Sekisui House, Ltd.

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

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

<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 third quarter of the current fiscal year were a record high for a third quarter due to factors such as the stable growth of the rental housing and commercial buildings segment of the Built-to-Order Business and Supplied Housing Business in addition to the domestic sales of properties in the Development Business. Operating profit declined due to condominium deliveries in Japan and sales of properties owned by multifamily business in the United States during the previous year as well as increase in cost of sales due to goodwill which arose from the acquisition of Chesmar, a United States builder. On the other hand, gross profit margin of detached houses and rental housings continued to improve in Japan compared to the third quarter of the previous fiscal year. In addition, with the sales of houses in the United States on a recovery trend and contracts for properties sales in Japan and overseas for ensuring the achievement of the full-year plan having been signed as of today, overall income is steadily progressing toward achieving a record-high profit this fiscal year.

Net sales increased by 2.8% year on year to ¥2,189.5 billion. While there was a decline in the Overseas Business, stable growth of the supplied housing business and growth of the Sekisui House Real Estate Group greatly contributed to the net sales.

Gross profit increased by 1.0% to ¥442.5 billion. Gross profit margin decreased by 0.4p to 20.2%. Although gross profit margin of the Domestic Business improved, cost of sales increased due to the goodwill which arose from the acquisition of Chesmar in the previous fiscal year. Built-to-Order Business also recovered to the previous year's level with the price change of 1% in June and August as well as with the soaring of material prices slowing down.

SG&A expenses increased by 8.5% to ¥255.8 billion. Personnel expenses increased by ¥7.5 billion, due partly to the increase in overseas subsidiaries. The SG&A ratio increased by 0.6p to 11.7%.

Operating profit fell by 7.8% to ¥186.6 billion and the operating profit margin decreased by 1.0p to 8.5%. While the operating profit margin in the Overseas Business decreased, the Built-to-Order Business recovered to the same level as the previous fiscal year and Supplied Housing and Development Business showed an increase.

Non-operating income/expenses decreased slightly year on year. Foreign exchange gain/loss increased by ¥1.8 billion year on year to ¥4.7 billion. Interest costs increased by ¥5.3 billion to ¥8.7 billion. Equity in earnings/losses of affiliates increased by ¥3.6 billion to ¥1.8 billion with the sale of shares of the hotel in the Fukuoka Daimyo Garden City. As a result, ordinary profit fell by 7.9% year on year to ¥186.6 billion.

Extraordinary income was ¥8.2 billion from the sales of a commercial building in Singapore, ¥1.7 billion from the sales of a hotel in the China Business, and ¥3.6 billion from the sales of investment securities. This decline is partly due to the liquidation of a subsidiary in China in the previous year.

Quarterly net profit attributable to owners of parent fell by 5.3% to ¥141.8 billion. EPS decreased by ¥7.76 to ¥216.29.

Overall orders increased by 12.2% to ¥2,421.4 billion.

[Page 5] Financial Position

Total assets increased by ¥422 billion from the end of the previous fiscal year.

Current assets increased by ¥465.2 billion. Of current assets, cash and deposits fell by ¥18.7 billion. Real estate for sale increased by ¥482 billion. Domestic real estate rose by ¥163.8 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 ¥318.1 billion, including ¥125.7 billion in foreign exchange gains. Non-current assets decreased by ¥43.1 billion. This is due to the progress of sales of urban redevelopment properties, which were changed to "real estate for sale," and goodwill decreasing by ¥11.5 billion due to allocation of the acquisition cost of Chesmar being determined.

Total liabilities increased by ¥320.6 billion due to an increase in interest-bearing debt. Interest-bearing debt increased by ¥300.1 billion. D/E ratio increased by 0.15p from the end of the previous year to 0.52x.

Net assets increased by ¥101.4 billion due to factors such as the recording of quarterly net profit attributable to owners of parent and increase of foreign currency translation adjustments.

Equity ratio decreased by 3.9p to 50.4%.

[Page 6] Cash Flow, Investment Status

Cash flow generated by operating activities decreased by ¥135.9 billion mainly due to the active purchasing of real estate for sale. Cash flow generated by investing activities increased by ¥89.6 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 ¥46.2 billion. Cash used for financing activities increased by ¥210.2 billion year on year due to increases of short-term bonds payable and short-term borrowings. Cash and cash equivalents at the end of the third quarter amounted to ¥313.9 billion.

