Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the First Quarter FY2023
(WEB Conference)

Date	:	Thursday, June 8, 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 3] Results Overview

The profits recorded in the first quarter of the current fiscal year were the second-highest ever for a first quarter, despite lower sales and profit due to differing property sales among other factors. With the current order volume as a benchmark, we are on track to achieve our full-year plan.

Net sales declined by 4.8% year on year to ¥708.2 billion. This includes a ¥44.4 billion decrease in Overseas Business due to the impact of differing property sales compared to the first quarter of the previous fiscal year.

Gross profit fell 15.4% to ¥138 billion. Gross margin decreased by 2.4p to 19.5%. The main reason for the decline in profits were the impact of soaring material prices as well as the goodwill which arose from the acquisition of Chesmar last fiscal year. In the first quarter of the current fiscal year, the allocation of the acquisition costs was determined and the goodwill was partly allocated as real estate for sale and recorded as cost of sales.

SG&A expenses increased by 9.2% to ¥82.3 billion. Personnel expenses increased by ¥2.6 billion, due partly to the increase in overseas subsidiaries. The SG&A ratio increased by 1.5p to 11.6%.

Operating income fell by 36.5% to ¥55.7 billion and the operating margin decreased by 3.9p to 7.9%.

Overall, operating income for the first quarter accounted for 21.0% of the full-year plan, remaining on track.

Non-operating income/expenses decreased by ¥0.9 billion year on year to a loss of ¥2.6 billion. Foreign exchange gain/loss increased by ¥0.3 billion year on year to ¥0.6 billion.

Equity in earnings/losses of affiliates improved by ¥1.2 billion year on year to a loss of ¥0.5 billion, given the lack of investment valuation loss of ¥1.5 billion in the United Kingdom recorded the previous fiscal year. As a result, ordinary income fell by 38.3% year on year to ¥53 billion.

Extraordinary income was boosted following a gain of ¥8.2 billion from the sale of a commercial facility in Singapore.

Quarterly net profit attributable to owners of parent fell by 27.1% to ¥41.9 billion. EPS decreased by ¥22.07 to ¥63.33.

Overall orders increased by 2.7% to ¥756.2 billion.

[Page 5] Financial Position

Total assets increased by ¥39 billion from the end of the previous fiscal year.

Current assets increased by ¥39.4 billion. Of current assets, cash and deposits fell by ¥29.6 billion. Real estate for sale increased by ¥69.8 billion. Domestic real estate rose by ¥37.4 billion following active purchasing made by Sekisui House real estate companies, while the ongoing construction of multifamily business in the United States boosted overseas real estate for sale by ¥32.3 billion, including ¥5.1 billion in foreign exchange gains. Non-current assets decreased by ¥0.3 billion. Of this, property, plant and equipment increased by ¥7.1 billion due mainly to the acquisition of investment properties. Goodwill decreased by ¥11.5 billion due to the allocation of the acquisition cost of Chesmar being determined.

Total liabilities increased by ¥29.5 billion due to an increase in interest-bearing debt, despite decreases in accrued income taxes payable and corporate tax payments. Interest-bearing debt increased by ¥69.7 billion. D/E ratio increased by 0.04p from the end of the previous year to 41%.

Net assets increased by ¥9.4 billion. The slight increase was due to dividend payments, despite recording net profit attributable to owners of parent for the quarter. Equity ratio decreased by 0.4p to 53.9%.

[Page 6] Cash Flow, Investment Status

Cash flow generated by operating activities decreased by ¥78.1 billion mainly due to the proactive purchase of real estate for sale. Cash flow generated by investing activities increased by ¥7.7 billion year on year, mainly due to proceeds from the sale of investment securities connected with the sales of a project in Singapore. Consequently, free cash flows declined by ¥70.4 billion. Cash used for financing activities increased by ¥46.1 billion year on year, reflecting dividends payment and the issuance of short-term bonds. Cash and cash equivalents at the end of the first quarter amounted to ¥303 billion.

Total investments include capital expenditure of ¥22.2 billion. Of this, investment in rental real estate comprised ¥16.4 billion.

The full-year plan figure of ¥85 billion remains unchanged.

[Pages 7, 8] Segment Information (Built-to-Order Business)

The classification of reportable segments has been changed and comparisons and analysis are based on the revised classification.

