Sekisui House, Ltd.

Transcript for Earnings Results Briefing for the Third Quarter FY2022
(WEB Conference)

Date	:	Thursday, December 8, 2022, 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 both net sales and operating income in the current third quarter. This was due to strong performance in the housing business, both in Japan and overseas, as well as steady property sales in the Development Business and Overseas Business.

Net sales increased by 15.5% year on year to ¥2,130 billion. Sales grew for all business models. Contributing factors include sales in the Built-to-Order Business of ¥67.1 billion, ¥32.3 billion in the Supplied Housing Business, ¥74.4 billion in the Development Business, and ¥107.4 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 14.2% to ¥438.2 billion. Gross margin decreased by 0.2p to 20.6%. Despite the impact of the sharp rise in the price of raw materials, high added-value proposals and cost reduction contributed to the Built-to-Order Business, while increased profit in the Development Business and Overseas Business contributed significantly to the improvement.

SG&A expenses increased by 9.4% to ¥235.7 billion. Personnel expenses increased by ¥9.7 billion due to increase in overseas subsidiaries. The SG&A ratio decreased 0.6p to 11.1%, partly due to the increase in net sales.

Operating income increased by 20.4% to ¥202.4 billion. Operating margin improved by 0.4p to 9.5%. Overall progress of the operating income achieved 78% of the 260 billion yen target set by the full-year plan.

Non-operating income/expenses decreased by ¥0.2 billion from the previous fiscal year to ¥0.1 billion. Foreign exchange gain/loss increased by ¥1.7 billion from the previous fiscal year to ¥2.9 billion due to the continued depreciation of the yen.

Equity in earnings/losses of affiliates decreased by ¥0.9 billion from the previous fiscal year to a loss of ¥1.7 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 20.1% year on year to ¥202.6 billion.

Extraordinary income was ¥16.8 billion after calculating the liquidated profit from the liquidation of a condominium project in Suzhou and Wuxi in China.

Including 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 ¥3 billion.

Quarterly net profit attributable to the owners of parent increased by 29.3% (¥33.9 billion) to ¥149.8 billion. EPS increased by ¥52.99 to ¥224.05.

[Page 4] Financial Position

Total assets increased by ¥277.6 billion from the end of the previous fiscal year. Assets of the Chesmar Homes acquired in July are included from the second quarter earnings results.

Current assets increased by ¥198.5 billion. Cash and deposits decreased by ¥175.8 billion. Real estate for sale increased by ¥309.1 billion to ¥1,485.7 billion. Domestic real estate increased by ¥6.9 billion and overseas real estate increased by ¥302.1 billion. In addition to the increase relating to the consolidation of Chesmar, there was an increase of ¥187.3 billion in effects of foreign exchange rates. Non-current assets increased by ¥79.1 billion. Property, plant and equipment increased by ¥36.7 billion. Goodwill from the consolidation of Chesmar, etc. was ¥36.2 billion.

Total liabilities increased by ¥117.3 billion due to an increase in borrowings, despite a decrease in accrued income taxes payable. Interest-bearing debt increased by ¥136.6 billion. Of the decline of approximately ¥65.5 billion in Japan and increase of ¥202.1 billion at overseas subsidiaries, the effects of foreign exchange rates were ¥95.4 billion. D/E ratio increased by 4.9p from previous fiscal year to 42.2%. Hybrid bonds of ¥120 billion were redeemed early in August by allocating cash-in-hand, etc.

Net assets increased by ¥160.3 billion. In addition to the increase in quarterly net profit, there was an increase of ¥102.1 billion due to cumulative foreign currency translation adjustments as depreciation of the yen continued. Equity ratio increased by 0.3p to 52.9%.

[Page 5] Cash Flow, Investment Status

Cash flow generated by operating activities decreased by ¥54.2 billion due to the increase in corporate tax payments, etc. Cash flow generated by investing activities decreased by ¥91.4 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 ¥95.1 billion. Cash used in financing activities decreased ¥27.2 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 third quarter amounted to 339.2 billion yen.

As for the investment situation, capital expenditures were ¥74.5 billion. Of this, investment in rental real estate comprised ¥62 billion.

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

Net sales in the Built-to-Order Business overall increased by 9.2% to ¥792.7 billion. Operating income was ¥80.7 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 increased by 1.9% to ¥259.8 billion. Sales increased due to robust receipt of orders continued from the previous fiscal year. Gross margin decreased by 1.4p to 25.1%. In comparison to the full-year plan of ¥19 billion, which including includes the Rental Housing Business and Houses for Sale Business and incorporates the effects of material price increase, progress was within the expected range. Operating margin decreased by 1.3p to 10.7%. Orders received was ¥256.4 billion The order backlog decreased by ¥3.4 billion. The ZEH ratio was 90%. ASP per building also increased by approximately 6.9% year on year to ¥45.58 million.

