Message from the CFO

Chapter 4

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Executive Vice President and CFO

Continue proactive growth-oriented investment to maximize corporate value, aiming for an optimum balance between profit growth and capital efficiency

Building portfolio of quality assets to underpin solid business growth

We are evolving our revenue model to optimize management efficiency, a policy in our Seventh Medium-Term Management Plan. We aim at steady growth by building a portfolio of quality assets by investing heavily in areas with prospects of expanding scale and steady profit expansion. We will return resulting proceeds to shareholders and reinvest in further growth. Our growth investments center on developing real estate for logistics and commercial facilities, and new areas such as data centers and public wholesale markets. In fiscal 2022, after spending ¥408.0 billion on real estate development, our investment real estate portfolio was ¥1.6 trillion, as we build a suite of quality assets to generate future capital gains. We are also investing in the housing sector for overseas growth, and making strategic carbon neutrality initiatives.

Our digital transformation initiatives include capex in our IT platform and digital construction, as well as robot technologies and drones for laborsaving and workflow automation. We are also investing in the human and intellectual capital that will sustain our businesses in the future.

Debt-equity ratio above 0.6 times, but higher investment hurdle rates prepare us for rate rises

Maintaining a sound financial position is a key to improving management efficiency. We target a debt-equity ratio around 0.6 times for financial discipline. At end-March 2023, interest-bearing debt stood at ¥1,849.4 billion, for a debt-equity ratio 0.72 times (taking into account hybrid finance).

This is partly because we are making upfront investments in overseas growth. With the US Single-Family Houses Business performing well, we upped our activities, but year-end inventories increased on a temporary downturn in orders following sharp rate hikes, with the balance sheet inflated by yen weakness. In Japan, inventories rose in the Rental Housing and Commercial Facilities Businesses on our aggressive rollout of subdivisions using our extensive local knowledge, in addition to contracted work. This boosted interest-bearing debt. However, sales in the subdivision business are solid and we maintained high asset turnover rates.

When we drafted our medium-term plan we expected the D/E ratio to exceed 0.6 times in the first half, due to frontloaded investments. However, in light of interest rate movements and the outlook we need to be prepared for future eventualities. We lifted our IRR hurdle rate for real estate development investment to 10% in February 2023.

When we set up the Real Estate Investment (now Business Investments) Committee in 2008, most of our profit came from contract work, and we adopted an IRR investment benchmark to raise awareness of capital costs inside the company. Lifting the rate recently reflected the importance of managing risks yet to emerge, and we hope it will instill awareness of our target ROE of at least 13% in our workforce. A review showed that many previous projects achieved an IRR of 10% or more, so the new benchmark will not significantly curtail our investments. We manage overseas investment projects with country-specific risk premiums. We also adopted internal carbon pricing (ICP) to help us prioritize eco-friendly investments, which we added to our investment evaluation criteria. We are promoting environmental investment as a result.

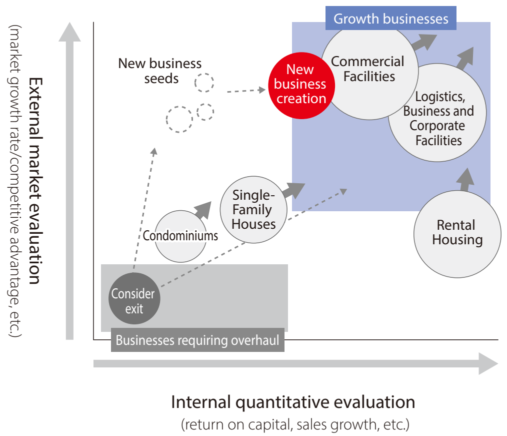
In fiscal 2022 we raised ¥200 billion via two bond issues. With prospects of higher interest rates, it is gradually becoming more difficult to raise long-term funds at low rates. In addition to raising funds from outside parties, we are recouping funds from sales of for-sale and investment real estate more quickly than before. Some investors have voiced concerns about changes in the property market with rates on the rise, but to date we see no signs of concerning developments in the domestic Japanese market. We have developed a rich variety of assets in a range of locations, attracted clients to suitable sites using our relationships with tenants, and exited real estate investments through a variety of means, generating significant and stable profits. We will continue leveraging our strengths to keep generating substantial profits and cash flows in the real estate development business.

