# Sekisui House, Ltd.

## Transcript for Question and Answer Session of the Management Plan Briefing for the Second Quarter of FY2022

Date: Friday, September 9th, 2022, 13:30–15:00

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

### < Summary of Question and Answer Session >

Note: The following generally omits the details of financial results presented in the Consolidated Financial Statements Summary or timely disclosure materials.

Question

Q1. What is the outlook for orders of Sha Maison ZEH?

Q2. Looking at your plan for profit in FY2023, I assume that rising interest rates in the United States will affect the overseas business, but what are the factors behind the increase in profit in Japan?

Answer

A1. Sha Maison ZEH accounted for 61% of built-to-order contracts in the first half of the fiscal year, up from around 40% in the second half of FY2021. It took about 10 years for the portion of custom detached houses that are ZEH to surpass 90%, so we have set the target of 90% Sha Maison ZEH by 2030. We expect its adoption to rapidly increase at some point to around 80% and then gradually climb from there. We have already surpassed 60% this fiscal year, so I think we may reach the target of over 90% sooner than 2030.

A2. As for forecasts for FY2023, I'd like to ask you to wait for the Sixth Mid-Term Management Plan, which we will announce in March 2023. Orders in the U.S. homebuilding business are currently slowing, but there are a number of factors that will help boost profit going into FY2023. One of these is the ongoing shift toward mid- to high-end products at Woodside Homes. The market includes some housing purchasing for investment purposes, but the customers of Woodside Homes are mainly owner-occupiers. Although the order environment is expected to remain harsh due to rising interest rates, I think that this will give us an advantage over other builders. In addition, we have an ample pipeline of properties in the U.S. multifamily business as well as properties in Australia and Singapore, and we will carefully consider the best timing to sell these. Our urban redevelopment business in Japan also has a strong pipeline of residential, hotel and commercial properties, so we will be able to realize property sales. Furthermore, to pass on rising costs we raised prices of steel-frame housing in June and August and, although we plan for a loss of ¥6.0 billion in the hotel business this year, we should see improvement when inbound tourism to Japan recovers. There are a variety of positive factors across our businesses, so we will consider the entire business portfolio as we make plans for the coming fiscal year.

Question

Q1. What is your policy going forward on investment and shareholder returns? What kind of ROE will you aim for?

Q2. Could you tell us about considerations related to future M&A in the United States?

Answer

A1. These policies will be laid out in the Sixth Mid-Term Management Plan, so I cannot yet provide details. However, we have been able to maintain a robust financial standing since the redemption of the hybrid bonds and have secured ¥200 billion for growth investment under the Fifth Mid-Term Management Plan as well as funds for real estate investment. As such, I think we will maintain a growth trajectory based on a similar or perhaps larger investment plan under the Sixth Mid-Term Management Plan. As for shareholder returns, we are currently discussing whether we should maintain the basic policy of the Fifth Mid-Term Management Plan or change it, so I will refrain from commenting at this time.

Under the Fifth Mid-Term Management Plan, we have targeted stable ROE of over 10%, so around 11% or 12%. ROE fell due to the COVID-19 pandemic, but going forward, as we see recovery from the pandemic's effects, we expect to reach our target. We are currently considering our overall financial strategy, including our approach to ROE and ROIC, as we work toward the Sixth Mid-Term Management Plan. Based on the characteristics of our businesses, we feel that we must prioritize efficiency, including with regard to ROE.

A2. In terms of investment in the overseas business, we anticipate an investment balance of around ¥2 trillion for the entire development business under the Sixth Mid-Term Management Plan. This will mainly be for inorganic growth, and we are not currently planning capital investment in factories or other facilities. In 2025 we aim to sell around 300 SHAWOOD homes, which will eventually require factory production, and from 2023 we plan to conduct pilot sales of about 60 SHAWOOD homes in California. We will announce management indicators for the overseas business, such as ROA, in the Sixth Mid-Term Management Plan.

I cannot go into detail about M&A, but there are two candidates with whom we have begun initial discussions.

Question

Q1. Could you tell us about price elasticity in the custom detached houses business, the rental housing business and the U.S. custom detached houses business?

