Aiming at sustained growth through effective use of shareholders' equity while maintaining financial health

Corporate Governance—making possible our contribution to society and value creation for our shareholders

By providing products and services essential to society, Daiwa House aims to enhance its enterprise value through value creation for shareholders, customers, employees, business partners and society.

To achieve this objective, we strive to meet society's needs as a group that co-creates value for individuals, communities, and people's lifestyles through business developments in a wide range of areas, proactive innovation and the cultivation of new fields (Contributing to Society); to generate economic value that stably exceeds the medium- to long-term cost of capital (Shareholder Value Creation); to pursue excellent corporate governance that maintains or enhances the high level of both aspects; and contributes to their ongoing fulfillment.

Aiming to achieve both active growth investment and financial stability

Achieving sustained growth is essential to raising shareholder value over the medium to long term, and to realize sustained growth, we must make vigorous growth investments. At the same time, we must continue to ensure that our financial base is sound, so as to enable the procurement of the funds required for stable growth investment. It is thus vital for us to maintain a balanced approach that secures both these business aspects.

From this perspective, we have positioned ROE as a high-priority management indicator, and we are working to ensure effective utilization of shareholders' equity. Simultaneously, we will aim to maintain shareholders' equity at a level within our risk tolerance by holding the debt-equity ratio—an important indicator of financial soundness—to around 0.5.

Under the Group's Fifth Medium-Term Management Plan (fiscal 2016-2018), we have set the benchmark for ROE at a minimum of 10%, but in fiscal 2016, the first term of this plan, ROE easily cleared this bar, reaching 16.3%. Going forward, we will continue working toward the effective utilization of shareholders' equity, so as to raise capital efficiency and achieve Shareholder Value Creation.

We target total growth investment of ¥900 billion over the three years of the current plan, of which ¥700 billion will be invested in real estate development, ¥150 billion will consist of capital investments, and ¥50 billion will be invested in M&As. Of the total investment in real estate development, ¥600 billion will be invested in the Japanese market in three businesses—Rental Housing; Commercial Facilities; and Logistics, Business and Corporate Facilities. The remaining ¥100 billion will be invested overseas, mainly in the US, Australian, and ASEAN markets. One of the purposes of these investments will be to expand and improve our marketing system, including our ability to attract new orders.

During fiscal 2016, the initial year of the current three-year medium-term management plan, investments were made in the amount of ¥359 billion, or 40% of the total planned investment of ¥900 billion. The pace of investment turned out to be somewhat faster than we had anticipated.

On the other hand, the balance of interest-bearing debt as of the end of fiscal 2016 (March 31, 2017) amounted to ¥640.6 billion, for an increase of ¥148.7 billion over the previous year-end, while the debt-equity ratio stood at 0.49 times.

The role of the Group's Administrative Division

Nobuo Ishibashi, the founder of Daiwa House, always used to say that the accounting and finance departments were the linchpin of a company's management. He also used to say that the top officers of a company's administrative division were second in importance only to the heads of the company's branches, and that the main responsibility for the success or failure of the business operations undertaken by a company's branches rested on the shoulders of the top officers at its administrative division. This attitude to corporate management is still very much alive and well at the Daiwa House Group today, and as a result, the administrative officers stationed at our domestic and overseas branches, as well as the officers in charge of the administrative divisions of Group-member companies, play a crucial role in ensuring correct corporate governance at each organization to which they belong.

A particularly important responsibility of ours in the Finance Department is to make the funds needed for business activities available to the business divisions. For this, it is vital to have a sound financial base that is able to raise the amount of funds needed, at the right time, and to ensure that we do not have to scramble to procure funding at times of emergency.

The Group was able to swiftly and flexibly handle the late-2000s global financial crisis sparked by the bankruptcy of Lehman Brothers in 2008, thanks to our high AA* credit rating.

Shareholder return

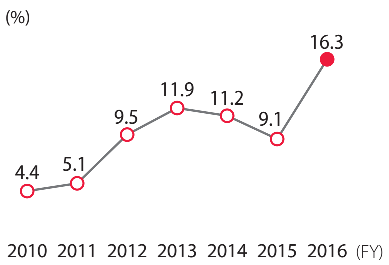
The Daiwa House Group follows a basic policy of investing the profits generated by its business operations into growth areas, thereby increasing its shareholder value by raising net income per share (EPS). We link shareholder return to business performance and maintain a stable level of dividend payments, maintaining a dividend payout ratio of 30% or higher of net income attributable to owners of the parent. Cash dividends per share for fiscal 2016 were initially planned at ¥80, but as EPS exceeded the original target, this was increased to ¥92 per share, for the seventh consecutive business term of increase.

Going forward, in order for the Group to achieve continued growth and allow us to meet the expectations of our shareholders and investors, I will fulfill my responsibility as CFO by working to further raise shareholder value.

I hope that our shareholders and investors will continue to support and encourage the growth of the Daiwa House Group.

