discounted sales, leading to a recovery in orders received in January and February.

Question

- What is the background to the recording of extraordinary income in FY2022 and the lower rate of corporate tax burden? How will that impact FY2023?
- What is the outlook for free cash flow at the end of FY2023?

Answer

- This was due to not including some of the gains from liquidation in China in the plan. In addition, regarding corporate taxes, the rate of burden is lower due to the impact of currency fluctuations associated with the gains from liquidation in China. This situation is expected to continue for a while in this fiscal year as well.
- The free cash flow for FY2023 is expected to be between ¥50 billion and ¥60 billion, assuming no M&A is taken into consideration.

Question

- What is the status of hotel revenues for FY2022 and the current hotel occupancy rate?

Answer

- The hotel revenue for FY2022 was a loss of ¥3.6 billion. The image for this fiscal year is that it will become break-even.

  The occupancy rate is undisclosed.

Question

- Is there outlook regarding the improvement of profit margin for Detached Houses and Rental Housing and Commercial Buildings businesses in the FY2023 plan, given rising material costs and other factors?
- What is the likelihood of further increases in material costs?
- What is the view on financial leverage in terms of ROE targets?

Answer

- Regarding the impact of the surge in material costs, during the Fifth Mid-term Management Plan period, there was an impact of approximately ¥27 billion. However, it is expect to be covered by about ¥8.5 billion to ¥11 billion annually during the Sixth Mid-term Management Plan period through price pass-through and internal efforts.
- We do not expect an increase in material costs greater than last year, but if it does rise, there may be a need for further efforts or price pass-through.
- As for leveraging, the response will change depending on the size and timing of investment projects, so it would be considered flexibly.

Question

- What are the growth factors for the Real Estate and Brokerage Business in the FY2023 plan?

Answer

- After the establishment of Sekisui House Real Estate Holdings February last year, the newly started land trading business has become a growth driver. Sekisui House comprises about 25% of the business, while the remaining 75% is distributed to other builders as part of the business model.