Q&A at IR Teleconference for Analysts/Institutional Investors (Summary)

at Announcement of Financial Results for FY2018 3Q

(For the fiscal year from April 1, 2018 to December 31, 2018)

Date & time: From 16:00 to 17:00, Friday, February 8, 2019

Presenters: Yuji Yamada, Senior Executive Officer and General Manager of Finance and IR Departments

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【Q1】

Could you describe your orders received situation for each business segment?

【A】

・In our Single-Family Houses Business, the number of visitors to our model house exhibitions has been trending positively on a year-on-year comparison since last September, and we have noted an increase in the number of potential customers who have already purchased a housing lot. Although we had previously stated that we saw no impact in the form of rush demand ahead of the scheduled increase in the consumption tax rate, this now seems to be having an emerging impact.

Orders received for custom-built houses for the month of January posted a year-on-year increase of 21 percent. While this may be partly due to the fact that the previous year's level was low, we expect to see good order figures in February and March, too.

・In our Rental Housing Business, orders were up by seven percent, but there has been no major change in the orders situation.

Regarding loans from financial institutions, the majority of the Company's business in this field is done directly with the landowners, and it is thus not severely affected. In the non-metropolitan regions of Japan, however, our business continues to be affected slightly, owing to the insistence by financial institutions that a portion of the funds required for investment in the building of rental housing properties must be financed by the landowners themselves, instead of relying entirely on loans from financial institutions.

・In our Commercial Facilities Business, as well as our Logistics, Business, and Corporate Facilities Business, orders received are continuing to trend firmly.

【Q2】

Could you provide a breakdown of your overseas operations by country, regarding the state of business and the operating environment?

(Reference) Financial Highlights: p17 "Overseas Business"

【A】

・In China, we have sold out all condominiums constructed in the cities of Changzhou and Wuxi, and these sales are contributing to earnings for the current term. We succeeded in selling these properties at higher prices than we had forecast, and the result is reflected in the earnings report. However, no completions are scheduled for next term, and thus both sales and operating income should record declines.

・In the United States, Stanley Martin Communities, LLC, which operates as a single-family home builder, is posting good business results as per projections, and is contributing to the business performance of the Daiwa House Group.

Our development of rental housing in the United States had sold more than ¥10 billion worth of properties as of the end of the third quarter, yielding over ¥2 billion in profit on sales. This is in line with the projected figures.

・In Australia, sales of condominiums are trending well, but the Rawson Group, which operates as a single-family home builder, is falling short of projections due to the well-known difficult housing market conditions in that country.

【Q3】

We would like to hear about your gross margin ratio in the Construction category.

Looking at the gross margin ratio for each quarter, we find that it has followed a gradual improvement trend, with 19.3% for 1Q, 21.7% for 2Q, and 20.3% for 3Q. We believe that the deterioration in the profit margin in the first quarter, which was a focus of concern at the time, was a purely temporary phenomenon, but how do you see the profit margin trending going forward?

Please give your projections based on the current state of materials and labor costs, as well as the degree to which you have been able to pass on additional costs to the customer.

(Reference) Financial Highlights: p8 “Business Segment Information (2)”

【A】

・There remain some grounds for fear of a continued tight supply situation for steel and the resulting price competition, but as the cost-of-sales ratio of our Logistics, Business & Corporate Facilities Business as of the time of receipt of order is showing improvement compared with the previous year, this indicates that we are managing to pass on the extra price to our users. Consequently, we expect the profit margin to remain stable in the near future.

【Q4】

The NOI yield on investment real estate being rented is falling.

While the yield is low on properties on which the first year has yet to elapse since completion, does this decline indicate that the yield level on properties that will be completed in the near future is falling compared with prior years?

(Reference) Financial Highlights: p9 “Breakdown of Investment Real Estates”

【A】

・The situation differs depending on the location and the asset class of the property concerned, but our projections for the NOI yield at the development stage have declined from prior years, and it is probable that this is reflected in the yield for the current term.

・At our Company, we make investment decisions with the Internal Rate of Return (IRR) set as a hurdle rate when making an investment, taking into accounts profits we gain at the time of sale. The capitalization rate (cap rate) has been declining, and we thus have been able to secure profits exceeding the hurdle rate even if our projections for the NOI yield level at the time of acquisition (investment) is lowered.

・The NOI yield on all logistics facilities is 4.0 percent, but if properties where less than one years has passed since completion are ignored, the rate improves to 4.9 percent. Among these, properties constructed one year or more ago include multi-tenant logistics facilities, which have yet to reach a stable level of tenant occupancy and operation. After these properties start gradually to come on line, we expect the yield to rise to between 5.3 and 5.5 percent.

【Q5】

Could you provide the gross margin ratio on sales of the Logistics, Business & Corporate Facilities Business in the Construction category?