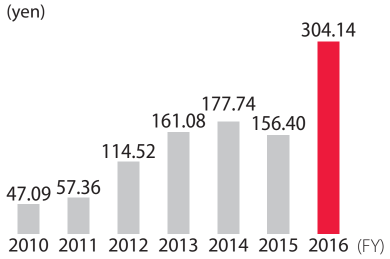
* (Long-term) Issuer Ratings: Rating and Investment Information, Inc. (R&I) AA-
Japan Credit Rating Agency, Ltd. (JCR) AA

Return on equity (ROE)

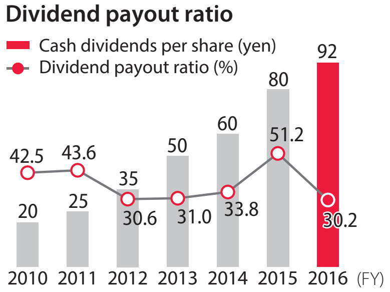


Note: By changing the discount rate used to calculate retirement benefit obligations from 1.7% to 0.8% in fiscal 2015, the Company posted extraordinary losses of ¥84.9 billion. As a result, the ROE dropped to approximately five points.

Net income per share (EPS)



Cash dividends per share and Dividend payout ratio



Takeshi Kosokabe

Takeshi Kosokabe
Representative Director and
Senior Managing Executive Officer and CFO

<Our responsibility>

"What I want to say here is that we have responsibilities.

Our first responsibility is to our shareholders. Our second responsibility is to our creditors. Our third responsibility is to ensure the livelihoods of our employees and their families and to provide them with stable lives. Our fourth responsibility is to society. Accordingly, we are obligated to further grow and develop the company, raise profits and return those profits to society.

To develop, we must cultivate various qualities within ourselves, such as a positive attitude, the ability to take swift action and cost-consciousness. Therefore, sloppy management cannot be tolerated in any way."

The Future of the Daiwa House Group: Nobuo Ishibashi (October 29, 1963)

