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

at Announcement of Financial Results for FY2019 1Q

(For the fiscal year from April 1, 2019 to June 30, 2019)

Date & time: From 16:00 to 17:00, Thursday, August 8, 2019

Presenters: Takeshi Kosokabe, Executive Vice President and CFO

Yuji Yamada, Managing Executive Officer and General Manager of Finance and IR Departments

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[Introductory statement from Daiwa House Industry Co., Ltd.]

Before beginning this question and answer session, we would like to provide an explanation of the current state of affairs regarding both the financial misconduct discovered at one of our affiliates in the People's Republic of China and the matter of off-specification components, two issues which have undoubtedly caused considerable concern to our stakeholders.

<The Chinese affiliate issue>

At Daiwa House, we have been studying a variety of options to allow us to continue the project with which this Chinese affiliate has been involved. Unfortunately, however, we have yet to determine a specific way forward. Unless changes are made to the composition of the board of directors of the local joint venture in question (the company's highest decision-making body, currently consisting of eight members, four from Daiwa House and four from the Chinese side), the decision-making process will be impossible. To this end, we are holding talks with the authorities of the city of Dalian and other public organizations, but no change has yet been effected.

Furthermore, as we have already announced, the affiliate in question has brought a lawsuit against those persons believed to be involved in this misappropriation of corporate funds, but we have not yet been informed of any concrete details regarding the ongoing investigation.

Regarding the properties being put on sale by the affiliate, contracts have already been concluded with some 450 customers. Under current circumstances, it is impossible to resume construction, and the end-of-June contractual deadline for handing over the properties in question has passed. Although we have received inquiries regarding this delay from some customers, the situation has not caused major problems.

<Off-specification components issue>

Next, regarding the issue of off-specification components in and remedial work on single-family houses and rental housing, we have already released the figures for the number of properties affected, i.e. 212 properties involving inverted-L columns and 3,763 properties involving off-specification pad footings. There has been no further increase in these figures since the last announcement.

A third-party institution has confirmed the safety of all the inverted-L columns, and repair work to 77 properties that were suspected of being insufficiently protected against fire risk was completed in June.

Regarding the pad footings, confirmation of their safety by a third-party institution is still ongoing, and as of the end of July approximately ninety percent* of the total had been inspected. As a result of the third-party body's assessment, not a single property has been adjudged to suffer from problems relating to safety.

* 3,363 individual buildings

Following the Company's receipt from the third-party institutions involved of authentication (architectural rating certificates) of the safety of all these properties, we have been visiting the customers involved and explaining the details of the issue. Apart from the aforementioned 77 properties, no repair work has been carried out to any other properties. Our schedule calls for the completion of verification of safety by the third-party institutions by the end of September of this year.

<Measures to prevent recurrence>

Finally, to prevent a recurrence of these types of issues, Daiwa House is already implementing a number of measures to improve its systems, in response to the suggestions received from the Third-Party Committee and the External Investigative Committee. For example, in the case of the Chinese affiliate, we revised our methods of management of the bank accounts and its methods of managing assets such as real estate in overseas subsidiaries and affiliates. In the case of the off-specification components, we have newly established a department to take charge of legal compliance and to oversee quality assurance, and have introduced an internal system of employee qualifications in order to conform to the type-approval and conformity scheme.

Nonetheless, in the wake of this series of issues, we recognize the need for the Company to strengthen its corporate governance, including undertaking a radical reform of its organizational system, and to this end we are currently pushing forward with discussions and examinations of our options, with the participation of specialists from outside the Group. Details will be provided to all our stakeholders at the time of the announcement of financial results at the end of the second quarter of the present fiscal year, in November.

Below is the summary of Q&A session.

【Q1】

Today, you announced a public offering of hybrid bonds (subordinated bonds). Please explain the background to this. Also, in the event that you receive capital certification, will the effect of this offering be included in the calculation of the D/E ratio?

(Reference) News release published on August 8, 2019: "Notice on public offering of hybrid bonds (subordinated bonds)"

【A】

・The value of this offering will be in the region of ¥100 billion. The purpose will be to provide funding for investment planned under our Sixth Medium-Term Management Plan, and the repayment of long-term borrowings is also included.

・As part of our capital policy under the Sixth Medium-Term Management Plan, we have laid down two targets—a D/E ratio of approximately 0.5 times, and an ROE of 13 percent or higher. We hope to achieve these targets and leave sufficient spare funds to implement the flexible acquisition of own shares. It is for these reasons that we have decided to procure fund through this public offering of hybrid bonds.

・Regarding the D/E ratio, if we receive capital certification from the credit rating agencies, this will also be included in the calculations.