Total investments include capital expenditures of ¥66.5 billion. Of this, investment in rental real estate comprised ¥48.6 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 increased by ¥4.5 billion to ¥921.9 billion. Operating profit fell by ¥0.7 billion to ¥92.8 billion.

Net sales in the Detached Houses Business declined by 2.7% to ¥342.1 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 profit margin improved by 0.1p to 23.0%. An improvement of 1.2p compared to the past three months. Of this, the impact of soaring material costs was around ¥0.9 billion. Profit margin improved due to price changes in the previous year having been mostly completed and because of progress in the sales of high-value-added houses. Operating profit margin decreased by 0.9p to 7.7%. This is due to fixed costs being higher as deliveries in the first and third quarter tend to be relatively fewer than in the second and fourth quarter. Margin of decrease is less than the first half of the fiscal year and is showing a steady improvement. We expect further improvement of the profit margin through our continued cost-cutting efforts. Orders received fell by 3.9% to ¥338.1 billion. Orders received continued a steady trend despite the high bar set in the previous year due to a spike before the price change. 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 ¥2.91 million year on year to ¥49.1 million.

Net sales in the Rental Housing and Commercial Buildings Business increased by 5.3% to ¥390.4 billion, maintaining steady progress. Gross profit margin decreased by 0.6p to 24.0%. Of this, the impact of soaring material prices was around ¥1.2 billion. Operating profit margin improved by 0.1p to 14.9%, Orders remained strong, increasing by 7.6% to ¥416.6 billion. The adoption rate of ZEH for Sha Maison rental housing continues to grow, reaching 75%. Non-residential has also increased significantly with the promotion of Zero-Energy Building (ZEB). The unit price per housing increased by ¥19.24 million year on year to ¥160.85 million.

Net sales in the Architectural/Civil Engineering Business fell by ¥5.8 billion to ¥189.3 billion. Operating profit slightly increased to ¥8.5 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. Operating profit margin improved due to improved profitability. Orders received increased by ¥59.7 billion to ¥229.2 billion. Demand for civil engineering work is on a recovery trend while 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 ¥608.4 billion. Operating profit increased by ¥3 billion to ¥54.1 billion.

Net sales in the Rental Housing Management Business increased by 4.5% to ¥482.6 billion. Operating profit margin was 7.9%, staying at the same level as the previous fiscal year. showing continued stable growth. The number of units under management exceeds 700,000 with an occupancy rate of 97.6%.

Net sales in the Remodeling Business increased by 5.7% to ¥125.8 billion. Operating profit margin also rose by 0.4p to 12.8%. The strength of this business is its extensive customer base, and its growth drivers are proposal-base remodeling such as "Family Suite Renovation," as well as remodeling proposal at the time of occupant replacement, which is indispensable for the long-term stable management of rental housing. Overall orders increased by 1.5% to ¥130.2 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 14.0% to ¥347 billion. Operating profit increased by ¥11.7 billion to ¥42.9 billion.

Net sales in the Real Estate and Brokerage Business increased by 23.1% to ¥199.1 billion. Gross margin was 20.1%. Orders increased by 31.4% year on year to ¥229.2 billion. With the strengthening of prime land purchases by Sekisui House real estate companies, housing sales contributed significantly to the orders. Land inventory increased by about ¥80 billion from the end of the previous fiscal year.

Net sales in the Condominiums Businesses fell by 5.7% to ¥59.8 billion, and the operating profit margin decreased by 2.2p to 15.1%. This decline in sales and profit was due to the delivery of large tower condominiums in the same period of the previous fiscal year. Contracts required for achieving the goal of increasing sales and profit set out in the full-year plan have been signed. However, sales activities for supplied properties were favorable, with orders amounting to ¥80.4 billion. Completed housing stock decreased by 107 units from the end of the previous fiscal year to 138 units.

Net sales in the Urban Redevelopment Business increased by ¥8.9 billion to ¥88 billion. Operating profit increased by ¥8.5 billion to ¥15.2 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 urban type luxury hotels, and is profitable in terms of net operating income.