Net sales in the Built-to-Order Business overall decreased by 4.2% to ¥289.4 billion. Operating income fell by ¥5.6 billion to ¥27 billion.

Net Sales in the Detached Houses Businesses declined by 7.4% to ¥105.8 billion due to an ongoing decrease in the initial order backlog following the decline in orders during the second half of the previous fiscal year. Gross margin decreased by 1.1p to 22.4%. Of this, the impact of soaring material costs amounted to around ¥1 billion, as expected in the plan. Operating margin decreased by 2.4p to 5.9%. Impact of the soaring material prices accounted for 1p and the increase in SG&A and other fixed costs due to decreased profit accounted for 1.3p. From the second quarter onwards, we expect improved profit margins due to the diminishing impact of material prices compared to the previous fiscal year and our cost-cutting efforts. Orders decreased by 3.4% to ¥112.6 billion. The decline can be attributed to a high benchmark set in the previous fiscal year, as such, the situation is robust. Advance indicators such as the sales performance of land for sale are promising, indicating potential for the second quarter and beyond. The order backlog increased by ¥6.7 billion and the ZEH ratio was 93%. The unit price per building increased by ¥2.34 million year on year to ¥48.53 million.

Net sales in the Rental Housing and Commercial Buildings Business increased by 0.7% to ¥125.6 billion, maintaining the level of the previous year amid steady construction progress. Gross margin decreased by 1.9p to 23.6%. Of this, the impact of soaring material prices was around ¥1.2 billion. Operating margin decreased by 1.7p to 14.2%. Orders remained strong, increasing by 4.4% to ¥122.5 billion. The adoption rate of ZEH for Sha Maison rental housing continues to grow, reaching 76%. Non-housing such as Zero-Energy Building (ZEB) offices has also increased significantly. The unit price per building increased by ¥10.61 million to ¥152.22 million compared to FY2022. The ratio of three-to-four-story houses also remained high at 92.2%.

Net sales in the Architectural/Civil Engineering Business fell by ¥5 billion to ¥57.9 billion, while operating income fell by ¥0.3 billion to ¥3 billion. The decline in both sales and profit are attributable to delays in construction progress due to orderer’s terms caused by soaring material costs and other factors. Orders received fell by ¥13.4 billion to ¥52.5 billion. Despite ongoing weak demand for civil engineering work, demand for architectural construction remains strong. Although adjusting costs with clients due to rising prices is taking time, order activity itself is relatively steady and the order profit margin is also improving.

[Page 9, 10] Results by Segment—Supplied Housing Business

Net sales in the Supplied Housing Business as a whole increased by 5.5% to ¥201.1 billion. Operating income increased by ¥1.5 billion to ¥19.3 billion.

Net sales in the Rental Housing Management Business increased by 4.4% to ¥161.2 billion. Operating margin improved by 0.2p to 9.1%. Despite a temporary cost impact due to the establishment of Sekisui House Real Estate Holdings, Ltd., which resulted in profit declining last fiscal year, profit is increasing again as expected.

The number of units under management is about 700,000 with an occupancy rate of 98.2%.

Net sales in the Remodeling Business increased by 10.1% to ¥39.9 billion. Operating margin also rose by 0.5p to 12%. A strong customer base anchored continued stable growth in both detached houses and rental housing remodeling, thanks to large-scale remodeling such as the Family Suite Remodeling for detached houses as well as remodeling proposals crucial for managing rental properties stably in the long term. Orders remained strong from the previous fiscal year, increasing by 6.6% to ¥44.3 billion.

[Page 11, 12] Results by Segment—Development Business

Net sales in the Development Business overall increased by 10.7% to ¥124.4 billion. Operating income decreased by ¥0.5 billion to ¥16.8 billion.

Net sales in the Real Estate and Brokerage Business increased by 15.6% to ¥61 billion. Gross margin improved by 3.0p to 23.2%. Orders increased by 10.3% year on year to ¥74.7 billion. Reinforcement of procurement of prime land and high real estate sales performance of the Sekisui House real estate companies were the contributing factors. Land inventory increased by about ¥38 billion from the end of the previous fiscal year.

Net sales in the Condominiums Businesses fell by 61.2% to ¥15.9 billion. Operating margin fell by 16.7p to 8.3%. This decline in sales and profit was due to the delivery of large tower condominiums in the first quarter of the previous fiscal year. However, sales activities for supplied properties were favorable, with orders amounting to ¥25.7 billion. Completed housing stock decreased by 81 units from the end of the previous fiscal year to 164 units.