Net sales in the Rental Housing Businesses increased by 13.8% to ¥314.6 billion. Sales increased significantly in line with strong progress in construction. Gross margin decreased by 1.0p to 24.6%. Operating margin decreased by 0.6p to 13.7%. Orders received increased by 11.9% to ¥322.2 billion. Strong performance in Sha Maison rental housing covered the decline in non-residential areas. The adoption rate for Sha Maison ZEH increased to 63%. The unit price per building is ¥138.64 million, an increase of ¥12.08 million from FY2021. The ratio of three-to-four-story houses also remained high at 86.3%.

Net sales in the Architectural/Civil Engineering Business increased by ¥23.9 billion to ¥218.2 billion. Operating income decreased by ¥3.6 billion. This decrease was due to decline in profits margin caused by competition for orders in the industry and the rise in the price of raw materials. Orders received decreased by ¥27.8 billion to ¥207.9 billion.

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

Net sales in the Supplied Housing Business as a whole increased by 5.9% to ¥581.4 billion. Operating income increased by ¥0.6 billion to ¥57.4 billion.

Net sales in the Remodeling Businesses increased by 6.2% to ¥118.2 billion. Operating margin also improved by 0.3p to 16.0%. Remodeling remained strong in custom detached houses and rental housing. This strong growth was due to large-scale remodeling such as Family Suite Remodeling and increased use of subsidies from project to support child-rearing families to acquire housing. Remodeling proposals that are vital to long-term stable management of rental housing showed continued stable growth atop a strong customer foundation. Remodeling for rental housing made up ¥38.4 billion of the net sales. Orders received increased by 5.7% to ¥127.4 billion.

Net sales in the Real Estate Management Fees Businesses increased by 5.8% to ¥463.2 billion. Operating margin decreased by 0.7p to 8.3%. Despite the decrease in profit due to temporary increase in costs associated with the establishment of Sekisui House Real Estate Holdings, high occupancy was maintained while rent prices increased.

The number of units under management is about 687,000 with an occupancy rate of 97.9%. In the third quarter, tenants were replaced in 88,351 units and monthly rental fees increased by ¥191 million as rental fees continued to increase.

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

Net sales for the Development Business overall increased by 27.2% to ¥347.9 billion. Operating income increased by ¥11.2 billion to ¥40.1 billion. Sales and profit increased in all segments.

Net sales in the Houses for Sale Businesses increased by 27.9% to ¥172.5 billion. Gross margin decreased by 0.6p to 18.3%. Orders received increased by 22.5% year on year to ¥190 billion. Effort was put into ongoing purchases of land in prime areas. Land inventory increased by about ¥37.5 billion from the end of the previous fiscal year.

Net sales in the Condominiums Businesses increased by 11.4% to ¥57.1 billion. Operating margin also improved by 3.3p to 17.5%. 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 increased by 2.9% to ¥62.6 billion. Completed housing stock decreased by 109 units from the end of the previous fiscal year to 56 units.

Net sales in the Urban Redevelopment Business increased by ¥30.9 billion to ¥118.2 billion. Sales from the sale of properties were ¥89.7 billion. Projected operating income for the current year is expected to exceed the ¥11.5 billion target thanks to the progress of the sales of Prime Maisons to Reit and sales of developed properties. In the Hotel Business, occupancy is recovering thanks to the national travel discount program and mitigation of entry restrictions.

[Page 12] Results by Segment—Overseas Business

Net sales increased by 44.2% to ¥350.4 billion. Operating income increased by ¥27.1 billion to ¥61.1 billion. Operating margin also improved by 3.4p to 17.4%. Profit increased in the United States, Australia and China. Orders received increased by ¥101.2 billion to ¥374.4 billion.

[Page 13] Overseas Business—Details by Country

In the United States, net sales increased by ¥87.5 billion to ¥279.9 billion. To break this down, the multifamily business is scheduled to sell four properties this year in contrast to the completion of sales of properties in two projects received in the first half, making net sales of ¥39.2 billion, an increase of ¥11.1 billion from the previous fiscal year. The remaining two properties have been signed as well. In the master-planned community business, net sales remained flat at ¥52.5 billion. The homebuilding business increased net sales by ¥76.3 billion to ¥187.3 billion through consolidating the Holt Homes from the first quarter and Chesmar from the third quarter. Operating income increased by ¥18.9 billion to ¥50.1 billion. There was an increase in all three businesses, with ¥8 billion in the multifamily business, ¥17.1 billion in master-planned community business, and ¥25.9 billion in the homebuilding business due to improved profit and the contribution to profit from Holt Homes and Chesmar. Orders received increased by ¥97.6 billion to ¥302.9 billion. Of this, the homebuilding business increased by ¥54.3 billion to ¥181.1 billion. In addition to the net increase from consolidating two companies, there was an increase in orders received at Woodside Homes. There was a continued rise in unit prices and an improvement in the gross profit margin. In the immediate future for sales, along with the rise in mortgage interest rates, even if sales slowdown, gradual recovery backed by the lack of available pre-owned homes and the stable demand from Millennials is expected in the mid- to long-term. Based on thorough PMI of the three companies in charge of housing sales, we are working to improve earnings in the homebuilding business as well as adoption of Sekisui House technologies. The investment balance increased by ¥348.8 billion against the end of the previous year to ¥930.1 billion due to M&A and other factors.

