Sekisui House, Ltd.

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

Date	:	Thursday, September 7, 2023, 5:00 p.m. to 6:00 p.m. (JST)	
Participants	:	Representative Director of the Board, Vice Chairman, Executive Officer	Yosuke Horiuchi
		Executive Officer, Head of Investor Relations Department	Atsushi Yoshida

<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 net sales recorded in the second quarter of the current fiscal year were a record high for a second quarter due to factors such as the stable growth of the rental housing and commercial buildings segment and supplied housing business in addition to the sales of properties in Japan. Operating income declined due to condominium deliveries in Japan and sales of properties owned by multifamily business in the United States during the second quarter of the previous year as well as the impact of sales being recorded before the price change in the Built-to-Order Business. The progress is mostly according to our plan, and we have achieved the second-highest level ever. Considering the state of rental housing orders received and the favorable trend of the Detached Houses Businesses, there is steady progress toward achieving the plan to reach new record-high profits during this fiscal year.

Net sales increased by 2.7% year on year to ¥1,462.4 billion. A new record-high was achieved through sales of real estate and developed properties in Japan.

Gross profit fell 2.7% to ¥293.3 billion. Gross margin decreased by 1.1p to 20.1%. The cost of sales increased due to the impact of soaring material prices as well as the goodwill which arose from the acquisition of Chesmar in the first quarter of the current fiscal year.

SG&A expenses increased by 8.5% to ¥168.4 billion. Personnel expenses increased by ¥5.3 billion, due partly to the increase in overseas subsidiaries. The SG&A ratio increased by 0.6p to 11.5%.

Operating income fell by 14.7% to ¥124.9 billion and the operating margin decreased by 1.8p to 8.5%.

Overall, operating income for the first quarter accounted for 47.0% of the full-year plan, remaining on track.

Non-operating income/expenses decreased by ¥0.9 billion year on year to ¥0.3 billion. Foreign exchange gain/loss decreased slightly year on year to foreign exchange gains of ¥2.3 billion.

Equity in earnings/losses of affiliates increased by ¥3.8 billion to ¥1.9 billion with the sale of shares of the hotel in the Fukuoka Daimyo Garden City. As a result, ordinary income fell by 15.2% year on year to ¥125.2 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 11.1% to ¥92.4 billion. EPS decreased by ¥14.75 to ¥140.31.

Overall orders increased by 9.9% to ¥1,593.9 billion.

[Page 5] Financial Position

Total assets increased by ¥269 billion from the end of the previous fiscal year.

Current assets increased by ¥278.4 billion. Of current assets, cash and deposits fell by ¥28.1 billion. Real estate for sale increased by ¥326.7 billion. Domestic real estate rose by ¥102.6 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 ¥224.1 billion, including ¥92.8 billion in foreign exchange gains. Non-current assets decreased by ¥9.4 billion. Goodwill decreased by ¥11.5 billion due to the allocation of the acquisition cost of Chesmar being determined.

Total liabilities increased by ¥176.1 billion due to an increase in interest-bearing debt. Interest-bearing debt increased by ¥171.9 billion. D/E ratio increased by 0.08p from the end of the previous year to 45%.

Net assets increased by ¥92.9 billion due to factors such as the recording of quarterly net profit attributable to owners of parent and increase of cumulative translation adjustments.

Equity ratio decreased by 1.7p to 52.6%.

[Page 6] Cash Flow, Investment Status

Cash flow generated by operating activities decreased by ¥111.5 billion mainly due to the active purchasing of real estate for sale. Cash flow generated by investing activities increased by ¥61.3 billion year on year, mainly due to proceeds from the sale of investment securities connected with the sales of a project in Singapore, despite the progress in the acquisition of tangible fixed assets. Consequently, free cash flows declined by ¥50.1 billion. Cash used for financing activities increased by ¥72.1 billion year on year due to increases of short-term corporate bonds and short-term borrowings. Cash and cash equivalents at the end of the second quarter amounted to ¥304.4 billion.