Q2. What is your strategy going forward for the hotel business? Are you leaning toward selling the properties you currently hold when the timing is right, rather than bolstering investment? Can we assume these assets will mainly be held off balance sheet?

Answer

A1. In Japan, price elasticity for custom detached houses is higher than that for rental housing, and we will need to carefully consider the impact that the general rise in prices expected going forward will have on housing investment attitudes. Because of this, we are passing on the increased costs of custom detached houses only to the minimum extent necessary. However, with an average price of ¥45 million, our custom detached houses target high-income customers, so we probably face lower price elasticity than other companies. In addition, orders for rental housing have remained strong even since we implemented measures to pass on costs. High-added-value housing in good locations commands higher rents and offers advantages in terms of stable long-term management, yield and future asset value, so tolerance for price increases is high.

In the United States, as of the second quarter, delivery-basis unit sales prices were up 18.5% year on year for Woodside Homes and up 12% for Holt Homes. Woodside Homes secured a gross profit margin of more than 29% in the first quarter, thanks in part to highly profitable lifestyle proposal option contracts. In the second quarter, too, the margin was up seven percentage points year on year, and we are making progress in transitioning to a lean profit structure that will contribute to profit even if the number of homes sold does not increase.

A2. The strategy of the development business has not changed. Our condominiums business is centered on development in prime locations within the major metropolitan areas of Tokyo, Nagoya, Osaka and Fukuoka, as is the urban redevelopment business, including the hotel business. Under this basic policy, we analyze the location of each project to decide its use, such as for offices, a hotel or residences. In particular, when a location is well suited to a luxury hotel, we seek to proactively develop it as such. At the other end of the spectrum is our *Michi-no-Eki* Stations Project, which we are developing with the Marriott Group. Under this project, we are developing small hotels with around 50 rooms at roadside rest stations in regional areas, based on the concept of showcasing the deep appeal of Japan's regional areas to tourists from overseas. Partly as a way of contributing to regional revitalization, we will continue this project going forward.

Our basic assumption is that hotel holdings will be off balance sheet, but we are also considering actively holding certain flagship properties with very high asset value, such as super-luxury hotels.

## Question

Q1. How has Sha Maison ZEH been received by individual customers?

Q2. You mentioned that orders in the U.S. homebuilding business are slowing somewhat, but they were up by about 60% year on year in the three months of the second quarter. Could you tell us about this in more detail, including the contribution of Holt Homes to consolidated results, the effect of the cheaper yen and the impact of sales price revisions?

## Answer

A1. The strong performance of Sha Maison ZEH reflects growing interest in ESG issues and the SDGs among corporate customers, as well as rental housing proposals based on excellent locations and high added value. Individual customers have responded positively to proposals for rental housing that will still be sought after and competitive in 20 and 30 years, as Japan's population declines. One such proposal, which has been well received by individual customers, is Sha Maison ZEH equipped with photovoltaic power generation systems that have a capacity of more than 2 kw per unit, allowing tenants to sell electricity.

A2. Conditions for receiving orders began to worsen around June, but orders still increased significantly year on year due to the contribution of Holt Homes and the effects of the cheap yen. The order backlog as of the second quarter was up about 20% year on year on a value basis, and down about 20% on a volume basis. The cancelation rate rose to around 12%, and we expect it to rise further going forward, but our profit plan for the current fiscal year is set at a level that will not be affected even if the cancellation rate doubles. Chesmar Homes has already been included in the balance sheet and order backlog from the second quarter, and it will also contribute to revenue, including orders received, from the latter half of the fiscal year.

Question

Q1. Going forward, how will you improve ROE and other management efficiency indicators?

Q2. How are you approaching investment timing and pricing in the United States? Do you aim to gradually expand in the United States while seeing how things go over the long term? Or do you see this as an opportune time for making multiple investment in the short term?