Boosting market value of company through ROE of at least 13%

IIn March 2023, the Tokyo Stock Exchange asked companies with a PBR of below 1.0 times to take remedial action. Unfortunately, at end-March 2023, our PBR was in the 0.9 times range, so there is room for improvement. In fiscal 2022, our ROE was 14.3%, but amortization of actuarial differences of retirement benefits inflated ROE by about 3 percentage points. Looking back, our highest PBR was 1.85 times in fiscal 2017, when we achieved ROE of 17%, more than double our cost of equity. This reflected high margins and profit growth in our three key drivers at the time (the Rental Housing, Commercial Facilities, and Logistics, Business and Corporate Facilities Business). I believe a favorable market rating requires an ROE of at least 13%.

To this end, we are optimizing our business portfolio as set out in our Seventh Medium-Term Plan. We plan to expand the scale of our growth-driver businesses through focused investment. Meanwhile, we are rethinking growth scenarios, and rebuilding and restructuring businesses that have issues with growth and capital efficiency. In December 2022, we decided to sell our resort hotels business. Considerations in optimizing our business portfolio include potential for synergies within the Group and whether we are the best owner. We will concentrate our business resources in areas where unique Daiwa House attributes can maximize value—businesses that will drive profit growth in the future. We believe these initiatives put the target of 13% ROE in the last year of the plan within reach. At end-March 2023, our PER was 6 times, which we consider low in terms of the overall market, despite industry-specific circumstances. We plan to streamline operations by reviewing business processes and using IT to strengthen cost competitiveness with Group purchasing.

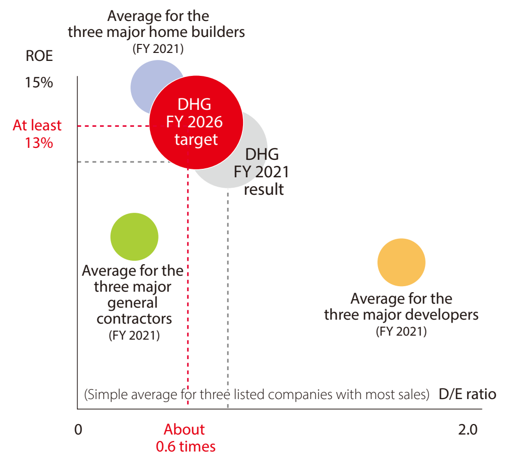
Business portfolio (conceptual)*1



Creation of new businesses and improved capital efficiency through swift action on businesses requiring overhaul and aggressive investment in growth sectors.

*1 Desired direction for each business shown, with flow of funds shown by dotted arrows
*2 Bubble sizes proportionate to sales

Daiwa House Group (DHG) position (conceptual)*2



Current position built using our unique business model leveraging strength as home builder, general contractor, and developer.

Boosting internal awareness of ROIC for capital efficient operations

We adopted ROIC as a KPI when we moved to a business division-based structure in April 2021. I feel that awareness of ROIC is taking hold under independent management by the business divisions. The aim is for division heads to be responsible for balance sheets (including at Group companies), striking a balance between our "stock businesses" and "flow businesses" (business lines that generate recurring profit or once-off profits) depending on their respective business characteristics. We do not expect a single-minded focus on profit, but decisions appropriate for focusing on investment efficiency as awareness of return on capital takes hold. We also expect intra-divisional cooperation to boost business margins overall.

We need to boost margins and improve our total asset turnover ratio to enhance capital efficiency. We are aggressively rolling out our subdivision business, which entails land purchases, and are keenly aware of how investment quality affects the total asset turnover ratio. Our turnover ratio has been about 0.8 times recently. It was trending at around 1.0 times from fiscal

2012 to fiscal 2019, and we will continue to sell inventories and investment real estate to improve it. When evaluating branch offices' performance, in addition to looking at their earnings we assess them from a cash-flow perspective, looking at details like whether they avoid long-term land holdings, whether and how early they collect receivables, and whether early payment collection rates have improved. We think that this kind of "being complete in small things" at our frontline business locations helps improve capital efficiency.

Our efforts to cull inefficient assets include ongoing reductions of cross-shareholdings. Each year the Board of Directors examines the holdings to test economic rationality from a longer term perspective. In fiscal 2022, we sold shares in 11 companies, including partial divestments. Since beginning the process at end-fiscal 2014, we have reduced the number of holdings from 98 companies to 56 at end-fiscal 2022.