("The Future of the Daiwa House Group") ▶P.15

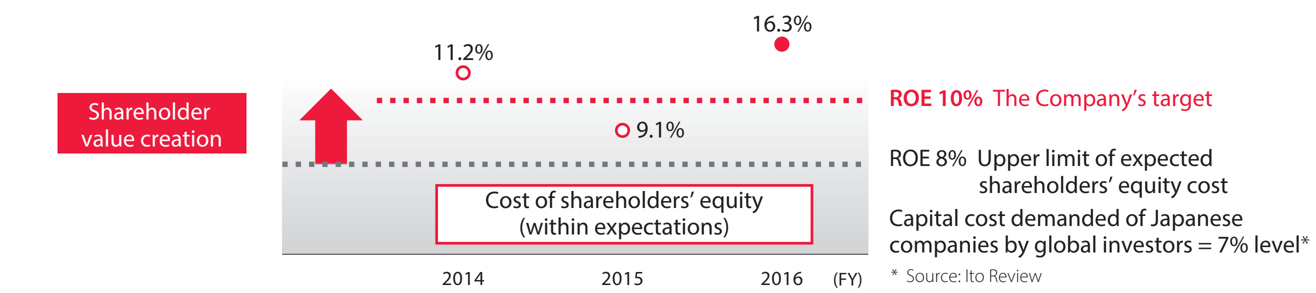
Basic Strategy for Capital Policy

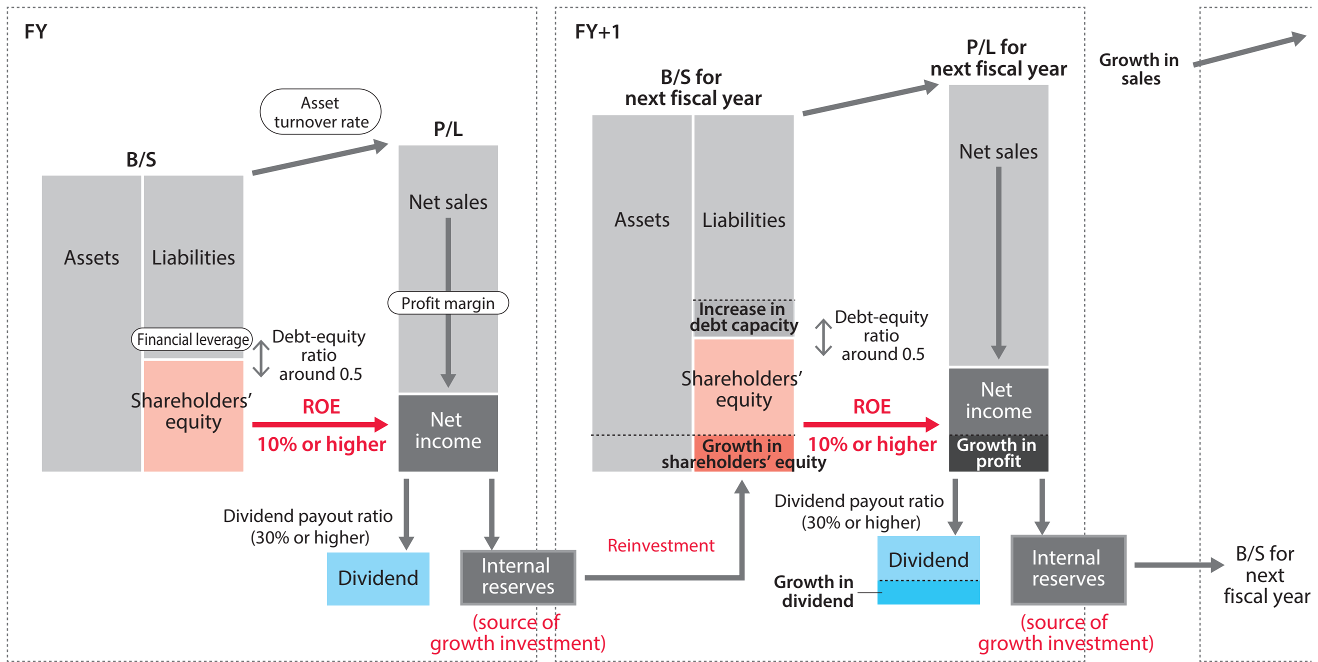
Basic strategy for capital policy

Considering sustained growth necessary to achieving increases in shareholder value over the medium to long term, the Company recognizes the need to maintain a level of shareholders' equity that allows for investment in growth and a tolerance for risk.

Considering return on equity (ROE) to be one of its topmost management priorities, the Company discloses its targets. To effectively deploy shareholders' equity and ensure a robust financial base that allows for the raising of funds for investment in stable growth, the Company discloses its target debt-equity ratio and other measures for financial soundness and works to create the optimal capital structure for reaching these targets.

Conceptual diagram of basic strategy for capital policy





FY

We are reinvesting capital in growth sectors while maintaining an appropriate level of financial leverage by securing operating cash flow, the source of funds required for growth investment, and increasing internal reserves after returning a portion to shareholders.

Secure stable operating cash flow

FY+1

The Company will realize return on reinvested capital with capital efficiency that exceeds the expected rate of return (cost of shareholders' equity) for shareholders in order to achieve growth in profits and dividends, as well as increase capital required for new growth investment.

Maintaining and improving ROE based on an optimal capital structure

Management's Discussion and Analysis of Financial Position and Results of Operations

[MD&A summary]

Note: This section analyzes the financial position and results of operations during the seven fiscal years from fiscal 2010 to fiscal 2016. For the list of financial data for these seven fiscal years, see "Financial Highlights" on pages 85 and 86.

Ⅰ. Financial position

Financial condition Figure 1

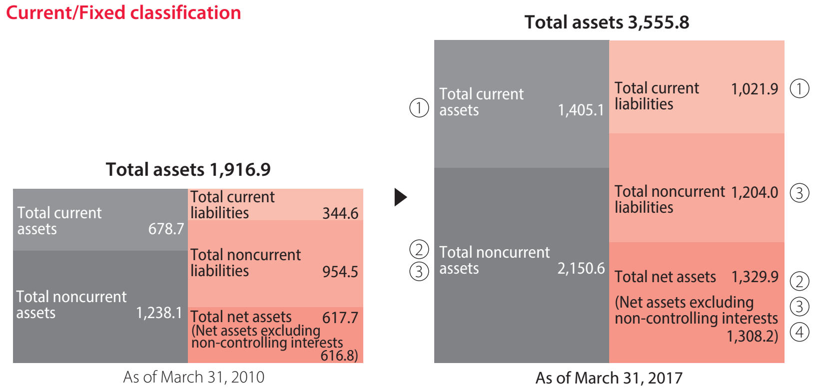
Total assets as of the end of fiscal 2016 increased by ¥298.0 billion from the end of the previous fiscal year to ¥3,555.8 billion. This was mainly due to the increase of property, plant and equipment through the acquisition of investment real estate. Total liabilities increased by ¥150.1 billion from the end of the previous fiscal year to ¥2,225.9 billion. This was mainly due to financing obtained by the Company through the issuance of corporate bonds and loans.

Total net assets increased by ¥147.9 billion from the end of the previous fiscal year to ¥1,329.9 billion. This was mainly because a net income attributable to owners of the parent of ¥201.7 billion was recorded.

The balance of interest-bearing debt increased by ¥148.7 billion from the end of the previous fiscal year to ¥640.6 billion and the debt-equity ratio was 0.49, which fell within the rough standard of approximately 0.5. The net assets ratio was 36.8% and remained at a favorable level in comparison with the balance sheets at the end of fiscal 2009 and the starting point of fiscal 2010. In terms of the breakdown of assets, the balance of real estate for rent was ¥924.8 billion and accounted for a large share in recent years. As assets are expected to grow in the future due to the acquisition of real estate for development and other factors, we will seek to maintain financial health by verifying the optimal capital structure.