Answer

A1. In terms of ROE growth, we are currently discussing our approach to using leverage going forward. Of our three business models—built-to-order, supplied housing and development—the built-to-order business has until now been our mainstay. We are considering how to optimally balance capital, including leverage, as greater weight shifts toward the development business, and we will present the results of these deliberations, including management efficiency indicators, in the Sixth Mid-Term Management Plan. In addition to increasing operational efficiency and real estate turnover, we hope to improve profit margins in the labor-intensive built-to-order and supplied housing businesses by investing in IT and applying DX technologies to raise efficiency, particularly as the numbers of units under management and orders received increase.

A2. As for the timing of investment in the United States, while rising interest rates have caused a decline in the housing market, the fundamentals of the economy are very strong. Under the Sixth Mid-Term Management Plan, we will once again aim for growth over three years and proactively pursue the M&A of companies that can share in our purpose. M&A in areas that we have not entered yet are promising in terms of synergies with the master-planned community business.

Right now, it's a buyer's market, but all market players, including sellers, share high expectations for the housing market over the medium to long term. The key things to look for will be potential for synergy with the Company and whether the companies in question could function as platforms for the SHAWOOD business in the future. Rather than timing or price, the perspectives we prioritize most will be alignment with the Company's philosophy and, as I said, whether candidates offer a platform that will work with the SHAWOOD business in the future.

Question

Q1. Could you tell us your thoughts about the overall housing market, including custom detached houses and houses for sale?

Q2. What is your outlook for the U.S. homebuilding business, particularly regarding sales prices, costs and number of homes sold?

Answer

A1. The domestic housing market fell in 2020 due to the outbreak of the COVID-19 pandemic but rebounded in 2021. Although we expected a correction this year as the market returned to normal, rising prices have made the current housing market quite challenging. In particular, it appears that low-cost builders are facing difficult conditions because of the rise in material prices.

A2. In the United States, average home prices continued to rise in July. More recently, some companies have lowered their prices by around 3%–5%, but this decrease follows an increase of more than 10%, so prices remain higher than they were two years ago, and we think they will most likely continue to rise going forward. At the same time, in part due to lower orders, the supply chain problems we were seeing have tapered off, so we do not expect the gross profit margin to fall far.

The number of houses sold is hard to predict. Focusing on completed inventory, inventory remains low compared to before the economic upturn, and we think it has room to increase. If the market environment takes a upturn, completed inventory will contribute to profit, so we see it as a positive factor for next year.

Question

Q1. Could you tell us about factors affecting rent levels for rental housing?

Q2. Please tell us about the sales environment for the U.S. multifamily business. Are you seeing changes in buyers or yields as rents increase?

Answer

A1. In the real estate management fees business, we are advancing a price leader strategy, supplying high-added-value rental housing in prime locations to lead local rent levels, and average rents for our more than 600,000 units under management are increasing. This increase in rents is due partly to the Sha Maison remodeling business; by remodeling older properties to have appealing interior layouts and exteriors, we have been able to increase rents and attract new tenants to maintain full occupancy.

A2. There has been no decrease whatsoever in the appetite for investment in multifamily properties among institutional investors. We have recently formed a contract that will be recorded in orders received for the third quarter, with sales recorded in FY2023. It is possible that the sales market could soften going forward, but we will work to time property sales to maximize sales prices. We have a number of properties with occupancy rates of more than 90%, and when occupancy is over 90%, we can expect to be able to raise rents. Paying close attention to buyers' appetite for investment, we will decide when during the three-year period of the mid-term plan to sell in order to maximize price.

Question

Q1. You mentioned that orders, based on number of units, were down around 20% in the U.S. homebuilding business; what period, from when to when, were you referring to? Also, is the increase in order value on a yen basis or dollar basis?

Answer

A1. The order backlog of Woodside Homes as of the second quarter fell about 20% year on year on a volume basis, but increased about 20% on a yen value basis.

Question

Q1. Could you tell us about why it is easy to find new buyers for properties after order cancellations in the U.S. homebuilding business?

Answer

A1. As in Japan, there is a deposit, but we do not discount the property's price by the amount of the deposit when putting it back up for sale. Currently, these properties are generally not selling within a month of being put back up for sale, but they are built-for-sale housing, so as long as we find a buyers by next year, they can be quickly delivered, contributing to sales.