Total investments include capital expenditures of ¥41.4 billion. Of this, investment in rental real estate comprised ¥28.7 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 slightly declined to ¥618.8 billion. Operating income fell by ¥1.9 billion to ¥65.1 billion.

Net sales in the Detached Houses Businesses declined by 3.9% to ¥231.4 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 0.5p to 23.0%. Of this, the impact of soaring material costs was around ¥1.2 billion. Profit margin is gradually improving from the effects of the cost pass-through effect. Operating margin decreased by 1.4p to 8.1%. From the second half of the year onwards, we expect further improvement of profit margins due to the diminishing impact of material prices compared to the previous fiscal year and our cost-cutting efforts. Orders received fell by 5.0% to ¥229 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 and number of showroom visit reservations are promising, indicating potential for future improvement. The order backlog is almost unchanged. The unit price per building increased by ¥2.66 million year on year to ¥48.85 million.

Net sales in the Rental Housing and Commercial Buildings Business increased by 6.8% to ¥263.7 billion, maintaining steady progress. Gross margin decreased by 0.9p to 24.1%. Of this, the impact of soaring material prices was around ¥1.5 billion. Operating margin decreased by 0.2p to 15.0%. Orders remained strong, increasing by 9.7% to ¥272.5 billion. The adoption rate of ZEH for Sha Maison rental housing continues to grow, reaching 77%. Non-housing such as Zero-Energy Building (ZEB) offices has also increased significantly. The unit price per housing increased by ¥15.13 million to ¥156.74 million compared to FY2022.

Net sales in the Architectural/Civil Engineering Business fell by ¥7.5 billion to ¥123.6 billion, while operating income increased by ¥0.1 billion to ¥6.7 billion. The decline in sales is attributable to delays in construction progress due to orderer's terms caused by soaring material costs and other factors. The profit margin improved due to improved profitability. Orders received increased by ¥14.3 billion to ¥144.1 billion. Despite ongoing weak demand for civil engineering work, demand for architectural construction remains strong. Order activity itself remain relatively steady.

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

Net sales in the Supplied Housing Business as a whole increased by 4.8% to ¥409.4 billion. Operating income increased by ¥2.1 billion to ¥38.3 billion.

Net sales in the Rental Housing Management Business increased by 4.5% to ¥321.1 billion. Operating margin improved by 0.1p to 8.2%, showing continued stable growth.

The number of units under management exceeds 700,000 with an occupancy rate of 97.7%.

Net sales in the Remodeling Business increased by 5.9% to ¥88.2 billion. Operating margin also rose by 0.2p to 13.7%. 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. Overall orders increased by 2.2% to ¥88.9 billion. Orders remained strong from the previous fiscal year.

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

Net sales in the Development Business overall increased by 32.4% to ¥248.5 billion. Operating income increased by ¥13.7 billion to ¥33.8 billion.

Net sales in the Real Estate and Brokerage Business increased by 18.7% to ¥130.2 billion. Gross margin improved by 0.6p to 20.4%. Orders increased by 29.6% year on year to ¥155.2 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 ¥64 billion from the end of the previous fiscal year.

Net sales in the Condominiums Businesses fell by 8.9% to ¥49.9 billion, and the operating margin decreased by 2.7p to 16.7%. This decline in sales and profit was due to the delivery of large tower condominiums in the second quarter of the previous fiscal year. However, sales activities for supplied properties were favorable, with orders amounting to ¥51.7 billion. Completed housing stock decreased by 47 units from the end of the previous fiscal year to 198 units.

Net sales in the Urban Redevelopment Business increased by ¥45.1 billion to ¥68.3 billion. Operating income increased by ¥12.5 billion to ¥13 billion. This was underpinned by the gain from the sale of shares of the Otemon Tower/ENEOS Building and Hommachi Garden City Terrace. Occupancy rates are recovering, particularly for luxury hotels, and have turned profitable in terms of net operating income.