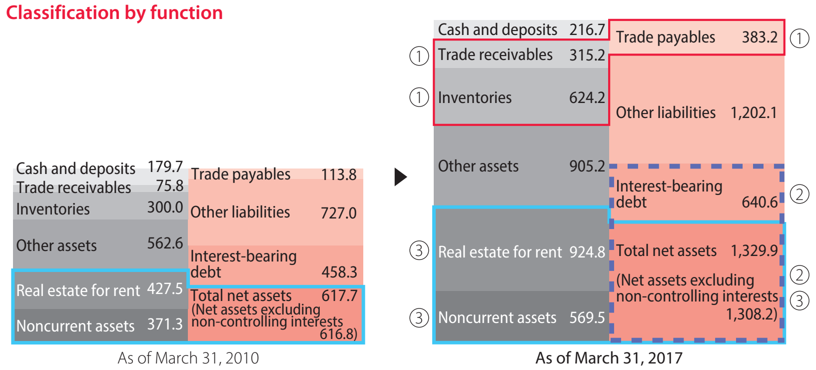
Figure 1 Comparison of balance sheets (¥ billion)

Current/Fixed classification



①The current ratio dropped from 197% to 137%.
②The fixed ratio dropped from 200% to 164%.
③The ratio of fixed assets to long-term capital rose from 78% to 85%.
④Net assets excluding non-controlling interests grew from ¥616.8 billion to ¥1,308.2 billion.

Classification by function



①Working capital (Trade receivables + Inventories - Trade payables) increased from ¥262.0 billion to ¥556.3 billion.
②Interest-bearing debt increased from¥458.3 billion to ¥640.6 billion, but the debt-equity ratio fell from 0.74 to 0.49.
③The ratio of real estate for rent and noncurrent assets to net assets excluding non-controlling interests fell from 1.29 to 1.14 while real estate for rent increased.

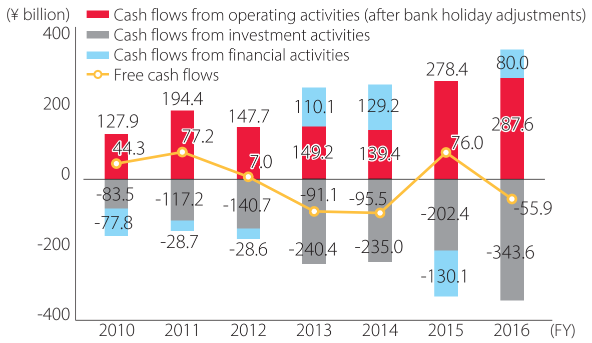
Management's Discussion and Analysis of Financial Position and Results of Operations

II. Cash flows

Basic approach

Our basic approach to cash management is to set investment limitations based on the amount of cash generated from business activities. However, for any favorable investment opportunities that are spotted, we quickly raise funds from external sources to make aggressive investments. As a rule, when implementing this policy, we seek to maintain a balance between growth investments and financial health by setting a debt-equity ratio at around 0.5 to control the level of interest-bearing debt.

Figure 2 Cash flows



Cash flow condition Figures 2 & 3

Cash flows from operating activities during fiscal 2016 increased by ¥9.1 billion from the previous fiscal year to ¥287.6 billion. The ratio of cash flows from operating activities to net assets excluding non-controlling interests remained at a relatively high level compared to that of several years ago, although it decreased by 2 points from 24% of the previous fiscal year to 22%.

In terms of cash flows from investment activities, outflows increased by ¥141.1 billion from the previous fiscal year due to the acquisition of real estate for rent, etc. and the implementation of the ¥280.6 billion investment into the real estate development business based on the investment plan under the Fifth Medium-Term Management Plan. As a result, free cash flows (cash flows from operating activities + cash flows from investment activities) were - ¥55.9 billion while cash flows from financial activities were ¥80.0 billion because of the response to demands for funds through bond issuance, loans, etc.

As a result of the above, the balance of cash and cash equivalents at the end of fiscal 2016 was ¥213.3 billion, an increase of ¥24.3 billion from the end of the previous fiscal year. This is equivalent to 16% of net assets excluding non-controlling interests . We believe that this is within an appropriate range as a level of cash on hand although the ratio itself is on a downward trend.