【Q2】

Could you explain the causative factors behind the ¥4.2 billion earnings increase posted by the Existing Homes Business?

(Reference) Financial Highlights: p9 "Business Segment Information (1) Results"

【A】

・The ¥4.2 billion earnings increase can be broken down into ¥3.2 billion by Nihon Jyutaku Ryutu Co., Ltd. and ¥1.1 billion by Daiwa House Reform Co., Ltd. The increase for Nihon Jyutaku Ryutu mainly resulted from the sale of subdivision-for-sale properties.

【Q3】

Please describe the orders received situation for July.

【A】

・In the Single-Family Houses Business, when drawing up our initial targets, we forecast that the orders situation would become difficult. Orders are currently roughly in line with targets. As a result of the planned consumption tax increase, and the effects of the off-specification components issue, we have been seeing a decline in the number of potential customers coming to view our model houses. We are keeping a close eye on the situation, and expect the orders situation among others to remain much as they are for some time to come.

・In the Rental Housing Business, our staff have been spending time explaining the situation regarding the off-specification components issue even to the owners of properties not affected, and this has negatively impacted our marketing efforts. An impact is also being felt from the tighter credit policies being adopted by financial institutions. As part of our announced policy, we will be making efforts to raise the per-building sales price of three-story, medium-rise, and high-rise apartment buildings, and are aiming for a full-term year-on-year increase of three percent.

・In the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business, the pace of orders received has been favorable. Steady progress is also being made on fulfilling orders received prior to the drawing up of the plan, and we expect both of these business segments to steadily perform in line with our targets.

・We do not expect a major increase in orders as a whole for the full term, with a rise of 0.5 percent being foreseen, but we hope to be able to exceed the initial targets.

【Q4】

Please describe your expectations for the project in Dalian, China in the near future.

【A】

・We definitely intend to resume the project, complete the construction of the properties, and hand them over to our customers, before winding up the joint venture. Currently, we are holding talks with the Dalian municipal authorities and other governmental organizations involved with a view to carrying out this plan, but, as stated in our introductory remarks above, things are not going as smoothly as we would wish.

・Approximately eighty percent of the real estate properties for sale (serviced apartments and commercial facilities under Phase II of the project) have been completed, and we hold assets worth roughly ¥34.5 billion. Moreover, we had a total amount invested in the joint venture of about ¥33.8 billion as of the end of June 2019. The contractual period of the joint venture is due to expire in December 2019, and if we are unable to reach a conclusion by that date, the company will be wound up. Even in the event that it proves difficult to continue with the project, the amount of loss we will bear will depend on the disposal value of the real estate currently under development, among other factors. Consequently, at the present moment we are unable to accurately predict the future impact on the Company’s earnings.

・With a view to resuming the project, we are examining our options for founding a new joint venture with a new partner, but as the current board of directors is unable to exercise decision-making powers effectively, no conclusion has yet been reached.

【Q5】

In the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business, what is your outlook for the gross margin ratio in the Construction segment?

(Reference) Financial Highlights: p14,15 “Commercial Facilities Business” “Logistics, Business & Corporate Facilities Business”

【A】

・The gross margin ratio for the Commercial Facilities Business for the first quarter of 2019 was 25.9 percent, but this is expected to improve in the second quarter and beyond, as a result of the application of the percentage-of-completion method, among other factors, and should approach our full-term target of 28.2 percent.

・The gross margin ratio for the Logistics, Business & Corporate Facilities for the first quarter of 2019 was 13.0 percent, roughly flat from the same quarter of the previous year, but this is because of approximately ¥20 billion worth of large-scale properties carrying a poor cost-to-sales ratio. For the second quarter, we expect a recovery to the 14-15 percent range.

【Q6】

What are the factors behind the increase in income but decrease in earnings of overseas operations in the Single-Family Houses Business?

(Reference) Financial Highlights: p9 “Business Segment Information (1) Results”

【A】

・This is mainly due to cost increases affecting Stanley-Martin Communities, (which accounts for a high proportion of our overseas sales), stemming from higher materials and labor costs among other factors, as a result of which the company recorded a 3.3-point deterioration in its gross profit margin.

【Q7】

The value of sales of development properties by your Commercial Facilities Business has already surpassed your full-term target. What are the factors behind this?

(Reference) Financial Highlights: p14 “Commercial Facilities Business”

【A】

・Sales increased thanks to the fact that we were approached by customers wishing to buy properties that had not been included in the initial business plan.

【Q8】

In investment in real estate development, the rate of progress appears to be high, particularly in overseas projects. What factors lie behind this?