[Page 13] Results by Segment—Overseas Business

Net sales declined by 16.5% year on year to ¥201.7 billion. Operating income fell by ¥33.7 billion to ¥12.4 billion, and the operating margin decreased by 12.9p to 6.2%. This decline in sales and profit was due to the large amount of properties sales and condominiums deliveries in the second quarter of the previous fiscal year. Orders received increased by ¥15.3 billion to ¥266.1 billion.

[Page 14] Overseas Business—Details by Country

In the United States, net sales increased by ¥7.8 billion to ¥184.4 billion. To break this down, the homebuilding business, bolstered by Chesmar's earnings, increased by ¥31.5 billion to ¥132.2 billion. Master-planned community business decreased sales by ¥8.7 billion to ¥30.1 billion. Multifamily business decreased by ¥14.9

billion to ¥21.4 billion, as there was only one property sale this quarter compared to the sale of two properties in the second quarter of the previous fiscal year. Operating income fell by ¥20.7 billion to ¥14 billion. A closer look at the figures shows a gain of ¥1.4 billion in the homebuilding business, ¥8.4 billion in the master-planned community business and ¥4 billion in the multifamily business.

The decline of profit in detached houses was mainly due to determining Chesmar's goodwill. Profit declined by ¥4.7 billion compared to the initial plan. Excluding this effect, profit is higher than planned.

Orders increased by ¥45.6 billion year on year to ¥242.4 billion. With the addition of Chesmar, orders in homebuilding business increased by ¥59.5 billion year on year to ¥194.9 billion. Orders continue to be favorable despite the rise in mortgage rates. Order backlog increased by ¥73.1 billion from the end of the previous year to ¥207.9 billion, with homebuilding business accounting for ¥144.3 billion and master-planned community business accounting for ¥62.9 billion. The investment balance increased by ¥175.3 billion from the end of the previous fiscal year to ¥1,020.6 billion.

In Australia, net sales decreased by ¥27 billion to ¥16.6 billion. Operating income declined by ¥6 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 fell by ¥27.2 billion to ¥23.2 billion. Sales of condominiums are expected to progress according to plan from the third quarter onwards. We plan to achieve the full-year plan by strengthening the sale of non-residential properties and detached houses. The investment balance increased by ¥42.6 billion to ¥214.2 billion.

In China, net sales fell by ¥20.6 billion to ¥0.5 billion, while operating income fell by ¥7 billion to a loss of ¥0.4 billion.

In Singapore, 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 Plan

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 outlooks on the future sales trend and profitability against the plan in the homebuilding business as well as property sales in the multifamily business in the United States?
- What is the prospect for recovery in orders for Detached Houses Businesses in Japan?

Answer

・ Sales in the homebuilding business in the United States is on a favorable trend despite the rise in mortgage rates in August. We have a target of around 400 houses per month, but the number of sales have been exceeding 400 houses, including in August. As for incentives, part of the mortgage may be borne by the builder to meet the demand. In terms of profitability, we make lifestyle proposals in the United States as we do in Japan and have made improvements of 4pt compared to the start of the current fiscal year. In the multifamily business, properties sales in the second half of the fiscal year was three properties in the initial plan, but we plan to change it to two properties. With the cautionary mindset of investors, we do not intend to make sales while the price is low and plan to compensate with the Development Business in Japan.
・ In Japan as a whole, housing starts was below the previous year for 20 months in a row until July this year. We have also been below the previous year results but are making valiant efforts through added-value proposals, expansion of the 3rd range customer demographic, and other activities.
With the current government policy is directing toward promoting high-quality houses, how customers think about new houses is also changing. We expect orders to recover when the policy comes into effect as we have an advantage in that regard.