Figure 3 Indices to net assets excluding non-controlling interests (as a ratio where net assets excluding non-controlling interests is equal to 1)

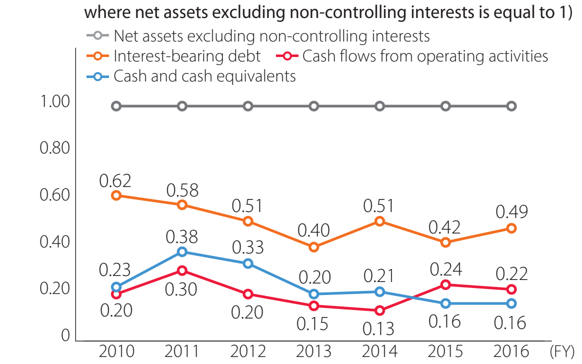
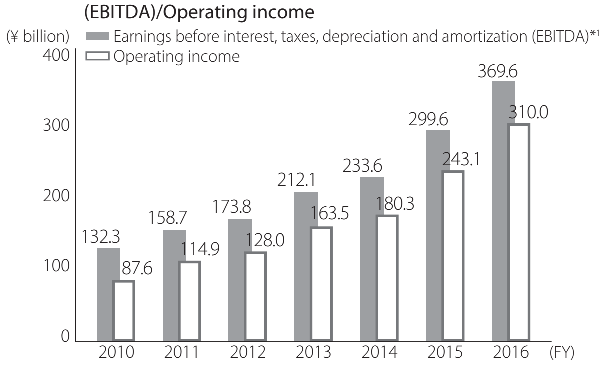


Figure 4 Earnings before interest, taxes, depreciation and amortization (EBITDA)/Operating income



*1 Earnings before interest, taxes, depreciation and amortization (EBITDA) = Operating income + Depreciation

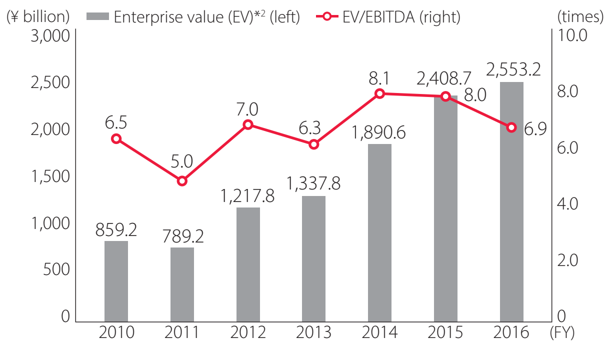
Enterprise value/Ability to generate cash Figures 4 & 5

Our ability to generate cash steadily grew as earnings before interest, taxes, depreciation and amortization (EBITDA)*1 as an indicator of ability to generate cash were ¥369.6 billion. We will further enhance the ability to generate cash and improve enterprise value by continuing the policy of maintaining interest-bearing debt at a certain level and aggressively investing in favorable investment projects, as well as by developing new revenue streams.

The enterprise value (EV)*2 at the end of fiscal 2016 was ¥2,553.2 billion, a sum of the market capitalization of ¥2,129.2 billion and the net interest-bearing debt of ¥423.9 billion.

The EV/EBITDA ratio, as an indicator of enterprise value to the ability to generate cash, was 6.9 as of the end of fiscal 2016.

Figure 5 Enterprise value (EV)/EV/ EBITDA



*2 Enterprise value (EV) = Market capitalization + Net interest-bearing debt

III. Profits and losses

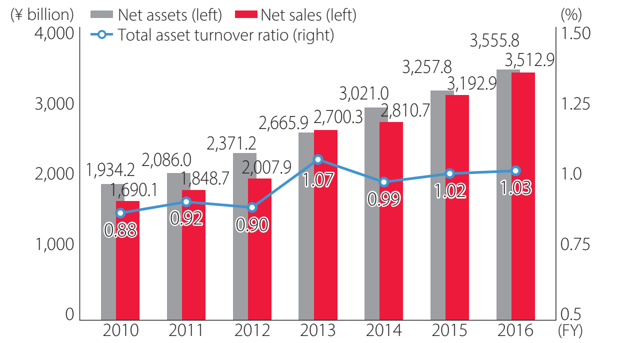
Net sales/Total asset turnover ratio Figure 6

Net sales amounted to ¥3,512.9 billion and the average growth rate for the period of seven years starting from fiscal 2010 was 12.2%.

In terms of the total asset turnover ratio, the period of four years from fiscal 2013 to fiscal 2016 shows a tendency of slight improvement in comparison to the performance in the period of three years from fiscal 2010 to fiscal 2012.

To further improve the turnover ratio, we will continuously seek to ensure the effective utilization of assets, such as the sale of some strategically held shares through a review of such shares.