Overseas business investments and moves to strengthen management and supervisory functions

As CFO, I will continue to monitor our overseas businesses, keeping an eye on interest rates and global developments. As touched upon earlier, in the land-based US housing business, real estate for sale increased by ¥108.6 billion versus end-March 2022 (including forex effects). The business slowed down from late 2022 on a downturn in demand following rises in mortgage rates and elevated house prices. Still, we do not think the circumstances will cause unrealized losses. We view this as an opportunity to buy land amid prospects of long-term US population growth and ongoing growth in demand for housing, and we are preparing to meet underlying housing demand by acquiring quality sites after careful scrutiny.

In the China condominuims business, we are working on two projects for delivery in fiscal 2025 and 2026. Real estate for sale will increase as construction progresses. Recently sales have been sluggish as property prices are in a downtrend, and with some time remaining until completion, we are not cutting prices and are pushing ahead with community-based sales, with an eye on conditions.

Strengthening risk management overseas has been an ongoing priority since the incidents of 2019, and we have put in place and enhanced regional corporate functions. In our Japanese operations, in February 2023 we announced an organizational restructure to strengthen management and supervisory functions. Now, head offices and local offices coordinate with branches to take responsibility for legal compliance and governance in areas under their purview. We aim to continue organizational reform for sound branch office operations with business workflow streamlining and thorough legal compliance.

Stable returns to shareholders

Our shareholder-returns policy entails returning profit generated through our businesses to shareholders, in tandem with growth investments in real estate development, overseas businesses, M&A, and R&D and production facilities, to maximize longer-term corporate value while growing earnings per share and working to improve shareholder value. In fiscal 2022, we paid an annual dividend per share of ¥130, for the 13th consecutive dividend increase.

Due to actuarial differences on retirement benefits, the dividend payout ratio was 27.7%, below our 35% target. We book the entirety of actuarial differences in the year they occur. In fiscal 2022, we changed the discount rate used to calculate retirement benefit obligations under our company pension plan and retirement lump sum schemes from 0.8% to 1.5% for the most part, reflecting market interest rates at year-end, following changes to monetary policy. An accompanying decline in retirement benefit obligations generated operating income (lower operating expenses) of ¥81.2 billion, combined with actuarial differences on pension fund asset management and other items of ¥15.9 billion, for a total of ¥96.6 billion. Because this did not entail cash flow, we set the dividend excluding the impact. The payout ratio was 35.6% excluding actuarial differences. As part of our moves to provide shareholder returns through flexible capital management in a changing operating environment, we have announced the cancellation of 7 million treasury shares and the share buyback of up to 10 million shares (acquisition cost up to ¥35 billion).

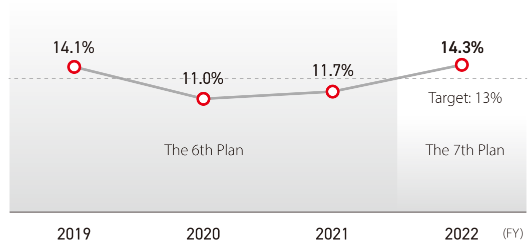
We will maintain the shareholder-returns policy outlined in our Seventh plan. We set a minimum dividend of ¥130, as our Group's diverse business portfolio proved its resilience during the temporary changes to the business environment during the pandemic. We aim to maintain stable shareholder returns with a payout ratio of at least 35% and flexible share buybacks as we generate steady profit growth.

We continue to aim at improved corporate value as we work toward Our Hopes for the Future

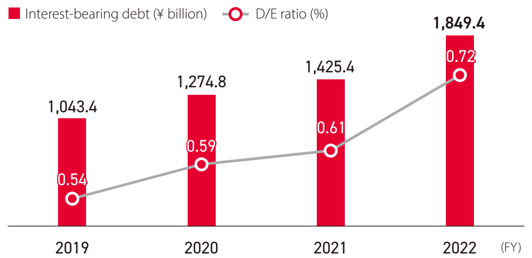
To realize Our Hopes for the Future (Purpose) heading toward 2055, in fiscal 2022 we held deep discussions through workshops at our branch offices nationwide. Each drafted a *Miraimachi Sengen* (Futuretown Declaration) to lay out how they planned to realize the aspirations set forth in our *Future Landscape*. In fiscal 2023 we will work to instill our hopes throughout the organization and individuals so that our employees take action with an eye on changing conditions and stakeholders such as customers. We hope the mindset and mentality cultivated through these activities help foster a fresh corporate culture.