Question

・ What is the prospect of Rental Housing and Commercial Buildings Business achieving the profitability target and demand?
・ How much impact do exchange rates have during the ongoing depreciation of Japanese yen?

Answer

・ Orders in the Rental Housing and Commercial Buildings are on a very favorable trend. We have high expectations as the delivery of properties after price change is getting closer. As for the demand, we have only built in areas where we think demand will continue for about 30 years and have not expanded the area only to gain orders. With the population centralizing to urban areas due to the declining birthrate and aging population, areas where long-term demand is expected are in high competition, but we hope to utilize our advantages.
・ We also think depreciation of the Japanese yen will work in our favor. With regards to the impact of exchange rates, we calculate that a change of ¥1 roughly equates to ¥300 million.

Question

・ What is the reason for the sales of properties in the Real Estate and Brokerage Business doing well? What is its future growth potential?
・ Can you give details about the sales of properties in the Urban Redevelopment Business during the second half of the year?

Answer

・ Sekisui House Real Estate Group is purchasing land for detached houses and selling them with excellent turnover. Land may be used for properties for detached houses by Sekisui House or sold to builders.

We think there is potential for growth. We introduce land to customers that are looking within the land we own for a set period and may later sell them to other builders.

- Contracts for two properties have already been signed. There are also offers and we will consider if they should be left for the next fiscal year as outstanding contracts or include them in this fiscal year and balance them with other businesses.

Question

- I believe the plan was to compensate for the master-planned community business with the sale of properties in Japan if it goes below the initial plan, but how are the master-planned community business and multifamily business performing against the plan in local currency?
- What is the policy for profitability of the Built-to-Order Business in Japan?

Answer

- We believe that there is a possibility that both homebuilding business and master-planned community business will exceed the plan. If they do exceed the plan, we will no longer have to compensate with sales of properties in Japan. Details will be explained during the Management Plan Presentation to be held tomorrow.
- We anticipate a certain degree of increase in labor and logistics costs caused by the 2024 issue and are working to reduce costs. However, please keep in mind that we believe further cost increases and increases in material costs cannot be ruled out.

Question

- Could you give details about the buyers of detached houses in the United States? The ratio of cash buyers is said to be increasing, but is there an increase in the number of cash buyers or customers that are making purchases for investment purposes?
- What is the future prospect for the demand in the master-planned community business in the United States?

Answer

- Customer characteristics mainly consist of individual customers, and we are not aware of those that make purchases for investment purposes.
- In general, our business takes time as we conduct residential land development construction and then sell the land to builders. There are often changes due to permits and other reasons. We have it as a balance sheet and own many land on the East Coast and in the South. Builders were located mainly on the West Coast. However, with the addition of Chesmar, we can to contribute in the South. If we enter the Southeast, we think we can also contribute in that area. As for purchases, prices are very high.

Question

- Can you provide more details about the business in Australia?
- What is the current state of orders for detached houses in the United States?

- How is the goodwill of Chesmar?

Answer

- In Australia, a contract was signed for a large property. Unlike the United States, sales of detached houses need more effort but the sales of condominiums are on a stable trend as planned.
- Orders increased by 30% year on year up until August. We believe it is also at the same level as the plan.
- Compared to the plan, the impact was ¥4.1 billion in the first quarter and ¥4.7 billion in the second quarter.

Question

- What are the expected sales for orders received during this fiscal year for the homebuilding business in the United States?
- What is the occupancy rate of rental housing in Japan?

Answer

- Houses that are near completion can contribute in the short-term to sales, but it is difficult to say as the situation differs depending on the area and level of completion. Even though there may be cancellations, properties near completion are easy to sell and can be recorded as sales in the short-term.
- Of the 700,000 units, 110,000 units change occupants annually. As we do not receive rental fees for about a month during the transition period, the maximum occupancy rate is about 98.5%. On the other hand, Sha Maison rarely have an opening. We are also renovating to ensure long-term stable management for owners.