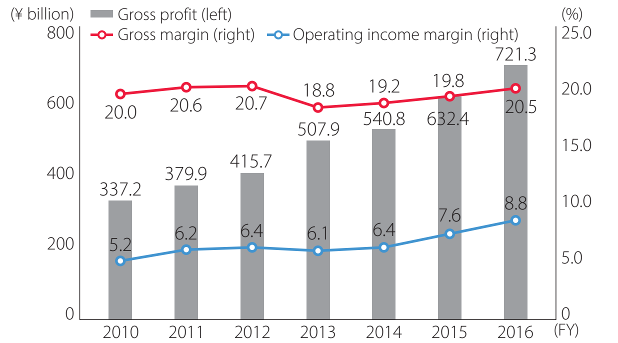
Figure 6 Net sales/Total asset turnover ratio



Gross profit/Operating income margin Figure 7

Gross profit amounted to ¥721.3 billion and the average growth rate for the period of seven years starting from fiscal 2010 was 13.1%. The gross margin increased by 0.7 points from the previous fiscal year to 20.5%. Operating income was ¥310.0 billion and the average annual growth rate for the period from fiscal 2010 was 26.1%. The operating income margin was 8.8%, an increase of 1.2 points from the previous fiscal year. This is because we successfully maintained the cost-of-sales ratio at a certain level through investments in production facilities and rationalization of production to deal with soaring construction materials and labor costs, and because the SG&A ratio was reduced.

Figure 7 Gross profit/Operating income margin



Return on invested capital (ROIC)/Return on equity (ROE) Figures 8 & 9

Net operating profit after tax (NOPAT)*1 was ¥214.5 billion and return on invested capital (ROIC), a ratio of NOPAT to the invested capital (= Net assets excluding non-controlling interests + Interest-bearing debt) of ¥1,805.6 billion*2, was 11.9%. One of the Company's business objectives is to earn an ROE of 10% or more. Since we are expanding our businesses by means of loans and the like where the debt-equity ratio of 0.5 is used as a guide, we make a conscious effort in our business investments to ensure that the return on the total invested capital will exceed the weighted average cost of capital (WACC), which is the weighted average of the cost of shareholders' equity and cost of liabilities. We will seek to maintain and improve the return on equity (ROE), a ratio of net income to shareholders' equity by maintaining and improving the ROIC.

*1 Net operating profit after tax (NOPAT) = Operating income × (1 - Effective corporate income tax rate)

*2 Average during the fiscal year.

(Details of the criteria for adoption of investments in real estate development) ▶P.77

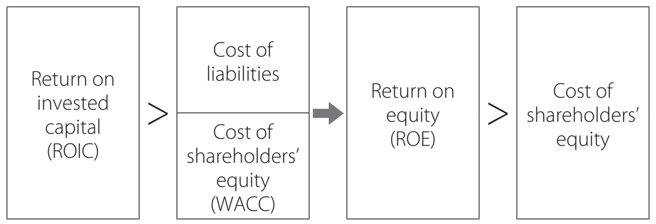


Figure 8 Return on invested capital (ROIC)

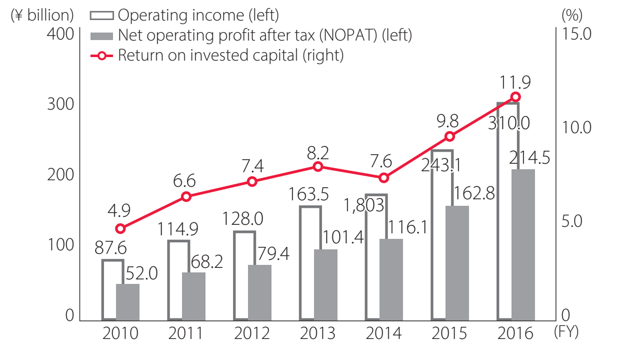
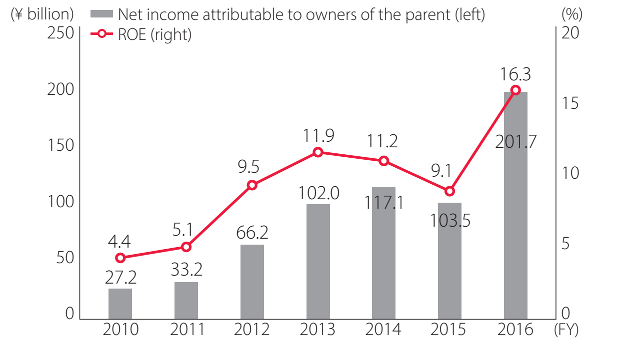


Figure 9 Net income attributable to owners of the parent/ROE



Note: By changing the discount rate used to calculate retirement benefit obligations from 1.7% to 0.8% in fiscal 2015, the Company posted extraordinary losses of ¥84.9 billion. As a result, the ROE dropped to approximately five points.

Management's Discussion and Analysis of Financial Position and Results of Operations

IV. Business results by segment

Growth potential analysis Figure 10

The profit growth rate for fiscal 2016 over fiscal 2010 showed an over six-fold increase in the Logistics, Business and Corporate Facilities, and Other Businesses segments, and an over three-fold increase in the Existing Home Business and Commercial Facilities segments. Since the Rental Housing segment had been already at a high level of profit seven years ago, its profit growth rate over fiscal 2010 was relatively low, but remained at a high profit rate.

