Continue growth investment while maintaining financial soundness and execute management strategy with focus on capital efficiency

Takeshi Kosokabe

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Executive Vice President and CFO

Financial strategy balances financial soundness and growth investment

Maintained financial discipline despite debt-equity ratio over 0.5

In fiscal 2020, our debt-equity ratio was 0.69*, above our financial discipline benchmark of 0.5. This was in response to demand for working capital during the pandemic from Group companies that manage hotels and sports facilities, and upfront investment in real estate developments that will be the source of future earnings. We think that bringing the ratio back down to about 0.5 over the next year will be difficult, as we expect conditions to be largely unchanged in fiscal 2021. Our financial strategy is based on the idea that we should seize new business opportunities even if we temporarily exceed our leverage benchmark. Our commitment to certain KPIs—ROE for shareholders and debt-equity ratio for creditors—is unwavering. We will continue working to reduce leverage to about 0.5 in the Seventh Medium-Term Management Plan from fiscal 2022, taking into account the operating environment and individual businesses' investment/divestment plans.

* 0.59 after factoring in the equity credit attributes of hybrid bonds and hybrid loans

Flexible fundraising to maintain financial soundness

I see a healthy balance sheet as critical for sustainable growth. We have raised funds to lower our debt-equity ratio, including ¥150 billion worth of hybrid bonds in a public offering in September 2019 and ¥100 billion via a hybrid loan in October 2020, aimed at maintaining our AA credit rating. Having witnessed the difficulty that companies rated A or lower had in raising funds and issuing bonds in the wake of the 2009 Lehman Brothers collapse, I think that maintaining our credit rating is important to ensure we have ample leeway to make investments even in tough economic times.

In September 2020, we issued ¥20 billion worth of green bonds to fund our efforts to reduce our environmental impact, such as developing eco-friendly facilities and using renewable energy. Amid rising awareness of environmental issues around the world, we are building environmentally conscious businesses as evinced by our long engagement in reducing CO_2 emissions and energy consumption. We intend to redouble our efforts going forward.

Solid progress in real estate investment and sales during pandemic

Increased real estate investment with focus on logistics facilities

We have a proactive approach to real estate investment. We foresaw increased demand for logistics facilities as e-commerce drove logistics volume amid mounting stay-at-home demand during the pandemic. In June 2020, we boosted our budget for investment in logistics facilities during the Sixth Medium-Term Management Plan by ¥300 billion to ¥650 billion. We are developing properties on sites we have purchased and aim to have these completed, occupied, and sold as soon as possible.

Diversified asset categories to spread risk

In our investment real estate portfolio, occupancy rates for hotels, serviced apartments, and commercial facilities have temporarily worsened due to the pandemic, but occupancy at logistics facilities—which comprise the lion's share of our real estate portfolio—remains solid and they continue to draw enquiries about availability. We nevertheless recognize that this overdependence on logistics assets also carries certain risks and think a balance across our traditional areas of rental housing, commercial facilities, and nursing care facilities would be ideal. Going forward, we will extend investment other types of properties, such as data centers, to diversify our asset portfolio.

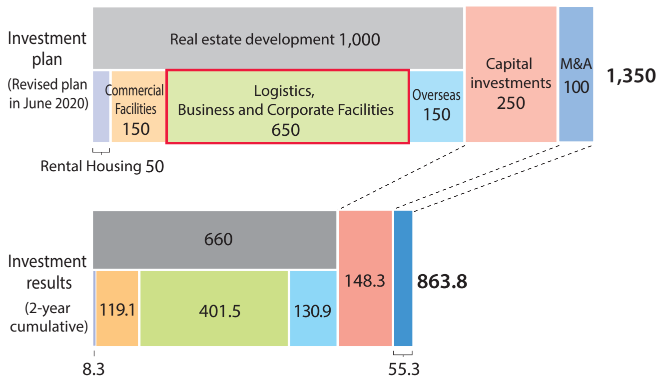
Diversified exit strategies to bolster our ability to generate cash

We use the internal rate of return (IRR) as a benchmark for new investments. Our hurdle rate is set above our cost of capital, which is about 6.5%. The Overseas Strategy Committee considers whether overseas investments meet investment management guidelines for the overseas business, and a country risk premium is added to reflect country-specific circumstances.