The gross margin ratio for the first quarter of this term was down by 4.3 percentage points from the same period of the previous year, but the year-on-year comparison for the third quarter was only minus 2.1 percentage points. In your forecast for the full term, you project the gross margin ratio at 15.0 percent: is this still achievable? Please take the trend of Fujita Corporation's cost-of-sales ratio into account in your answer.

(Reference) Financial Highlights: p12 "Business Performance Forecasts for FY2018 (3)"

【A】

・We thoroughly check the cost-of-sales ratio for each property, and we take into account that the adjusted cost often decreases compared with the initial projection and expect the cost to sales ratio to improve to 15.0 percent.

・In the case of Fujita, too, the gross margin ratio for the third quarter came to 10.0 percent, down by 2.5 percentage points from the previous year, but as this represents an improvement of 0.4 percentage points from the 9.6 percent recorded for the second quarter, the trend is not downward. As a result, we are not overly concerned about this situation.

【Q6】

Orders received by the Rental Housing Business, excluding the sale of development properties, grew by four percent in the first half of this current term, but the trend has effectively flattened out, with year-on-year growth for the period up to and including January 2019 being a mere one percent. How do you see market conditions going forward?

【A】

・Factoring in orders received in January, aggregate orders for the four-month period from October were at minus four percent year on year, but one of the factors behind this is the fact that we had conducted a marketing campaign in December 2017, making the year-on-year comparison rather difficult. The value of orders posted a firm trend, exceeding ¥40 billion for each month, and while it may be too soon to declare that the order environment has recovered, we feel that we are now over the worst.

・At Daiwa House, we feel that the maintenance of high occupancy rates constitutes a strong attraction to landowners. The average occupancy rate across all our properties as of the end of December 2018 stood at 95.2 percent. This is down slightly from the end of the previous March, due mainly to seasonal factors, but it represents an improvement of 0.2 percentage points from the same month of the previous year.

The aggregate operating income for the first three quarters of the current term of Daiwa Living, which manages apartments, has improved by approximately ¥4 billion. This is the result not only of an improved occupancy rate, but also because of an increase in rental charges which the company implemented. We believe that this was made possible by the construction by Daiwa House Industry of apartments in superior locations.

【Q7】

Is your Logistics, Business & Corporate Facilities Business able to procure materials smoothly, including steel? Concern has been expressed that you may suffer delays in construction owing to procurement difficulties.

【A】

・Despite the concern about materials procurement, thus far we have secured all necessary materials, and no significant construction delays have been experienced.

【Q8】

We would like some figures for Fujita Corporation’s third-quarter performance.

【A】

・Sales were ¥375.4 billion, with operating income of ¥12.7 billion and an OP margin of 3.4 percent.

【Q9】

What is the current situation with regard to actuarial loss on employee retirement benefits?

【A】

・As of the end of December 2018, there was a negative impact of approximately ¥6 billion.

【Q10】

The gross margin ratios for the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business are lower than projected in your full-term plan. Assuming that you fail to reach the projected figures, do you have any measures in mind or factors that may contribute to meeting the projected operating profit figure, such as increasing the pace of selloff of development properties or a likely increase in profits on overseas operations?

【A】

・There is scope for upward deviation from our full-term business forecasts in the Condominiums Business. In November 2018, we revised downward by ¥24.9 billion our projection for sales on two condominium buildings scheduled for completion in February and March 2019, as a result of the impact of the KYB Corporation's nonconforming acts involving its building equipment. In both cases, replacement of nonconforming products has been completed, and we expect to be able to hand them over to the buyers within the current term.

【Q11】

Over the past three months, you have increased the cumulative overseas investment balance by roughly ¥10 billion. What are the prospects from now up to the end of March?

(Reference) Financial Highlights: p17 "Cumulative overseas investment balance"

【A】

・We expect to increase the balance by a specific amount, but we have no plans at this moment to conduct a significant increase. We plan on aggressive investment next term and beyond.

【Q12】

Sales for the Commercial Facilities Business in the third quarter for the Construction category were up by ¥33.1 billion year on year, which exceeds your business performance forecast. On the other hand, while the gross margin ratio is improving, it is on track to fall short of your projected 29.5 percent. Could you give a projection for this factor?

(Reference) Financial Highlights: p12 “Business Performance Forecasts for FY2018 (3)”

【A】

・There is room for upward adjustment in sales compared with the full-term projection.

・Regarding the gross margin ratio, there was a slight deterioration in the third quarter compared with the second-quarter figure and with the full-term performance forecast. However, few completed properties were handed over to customers in the October-December period, and one of the causative factors was that the amount of sales on the percentage-of-completion basis was large. Consequently, we expect to see an improvement as we approach the end of the full term.

(End)