One of the Company's strengths is its ability to make business proposals with no gap between business segments. As society changes at an accelerated pace, we anticipate that multiple products and services held by individual business segments will be combined in order to cope with diversified construction needs and that there will be a further increase of new business opportunities through business development in peripheral areas. In order to ensure that these new markets will lead the company-wide growth rate, we will make an effort to grow in view of a balance with overall profitability.

Profitability analysis Figure 11

In terms of operating income, three segments, Rental Housing, Commercial Facilities, and Logistics, Business & Corporate Facilities, accounted for 81% of the total. The Existing Home Business segment constituted 2.9% of net sales, but its profit rate and capital efficiency were high (Figure 12) and its market is expected to grow. Therefore, we will aggressively work on this business in conjunction with the efforts of the pre-owned home renovation business. In terms of the Single-Family Houses and Condominiums segments, we will seek to improve their profit rates by selecting areas and clarifying targets as new housing starts are decreasing in number due to falling population.

Operating income margin to segment assets Figure 12

The Existing Home Business, Rental Housing, and Commercial Facilities segments showed higher operating income margins to segment-specific assets. The current return on assets in the Logistics, Business & Corporate Facilities segment is at a low level because we are making aggressive investments to address the rapidly growing market for logistics facilities. However, this segment is expected to significantly contribute to cash flows at the time of payback in the future.

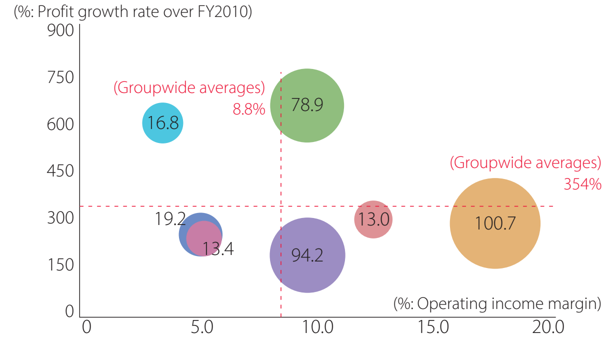
Investments in businesses Figure 13

With regard to investments in businesses, we are aggressively investing in the Logistics, Business & Corporate Facilities segment, which is highly profitable and shows a high growth rate. We are also investing in the Commercial Facilities and Rental Housing segments, both of which are the second-most profitable. In addition, investments in the Other Businesses segment (overseas) are being made to develop new revenue streams through the use of funds generated by the above-mentioned core segments.

(For the progress of investments in real estate development and the balance of investment real estate for the period of the Fifth Medium-Term Management Plan, see the charts on Page 26.)

[Business segments]
Single-Family Houses / Rental Housing / Condominiums
Existing Home Business / Commercial Facilities
Logistics, Business and Corporate Facilities / Other Businesses

Figure 10 [Business segments] Operating income*1/Operating income margin/Profit growth rate over FY2010



*1 The size of the circle depends on the relevant amount of operating income for FY2016.

Figure 11 [Business segments] Operating income margin/Net sales ratio by segment (FY2016)

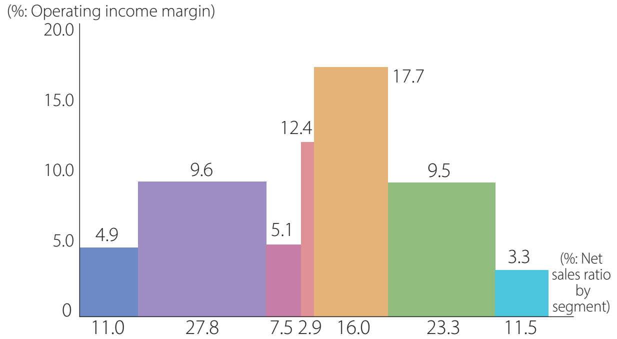
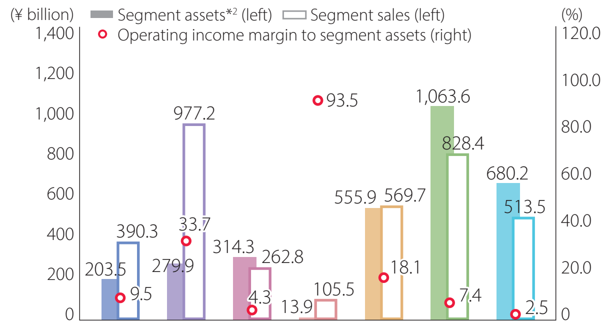
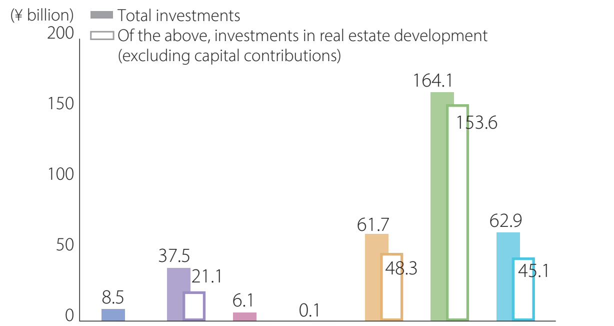


Figure 12 Operating income margin to segment assets (FY2016)



*2 Segment assets are averages during the fiscal year.