I think that enhancing the corporate value of the Daiwa House Group requires both business value—that generates profit—and social value—derived from our approach of service to society. We also need to improve the skills of our human capital responsible for such actions. Our aim is resolutely on maintaining Daiwa House's status as a group people can depend on, while improving corporate value as we work to fulfil Our Hopes for the Future.

ROE Operate with eye on ROE above shareholders' expected returns

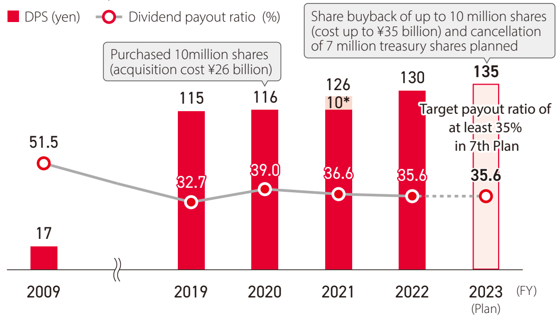


D/E ratio Target: about 0.6 times



Dividend, dividend payout ratio

Forecasting 14th consecutive year of dividend increase
Dividend payout ratio: at least 35%, minimum DPS of ¥130
Flexible share buybacks



* Commemorative dividend to mark the 100th birthday of founder Nobuo Ishibashi

Basic Strategy for Capital Policy

❶ Secure cash flow required for growth investment

- Generate operating cash flow via steady profit growth
- Secure investment cash flow by reducing strategic shareholdings and inefficient assets

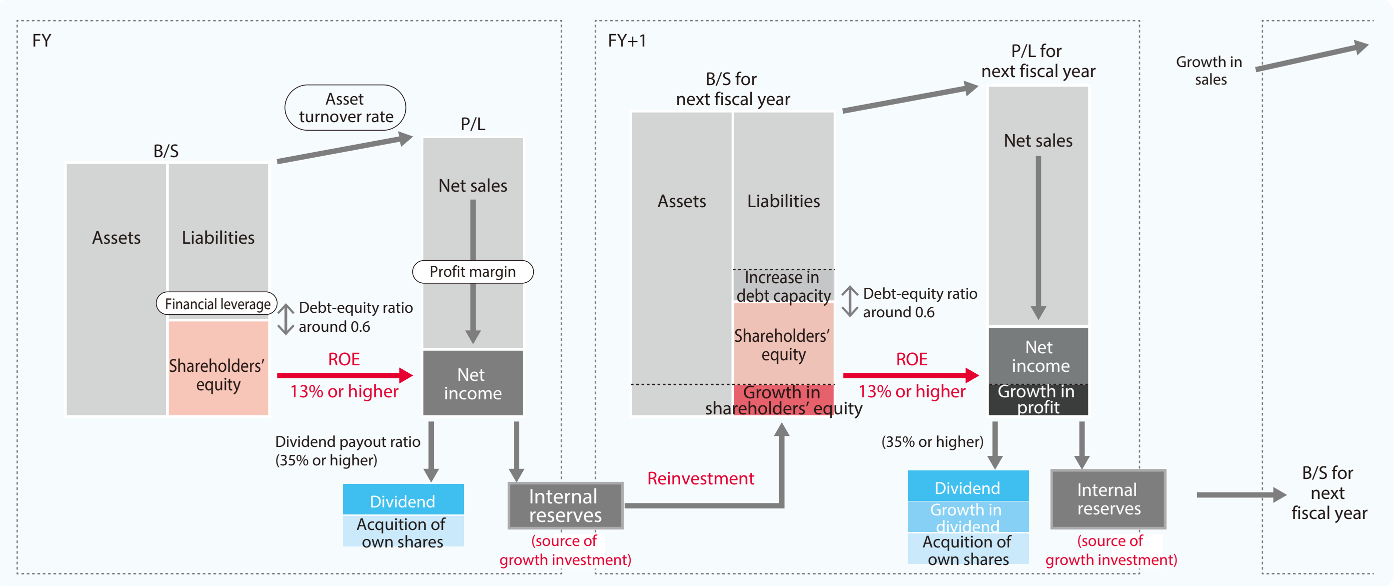
❷ Reinvest in growth areas while maintaining a D/E ratio of about 0.6 times

- Draw on internal reserves to reinvest in growth areas while vigilantly maintaining appropriate level of financial leverage

❸ Achieve ROE of at least 13%, profit growth and dividend payout ratio of 35% or higher

- Realize return on reinvested capital with capital efficiency that exceeds the expected rate of shareholders in order to achieve growth in profits and dividends, as well as increased capital required for new growth investment.