[Page 13] Results by Segment—Overseas Business

Net sales declined by 5.1% year on year to ¥332.5 billion. Operating profit fell by ¥27.8 billion to ¥33.3 billion, and the operating profit margin decreased by 7.4p to 10.0%. This decline in sales and profit was due to the large amount of properties sales and condominiums deliveries in the same period of the previous fiscal year. Orders received increased by ¥31.6 billion to ¥406.1 billion.

[Page 14] Overseas Business—Details by Country

In the United States, net sales increased by ¥20.9 billion to ¥300.9 billion. To break this down, the homebuilding business, bolstered by earnings of Chesmar and Hubble, the latter of which we acquired this fiscal year, increased by ¥39.1 billion to ¥226.4 billion. Master-planned community business decreased sales by ¥4.8 billion to ¥47.7 billion. Multifamily business decreased by ¥13 billion to ¥26.1 billion, as there was only one property sale this period compared to the sale of two properties in the same period of the previous fiscal year. Contracts for properties to be delivered in the fourth quarter have been signed. Considering the tempered investor sentiment, we expect sales of two properties during the fiscal year. Operating profit fell by ¥22.2 billion to ¥27.9 billion. A closer look at the figures shows a gain of ¥8.9 billion in the homebuilding business, ¥13.9 billion in the master-planned community business and ¥4.9 billion in the multifamily business.

Gross profit margin continued its steady recovery due to measures such as advance orders placed by Chesmar.

We expect external growth of Chesmar and Hubble, internal growth of existing builders, and master-planned community business exceeding the plan will cover the downturn from goodwill which arose from the acquisition of Chesmar and postponing of sales in the multifamily business.

Orders increased by ¥53.1 billion year on year to ¥356.1 billion. With the addition of Chesmar, orders in homebuilding business increased by ¥108.2 billion year on year to ¥289.3 billion. Although the speed of sales is showing a sign of slowdown due to mortgage rates remaining high, the impact on the orders is limited as having a robust base line, unlike the decline seen in the previous fiscal year. Order backlog increased by ¥70 billion from the end of the previous year to ¥204.7 billion, with homebuilding business accounting for ¥144.2 billion and master-planned community business accounting for ¥60.1 billion. The investment balance increased by ¥257.8 billion from the end of the previous fiscal year to ¥1,103.1 billion.

In Australia, net sales decreased by ¥16.2 billion to ¥30.8 billion. Operating profit increased by ¥1.9 billion to ¥7.3 billion. Despite the decrease in income due to sales of land for development near Sydney in the same period of the previous fiscal year and a decline in number of detached housing sales from the impact of higher mortgage rates, profit increased due to delivery of a condominium and sales of development properties as planned. Orders received fell by ¥18 billion to ¥49.2 billion. We expect to achieve the full-year plan with the planned delivery of a condominium in the fourth quarter. The investment balance increased by ¥54.4 billion to ¥226 billion.

In China, net sales fell by ¥22.6 billion to ¥0.7 billion, while operating profit fell by ¥7.5 billion to a loss of ¥0.6 billion. The investment balance is ¥2.7 billion.

In Singapore, extraordinary income of ¥8.2 billion was recorded from the sale of a commercial facility. The investment balance is ¥40.3 billion.

[Page 16] Full-year Plan

Full-year plan remains unchanged. We are steadily progressing toward achieving a record-high operating profit of ¥265 billion.

<Summary of Question and Answer Session>

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

Question

・ The plan is to sell three properties in the multifamily business in the United States this fiscal year, one in the first half and two in the second half, but, including the sales and purchasing environment, what is the current situation?
・ Can you provide details on the leasing, etc. of AKASAKA GREEN CROSS which is planned for completion in May 2024?

Answer

・ One building has been delivered in the first quarter and a contract has been signed for the delivery of another building in the fourth quarter. The initial plan was four buildings but, with the very favorable progress with leasing, we have postponed it to next fiscal year to avoid selling at a lower price and ensure profitable sales. We explained in the previous meeting that if the sales do not progress, we would like to cover for it with the sales of properties for urban redevelopment, but we are expecting that it can be covered by the United States Business as a whole. Postponed properties will contribute to increasing profit of the next term or beyond.
・ We have established a floor for developing startup companies, and we hope it will yield social contributions. The location is favorable, and we have high expectations for the floor layout. We are pleased with the leasing situation as well.