Figure 13 [Business segments] Total investments (FY2016)



V. Investments

Investments and returns for employees Figures 14 & 15

One of the essential elements for sustaining growth is to invest in the development of human resources and to maintain and improve the living environment of employees. The human resources development costs*1 for fiscal 2016 were ¥440 million (on a non-consolidated basis), 76% up from fiscal 2010 (Figure 15). Employee salaries on a non-consolidated basis increased by ¥37.3 billion from fiscal 2010 (an average increase of 23% or ¥1,642,000 per employee).

Meanwhile, the ratio of employee salaries to operating income*2 decreased from 62% in fiscal 2010 to 40% in fiscal 2016, and the growth rate of profits significantly exceeded the rate of increase in personnel costs. As a result, we have successfully secured funds for growth investments and increased returns to shareholders, and will actively promote investments in human resources, which are the most important source for growth.

*1 Personnel costs on training, etc. + Transportation costs on training
*2 Employee salaries/(Operating income + Employee salaries)

(Details of our human resources development) ▶P.56

Investments in research and development (R&D) Figure 15

R&D expenditures in fiscal 2016 were ¥8.3 billion, of which ¥4.3 billion was for the housing business, ¥2.6 billion for the general construction business, and ¥1.3 billion for other businesses. Our research and development activities range from basic and applied research to the development of new technologies and new products, and further to utilization and verification of these new technologies in architectural structures and urban development.

(Details of our research and development) ▶P.62

Capital investments Figure 16

Capital investments of ¥77.1 billion (excluding investments in real estate development) were mainly for replacing production lines in plants to increase production efficiency and for renovating plant facilities. Well-planned investments in production lines are carried out based on market trends, order trends, and other factors. With regard to major assembly processes in particular, which are a significant element affecting the cost-of-sales ratio and quality improvement, we will work on further increasing the rate of automation.

(Details of our technology and manufacturing base) ▶P.61

IT-related investments Figure 17

IT-related investments involve significant elements that may lead to revenue increases and cost reductions in the future, such as through the enhancement of added value in products and services, through utilization in marketing, and through the achievement of higher efficiency in production processes and operations. Therefore, we will actively work on such investments by combining the injection of more funds with the improvement of the organizational structure.

(Major efforts for strategically utilizing IT) ▶P.64

Figure 14 Ratio of employee salaries to operating income (non-consolidated)

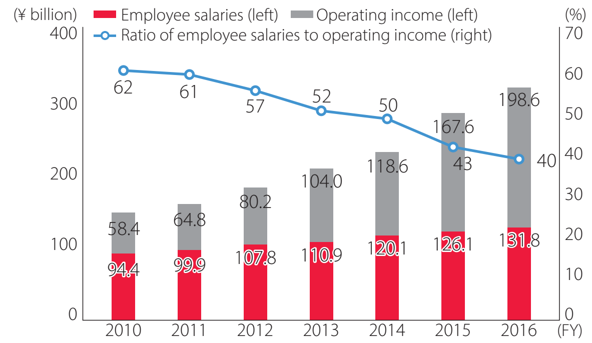


Figure 15 Research and development expenditures/Human resources development costs

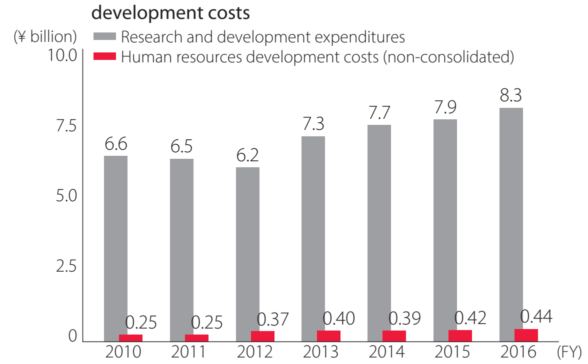


Figure 16 Capital investments (excluding investments in real estate development)

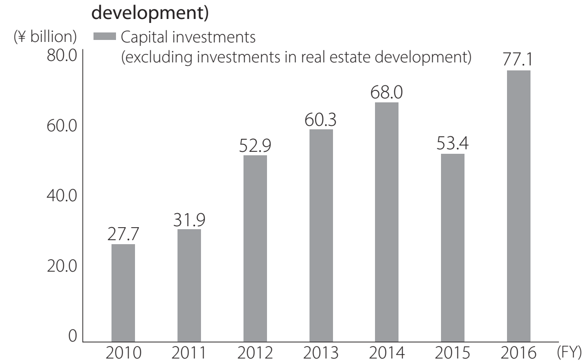


Figure 17 IT-related investments