In Australia, net sales increased by ¥23.8 billion to ¥47.1 billion. Operating income increased by ¥5.8 billion to ¥5.4 billion. The delivery of condominiums in Sydney, which had been delayed by the COVID-19 pandemic in the previous fiscal year, and the sale of properties made a contribution. Orders received increased by ¥21.8 billion to ¥67.2 billion. Custom detached houses and condominiums are expected to continue to be in adjustment phase while mortgage rates continue to rise.

In China, net sales decreased by ¥3.8 billion to ¥23.3 billion. Operating income increased by ¥2.7 billion to ¥6.8 billion. Delivery of properties in the city of Taicang was recorded. The order backlog is ¥0.3 billion. The investment balance decreased by ¥13.7 billion against the end of the previous year to ¥7.8 billion. Progress is steady toward the completion of all projects, including the liquidation of project companies in Suzhou and Wuxi.

In Singapore, the equity in earnings of affiliates increased by ¥0.2 billion from the previous fiscal year to ¥0.5 billion.

[Page 15] Full-year Plans

Full-year plans have not been revised from the plans released on September 8.

<Summary of Question and Answer Session>

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

Question

- What is the breakdown of orders during the third quarter in the homebuilding business in the United States and the outlook of adjustment phase?
- What is the outlook of the homebuilding business in Japan in the next year with cost pass-through effect and current state of material prices in consideration?

Answer

- We are currently discussing the forecast for the next year and beyond with three homebuilders in our Group. Currently, there is an increase in completed housing stock due to cancelations. We understand that some of the homebuilders are selling at reduced prices but the three homebuilders in our Group are considering to continue sales without reducing prices.
  Orders received were ¥32.9 billion/337 units at Holt Homes and ¥18.6 billion/273 units at Chesmar.
  Order unit price in local currency was $486,000 for Holt Homes as of end of September in the previous year.
  Average sale price at Chesmar was $445,000.
  At Woodside, orders received were ¥127.5 billion/1,292 units compared to ¥126.7 billion/1,977 units in the previous year.
  Order unit price in local currency was $654,000 compared to $542,000 in the previous year.
- Impact of rising material prices is expected to not only impact the Custom Detached Houses Business and also Rental Housing Business by ¥19 billion. Cost pass-through effect is expected to appear after next year.

Question

- How were the extraordinary incomes in the third quarter compared to the company plan?
- What is the forecast for the material price in Japan?

Answer

- Liquidation of project company in Wuxi was not included in the extraordinary income under our plan.
- It is difficult to make a forecast but the prices are currently declining. We understand that procurement costs for general contractors are still increasing but are hoping to improve profit through cost pass-through.

Question

- What are the planned property sales in the Urban Redevelopment Business and the occupancy of hotels.
- What is the forecast for the master-planned community business in the United States next year?

Answer

- There are no planned property sales in the fourth quarter. Currently, occupancy of hotels and average daily rate are increasing but are still at a loss. If restrictions on activities and entry continue to be lifted, we can expect a recovery.
- With the slowdown of homebuilding business, purchases of land by homebuilders are on the decline. We expect master-planned community business will also enter an adjustment phase like the homebuilding business.

Question

- What is the investment policy for the businesses in the United States?
- What are the investment needs of buyers in the multifamily business in the United States?
- Can you give details about the Sixth Mid-Term Management Plan?

Answer

- We are targeting to supply 10,000 units in 2025 in overseas markets. We are planning to supply 7,000 to 8,000 units in the United States, which is the main focus area. The current total of three homebuilders in our Group is approximately 3,800 units. We are considering how much this should be increased as well as search for a homebuilder around the Florida, which has the second largest supply of houses. This will lead to increase in investment balance but we expect that businesses in the United States will boost our growth as its population is continuing to grow and having a demographic structure with large number of Millennials and Generation Zs.
- Interest in investment decreases as interest rate increases, but rent price is also currently increasing. Our policy is to not rush sales when conditions are undesirable and continue holding the property.
- We are currently reviewing the new plan with a target of a greater growth in profit than the Fifth Mid-Term Management Plan with all businesses combined. Return policy in the Sixth Mid-Term Management Plan is still being actively discussed.

Question

- What was the cause of decline in profits in the Real Estate Management Fees Business?
- What is situation of mortgage rate in the Unites States?

Answer

- Major factor of the decline was the increase in personnel expenses due to the establishment of Sekisui House Real Estate Holdings and increase in costs due to changes in the management system. We expected its impact to be offset in the full-year.
- Mortgage rate exceeded 7% at one point but is currently around 6.4%. A lower mortgage rate does not translate immediately to sales recovery and we are reported that the current holiday season is not a desirable sales timing. Depending on mortgage rates, we believe the next raise in demand will the housing sales season in the spring.

Question

- What is the shareholder return policy for the next year?

Answer

- We cannot say for certain at this point. We plan to maintain the payout ratio of 40% as planned in the Fifth Mid-Term Management Plan and return higher dividend for the current year but the Sixth Mid-Term Management Plan is still being discussed. We appreciate your understanding.