Net sales in the Urban Redevelopment Business increased by ¥28.9 billion to ¥47.4 billion. Operating income rose by ¥5.5 billion to ¥8.1 billion. This was underpinned by the gain from the sale of shares of the Otemon Tower/ENEOS Building. Occupancy rates are recovering, particularly for luxury hotels.

[Page 13] Results by Segment—Overseas Business

Net sales declined by 30.4% to ¥101.8 billion. Operating income fell by ¥24.2 billion to ¥4.3 billion. Operating margin declined by 15.3p to 4.3%. The fall in sales and profit are due to the high number of property sales and condominium deliveries in the first quarter of the previous fiscal year. Orders fell by ¥46 billion to ¥110.2 billion.

[Page 14] Overseas Business—Details by Country

In the United States, net sales dropped by ¥5.1 billion to ¥96.3 billion. To break this down, the homebuilding business, bolstered by Chesmar's earnings, increased by ¥17.5 billion to ¥62.9 billion. Master-planned community business decreased by ¥6.8 billion to ¥15.4 billion. Multifamily business decreased by ¥15.6 billion to ¥17.9 billion, as there was only one property sale of one property in this quarter compared to the sale of two properties in the first quarter of the previous fiscal year. Operating income fell by ¥15.6 billion to ¥5.3 billion. A closer look at the figures shows a loss of ¥1.9 billion in the homebuilding business and a gain of ¥4.6 billion in the master-planned community business and ¥2.4 billion in the multifamily business.

The decline of profit in homebuilding business was mainly due to determining the allocation of the Chesmar acquisition cost, which were provisionally recorded as goodwill, to be partially allocated to land and other real estate for sale. Profit declined by ¥4.1 billion compared to the previous amortization of goodwill because of the increase in the cost of sales being recorded in this quarter, even for the properties sold last fiscal year. Excluding this effect, profit is higher than planned. On the other hand, amortization of goodwill was reduced and profit is expected to improve from the next fiscal year onwards, when the real estate for sale with increased cost will decrease.

Orders decreased by ¥1.7 billion year on year to ¥102.4 billion. With the addition of Chesmar, orders in homebuilding business increased by ¥11.7 billion year on year to ¥87 billion. Order backlog increased by ¥6 billion year on year to ¥140.7 billion, with homebuilding business accounting for ¥90.4 billion and master-planned community business for ¥48.7 billion. The investment balance increased by ¥16.3 billion from the end of the previous fiscal year to ¥861.7 billion.

Net sales in Australia decreased by ¥27.7 billion to ¥5.1 billion. Operating income declined by ¥5.1 billion to a loss of ¥0.3 billion. Sales and profit declined due to the impact of the sale of land for development near Sydney and the delivery of condominiums in the same period of the previous fiscal year. Orders received decreased by ¥43.4 billion to ¥7.5 billion. Meanwhile, contract rate for condominiums scheduled for sale this fiscal year is 98%, in line with the plan. Investment balance increased by ¥6.4 billion to ¥178 billion.

Net sales in China fell by ¥11.5 billion to ¥0.2 billion, while operating income fell by ¥3.4 billion to a loss of ¥0.2 billion.

In Singapore, an extraordinary income of ¥8.2 billion was recorded from the sale of a commercial facility. The investment balance is ¥38.8 billion.

[Page 16] Full-year Plans

Full-year plans remain unchanged based on steady orders in Japan and overseas.

<Summary of Question and Answer Session>

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

Question

- What are the current business environments and the future prospects of the homebuilding business and multifamily business in the Unites States?
- Can you give a detailed breakdown of the Real Estate and Brokerage Business and Urban Redevelopment Businesses in the sale of urban development-related properties?

Answer

- In the homebuilding business, strong order trends are anticipated to persist through the summer. Post-summer, a consistent favorable trajectory is predicted, contingent upon stable interest rates amidst a scarcity of second-hand houses. However, for the multifamily business, we sense that the marked caution among small- and medium-sized regional banks have somewhat tempered investor sentiment. Regardless, we expect a revival of this sentiment in the second half of the current fiscal year and aim to achieve the full-year operating income target by fulfilling the remaining ¥12 billion via the sales of three properties. As we have no intention to sell at a lowered price, we may change the plan for the Urban Redevelopment Business and sell properties there if the situation remain unchanged.
- In line with the change in segments, sales and profit of the previous first quarter were revised from ¥25.2 billion and ¥6.5 billion under the previous standards to ¥27.7 billion and ¥6.3 billion, respectively. To date, the sale of land purchased for condominiums, etc. were accounted for based on set criteria and combined with the property sales within the Urban Redevelopment Business. However, in line with the change in segments, it has been decided to disclose only the combined total of urban redevelopment projects and projects developed by Sekisui House Real Estate. No significant monetary change is anticipated.