Basic Strategy for Capital policy (conceptual diagram)



In addition to securing operating cash flow, the source of funds required for growth investment, we generate investment cash flow by reducing cross-shareholdings and inefficient assets. While increasing internal reserves after returning a portion to shareholders, we reinvest capital in growth sectors, factoring in an appropriate level of financial leverage.

Secure operating cash flow through steady growth of profits

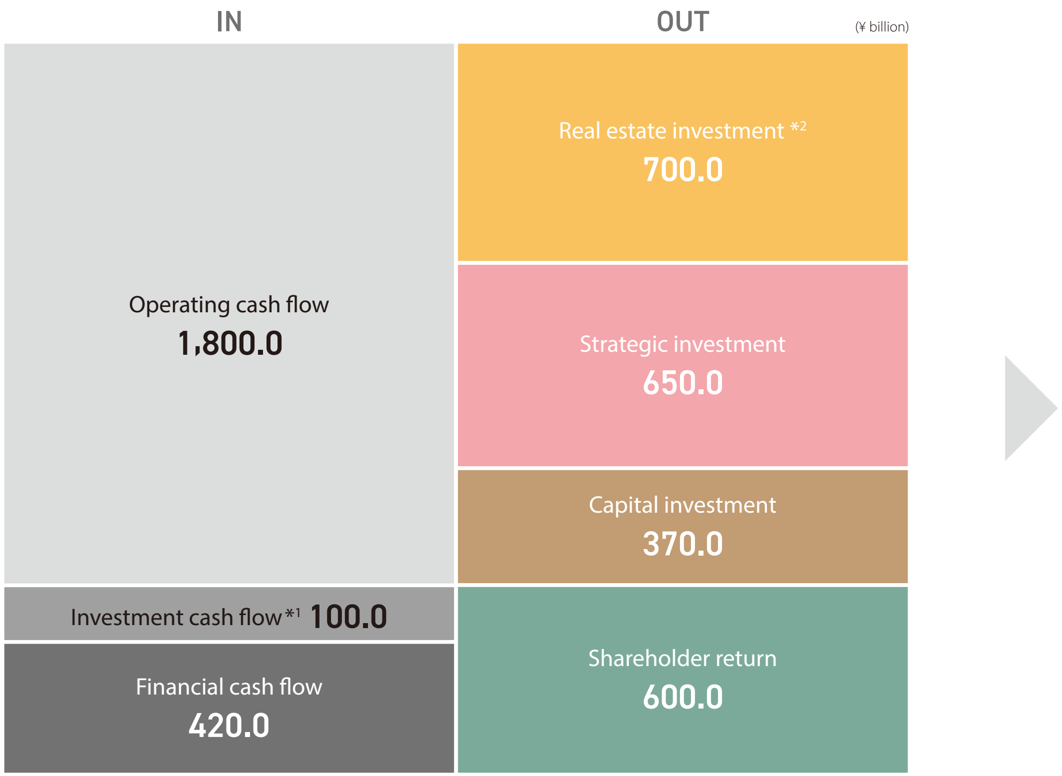
The Company will realize return on reinvested capital with capital efficiency that exceeds the expected rate of return (cost of shareholders' equity) for shareholders in order to achieve growth in profits and dividends, as well as increased capital required for new growth investment.

Achieving ROE target based on an optimal capital structure

Capital Allocation and Shareholder Return

We engage in real estate development and strategic investments necessary for sustainable growth.
We also increase operating cash flows based on stable growth of profits and steadily return profit to shareholders.

Capital allocation in five years



*1 Reduction in cross-shareholdings and inefficient assets, etc. *2 Real estate properties for rent held for sale or holding purpose

Real estate investment

- **Development investment** in logistics facilities and commercial facilities, which are profit drivers
- **Investment in new fields,** such as data centers and public wholesale markets
- Investments to increase in steps **profit-earning real estate (stock assets)**

Strategic investment

- Upfront investment for **overseas growth**
- **Investment for realizing carbon neutrality,** such as solar power generation

Capital investment

- Strengthen production sites for the business field
- Invest in IT platform to promote DX and invest in digital construction

Shareholder return

- **Dividend payout ratio of 35% or higher** and **dividend per share of ¥130 or more**
- Flexible acquisition of own shares