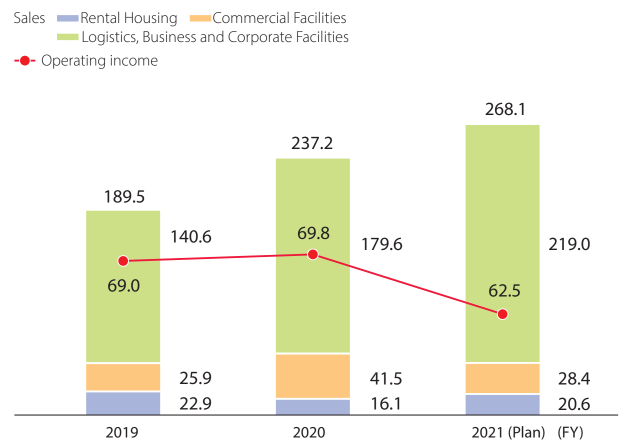
In terms of property sales plan, we lifted our payback expectations when we increased our investment plans, and progress is solid as expected. The Daiwa House Logistics Core Fund started operating in December 2020, and we plan to build its asset portfolio, focusing on logistics facilities in Japan's three major metropolitan areas around Tokyo, Osaka, and Nagoya. Our approach is to operate and manage prime properties within our Group from a long-term perspective. We will raise funds flexibly with a focus on Daiwa House REIT Investment Corporation, which has preferential negotiating rights on property acquisitions; Daiwa House Global REIT Investment Corporation, established to provide an exit for properties developed abroad; and the recently launched Daiwa House Logistics Core Fund.

We want to gradually increase the number of tenanted properties to build up our portfolio of revenue-generating properties in parallel to accelerating sales so as to strike a balance between capital and income gains. About 50% of the investment properties on our balance sheet are either still under construction or yet to be occupied, so we will be working to maintain a robust construction program and strike a balance in our investment

Investment plan (¥ billion)



Sale of developing properties (¥ billion)



properties, with a steady 70% ready for occupancy or occupied to generate stable revenue, while retaining scope for capital gains. We believe this will help stabilize long-term earnings.

Daiwa House Group changing via management and work-style reforms

Adopted business division-based system, changed course to ROIC management

We moved to a business division-based system in April 2021. There are three main changes from the previous business-based structure. First, business divisions will be in charge of the entire supply chain, including design and construction, in addition to sales; second, they will manage Group companies, strengthening the value chain; third, management will be mindful of balance sheet issues as well as profit. Much of the authority previously concentrated in the CEO will be delegated to the division heads, each of whom will be responsible for overall management.

As part of the new arrangements, we introduced a new benchmark of return on invested capital (ROIC). In essence, management will be based on capital efficiency targets for each business division. In my role as CFO I have until now focused on financing operations from cash flow, and as we branch out from primarily contracting into more stock businesses such as rental management and property development, we hope more stringent management of capital efficiency at the business level will maintain and improve companywide ROE. We are looking into incorporating ROIC into internal evaluations and plan to instill this approach at the workplace level.

As our management structure changes, we have a powerful internal management reform project looking into a range of issues, including a review of our business portfolio. We have already spun off the renovation business and integrated the business-hotel operations; aiming to run the Group in a more capital-efficient manner, moving ahead we will be examining our businesses for overlap that can be eliminated through further consolidation and similar steps.

Accelerated work-style reform to encourage diverse human resources to fulfil their potential

The Sixth Medium-Term Management Plan already called for investing ¥100 billion in technological infrastructure and work-style reform, and the pandemic prompted a significant acceleration of work-practice changes. Prioritizing employee safety, we responded swiftly to pressing issues and reconfigured our operations to reduce face-to-face interactions. We intend to maintain 50% of the current teleworking arrangements post-pandemic while continuing to bolster information security. We introduced a flextime system beginning in April 2021. Fewer constraints on work location and hours enabled employees to choose to work in ways that increased their efficiency and productivity.

Value creation for Daiwa House springs from human resources development—our corporate creed opens with a call to "develop people through business." By passing on this corporate culture, built up and nurtured over decades, we will continue to provide a working environment where people of diverse backgrounds can make the most of their personal talents.

Shareholder returns

11th consecutive dividend hike in fiscal 2020

Our shareholder returns policy is to maintain a stable dividend and dividend payout ratio of 30% or higher. In fiscal 2020, we stuck to this policy despite lower sales and profit during the pandemic, enabling us to pay an annual dividend of ¥116 per share, the 11th consecutive annual increase.