Question

- Can you elaborate on the income of hotels for the current fiscal year?
- How will the unplanned ¥4.1 billion (cost increase due to the determination of goodwill) incurred in the first quarter under review be recouped?

Answer

- The initial plan for the income of hotels was to come out even. Although the hotels are in the red if depreciation, etc. is included, number of guests from abroad has recently been increasing and the occupancy rate has recovered to around 45%. We expect occupancy rate to continue to rise but we intend to stick to the initial plan in the current first quarter.
- Orders for detached houses in the United States are currently strong, which should offset the cost hike. In terms of units, orders received for the first quarter under review, excluding Chesmar before the acquisition,

is 150% year on year. Compared to the plan with Chesmar included is 135%, showing favorable progress.

Question

- What are the prospects for recovery in gross margins for detached houses and rental housing, and current material price trends in Japan?
- What are the profit margin trends excluding goodwill for the homebuilding business and the future prospect in the United States?

Answer

- The decline in the orders after price increases passed in June and August last year also impacted on the decline in sales of the first quarter under review. Price pass-through effect will appear from the second quarter onwards for detached houses and from the third quarter for rental housings. Profit margin fell in the first quarter under review due to the rise in costs as well as many of the orders being received before the price change. Prices are increasing for some raw materials but are more stable than the previous fiscal year.
- The profit margin remained low for the homebuilding business in the United States due to difficult selling conditions that continued until December last year, but current cancellation rate is low and sales is possible with fewer needs for discounts. We do not believe that sales prices will rise to the levels of the first or second quarter of the previous fiscal year and do not see the potential for large profits, but given the many customers minded to buy, we expect the sales-friendly environment to continue.

Question

- What is the outlook for the second quarter onwards against the full-year plan?
- What is the timing of Australia's recovery against the full-year plan?

Answer

- Despite the fact that the cost increase of ¥4.1 billion due to the determination of Chesmar's goodwill was unplanned, do note that the rest of the cost increases are within the planned range.
- The decline in sales and profit in Australia during the first quarter is in line with our plan. We plan to sell properties in the second half of the current fiscal year.
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Question

- What are the demand trends and future prospects for the master-planned community business in the United States?

Answer

- In addition to the favorable orders for detached houses, land sales are also underway with some time lag. Our builders, like many other builders, are also revising plans to increase land purchases.

Question

- What is the status of Sekisui House Real Estate's building sales, etc., given the increased real estate for sale in the Real Estate and Brokerage Business (increase of ¥38.8 billion year on year)?
- What is the prospect for the sale of properties in the Urban Redevelopment Business from the second quarter and onwards?

Answer

- Sekisui House Real Estate sells land rather than ready-built houses. About 25% is land sold to Sekisui House customers who do not own land and the remainder is sold to external parties as bare land. It is currently able to sell with excellent profit margins and turnover. We will focus on residential land and hope to promote its business with the aim of becoming a real estate company that is strong in residential land.
- The value of properties held by the Urban Redevelopment Business in Japan was approximately ¥300 billion as of the end of the previous fiscal year. There is a steady stream of inquiries, and even if property sales for the multifamily business in the United States were to decline, property sales in Japan would be possible to compensate. We will monitor sales in the multifamily business in the United States and consider the sale of properties in the Urban Redevelopment Business accordingly.

Question

- Can you provide details on the changeover period of the condominium deliveries in Australia Business?
- What factors lay behind the rise in gross margins in the Real Estate and Brokerage Business?

Answer

- Please note that, rather than a changeover period, the timing of when profit is recorded after properties are completed and delivered to customers differs between the previous and current fiscal year.
- Sekisui House Real Estate started selling residential land in the second half of the previous fiscal year. We have since bought more land from the beginning of this year, with purchasing progressing well. The lands purchased have been sold as residential land with a high turnover.