Question

・ What is the current state of orders for the homebuilding business in the United States?
・ How are the demands/inquiries for the multifamily business in the Unites States?
・ How certain is it to achieve the gross margin target for the Detached Houses and Rental Housing Businesses in Japan? Will there be further price changes?

Answer

- The current state of orders for detached houses in the United States does not require us to actively sell by adding incentives. Order backlog is higher than the previous year. For the usage of incentives, we may add some incentives to promote sales of properties that became completed housing stock due to cancellation or other reasons.
- As for inquiries, with the current deviation between prices proposed by purchasers and our desired prices, we do not intend to rush sales at a lower price. Many believe that the mortgage rate will decline in the latter half of the next year. If so, properties of other companies will also enter the market. That cannot be ignored, but we have confidence in our properties and we hope to sell them at an appropriate price.
- As the amount of deliveries in the first and third quarter is fewer than the second and fourth quarter, profit margin appears low. We will strive toward achieving the profit margin target set in the initial plan. As the size of properties is getting larger, there seems to be a tendency for the construction time to get slightly longer. We may need to consider a price change if material prices increase further, but we hope to cover for it with cost reduction efforts.

Question

- Mortgage rates in the United States are recently declining but what is the prospect for recovery of orders in the homebuilding business?
- What is the ratio of sales of properties for detached houses in the Real Estate and Brokerage Business? What is the reason for the improvement of profit margin?

Answer

- While mortgage rates were on the rise, orders peaked in August and slowed down after that. We were able to receive orders by adding incentives, etc. but houses sold with incentives have declined from around the latter half of November. There are several ways to look at the market conditions in the next fiscal year and beyond, but we think conditions will differ by region. Differences by region are evident by looking at Chesmar, which is located in the South, doing well, while the West Coast is having a slower recovery.

  (We estimate that second-hand properties will increase in circulation when the mortgage rate comes down to around 4%.)

  It depends on the person changing houses so it is not an universal indicator, but we think a mortgage rate of 6% is one index.
- For the first three months, properties for detached houses that Sekisui House real estate companies purchased will be sold in a way that Sekisui House will handle construction. After that, they may be sold to other builders or handled in other ways to make a turnover. Each company is exceeding a turnover rate of 1.0 and some are even exceeding a turnover rate of 1.3. For the breakdown of Real Estate and Brokerage Business, Sekisui House Real Estate makes up 76% of the overall sales of ¥199.1 billion. About ¥119 billion of that is from the sales of residential properties. It grew significantly, as it was about ¥83.7 billion in the previous fiscal year. There is also an increase in terms of profit. Sales and profit of residential properties have increased by about 40%. We are conducting sales while ensuring profit margin and with turnover rate

in mind.

Question

- What is the reason for the Real Estate and Brokerage Business doing well?
- What is the major reason for the gross profit increasing more than the net sales in the Urban Redevelopment Business? Can you provide separate explanations for profit from sales and for others?

Answer

- We think the business has potential for growth as this is just the first year of its full scale launch. We are working on the turnover through referrals from financial institutions and tax accountants that were consulted by customers looking for land. Recently, we are actively purchasing and selling land for logistics warehouses near highways.
- A large part is from the sales of properties. For hotels, inbound needs are recovering and net operating income is improving mainly in luxury hotels.

Question

- Occupancy rate fell 0.2p. Is this due to the rise in rental fees? What is the state of price increase and forecast for vacancy rates?
- What is the impact of the enforcement of energy conservation standards on demand?

Answer

- Owners greatly welcome the higher rental fees after the renovation when occupants change. Renovation is also welcomed by the occupants and some even move into the same rental housing. We believe the price change has no effect of lowering the occupancy rate.
- All our detached houses comply with the standards that will be enforced, as they have been a basic standard in our detached houses. When energy conservation standards are enforced, often times doors and windows need to be made smaller, which has a negative impact on the view. However, we are conducting presentations showing that ZEH and meeting energy conservation standards are possible even with large doors and windows by improving the performance of houses and sashes.