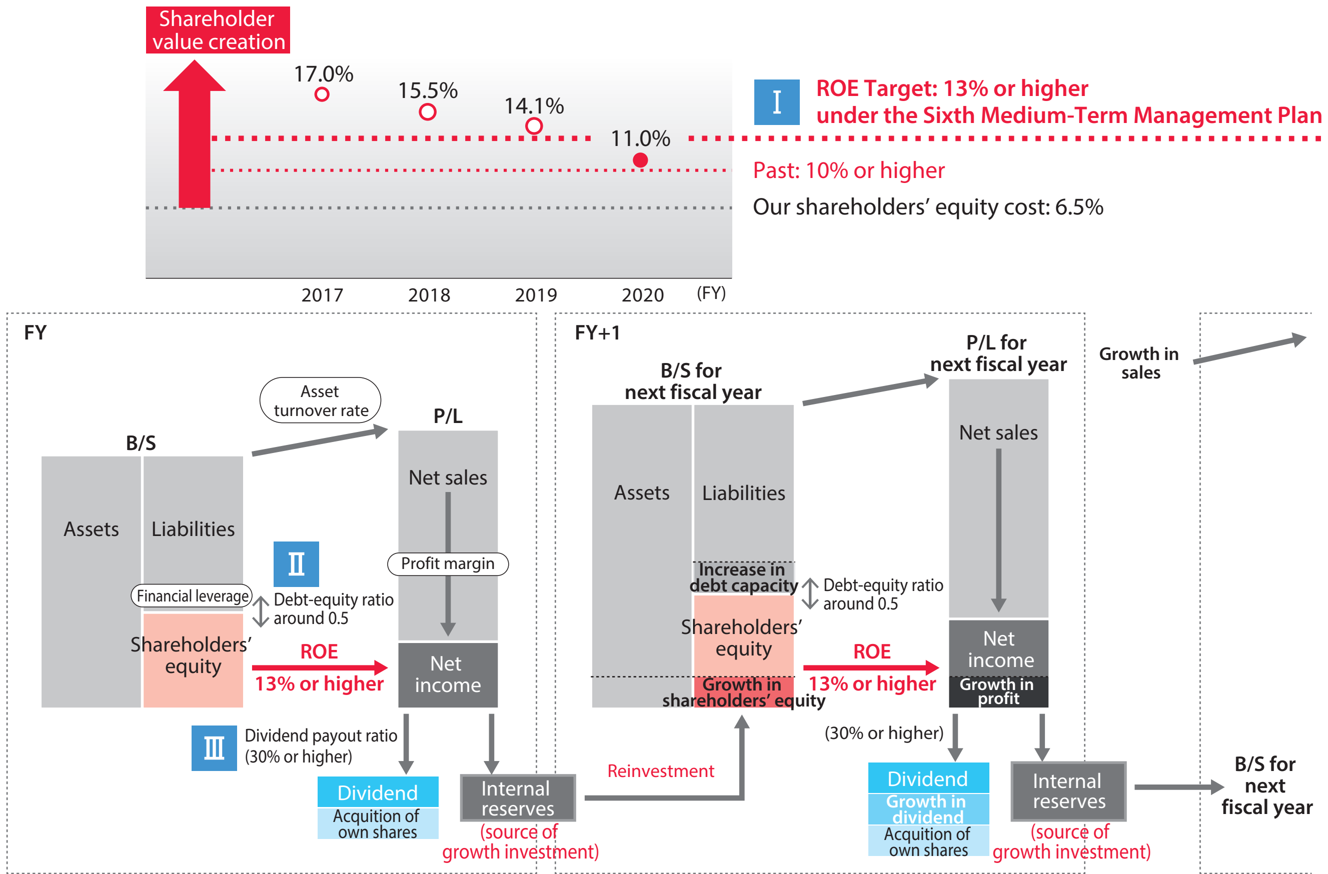
In fiscal 2020, we bought back 10 million shares for a total outlay of ¥26 billion. Looking ahead, our short-term cash flow is declining during the pandemic, so we aim to deploy surplus funds to growth investment while keeping ample cash on hand, and will take a flexible approach toward share buybacks while keeping an eye on the company's share price.

To our stakeholders

We announced several unfortunate incidents which caused considerable concern and inconvenience to our valued stakeholders prior to the start of our Sixth Medium-Term Management Plan. We view these matters with the utmost gravity. Over the past two years we worked to further strengthen governance and undertook a variety of corporate reform initiatives. While reforms are still at the halfway point, progress has been solid. We hope you will watch the Daiwa House Group as we bring about changes and a renewed awareness across the entire group.

Basic Strategy for Capital Policy

Conceptual diagram of basic strategy for capital policy



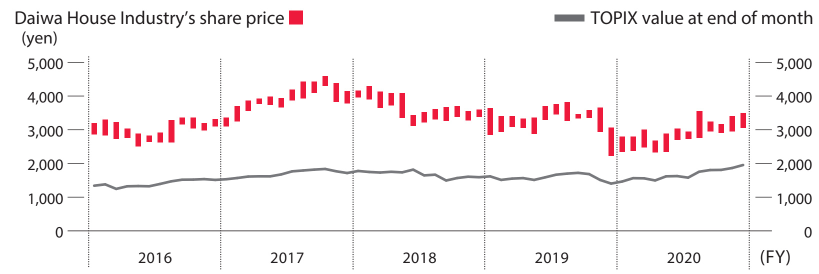
We are reinvesting capital in growth sectors while maintaining an appropriate level of financial leverage by securing operating cash flow, the source of funds required for growth investment, and increasing internal reserves after returning a portion to shareholders.

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 increased capital required for new growth investment.

Secure stable operating cash flow

Achieving ROE target based on an optimal capital structure

Trends in share price of Daiwa House Industry and TOPIX



	2016	2017	2018	2019	2020
Market capitalization (¥ million)*1	2,129,297	2,731,576	2,344,492	1,783,852	2,159,278
Total shareholder return (%)*2	103.9	135.8	121.0	98.1	119.6
Share price high (yen)	3,367.0	4,594.0	4,293.0	3,819.0	3,552.0
Share price low (yen)	2,500.5	3,096.0	3,119.0	2,230.5	2,332.0

*1 At the end of the fiscal year
*2 Numerical yield value incorporating both dividends and capital gains on shares