(Reference) Financial Highlights: p16 “Status of Investment Plan”

【A】

・This is because of investment in new condominium development projects in China.

【Q9】

Could you provide any reasons why, as stated above, your discussions with the Dalian municipal authorities are not going as smoothly as you would wish?

【A】

・The board of directors of the Chinese joint venture, which is the company’s highest decision-making body, consists of four appointees from Daiwa House and four Chinese members. In order to convene a meeting of the board, two-thirds or more of the total board membership must be present. Of the four Chinese board members, one has received the approval of Daiwa House, but that still only makes five members, which does not count as "two-thirds or more," and thus it is not possible to convene a board meeting. Consequently, no decision making can be conducted.

【Q10】

Could you provide some details about the investment planned in the twin buildings development project scheduled for Yodoyabashi in Osaka, as recently announced in the newspapers?

【A】

・This project will be a redevelopment project undertaken as a joint venture. The total cost for Daiwa House is estimated at ¥39 billion. Within our Fifth Medium-Term Management Plan, we have already acquired the necessary land from the owner, a bank, for roughly ¥10 billion, and the remaining investment amount is ¥29 billion.

【Q11】

What sort of change to the Company's D/E ratio at the end of the current term can we expect to see as a result of the issue of hybrid bonds?

(Reference) News release published on August 8, 2019: "Notice on public offering of hybrid bonds (subordinated bonds)"

【A】

・Assuming that the amount of investment over one year is one-third of the ¥1,050 billion planned for the three-year period of the 6th Medium-Term Management Plan, if we do not issue the hybrid bonds, the term-end D/E ratio will be 0.53, whereas if the bonds are issued, it should fall to 0.5 or lower according to our calculations, although this depends on the monetary value.

【Q12】

Orders are flowing in to the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business at a favorable pace, but what sort of period are we looking at on average between start of construction and completion?

【A】

・In our Commercial Facilities Business and Logistics, Business & Corporate Facilities Business, we register orders on the books once a target date has been decided on. The period to completion naturally differs from one property to another, but on average, large-scale projects take around 18 months while small-scale properties take around six months.

【Q13】

We understand that new projects are underway in China. Do you expect to achieve profitability amid a situation where restrictions are being placed on increases in sales prices?

【A】

・The projects in question are located in Changzhou and Nantong. They were won in public bidding, but this certainly does not mean that we bid above the market price, and we expect them to yield an adequate profit.

【Q14】

In your Logistics, Business & Corporate Facilities Business, the sales progress in the Construction segment appears to be faster than in your full-term sales forecasts. What is the reason for this?

(Reference) Financial Highlights: p15 “Logistics, Business & Corporate Facilities Business”

【A】

・Reasons include around ¥20 billion worth of sales of large-scale properties to which the percentage-of-completion method was not applied, and roughly ¥10 billion in sales by Fujita of built-for-sale properties.

【Q15】

In your Rental Housing Business, despite a decline in revenue from sales in the Construction segment, the gross profit margin has improved by 0.9 points. What is the causative factor behind this?

(Reference) Financial Highlights: p12 “Rental Housing Business”

【A】

・The gross margin ratio is improving thanks to an improvement in the cost of properties in hand at the time of receipt of order. We believe that this is the result of our efforts to promote marketing with a focus on profit margins. In our full-term forecast, we see an improvement of 1.5 percentage points.

【Q16】

Are you seeing any adverse effects of the rush demand before the consumption tax increase compared to the previous year?

【A】

・The number of visitors to our model house display sites posted year-on-year increases for seven consecutive months from August 2018 to March 2019. This term, visitor numbers posted year-on-year declines in April, June, and July, and we believe this is to a certain extent the result of the adverse effects of the consumption tax increase.

【Q17】

Has there been any change in your stance regarding investment in China?

【A】

・The Dalian project involving which the recent scandal has occurred was begun as one of the first such projects in China, and the fact that the affiliate was a 50:50 joint venture may lie at the root of the problem. Subsequent projects have been financed entirely by the Group's own funds. The Japanese-style condominiums that we offer in China—whose interiors are fully finished with proper interior decoration, unlike normal Chinese condominiums—enjoy a very good reputation for high quality among Chinese consumers.

・Going forward, we hope to make aggressive investments whenever good opportunities present themselves for the acquisition of land at fair prices.

【Q18】

Despite the planned consumption tax increase, and the negative impact of the off-specification components issue, orders received in July rose by five percent. What do you identify as the cause of this?

Additionally, do you expect the impact of the off-specification issue on your marketing activities to tail off in the near future?

【A】

・This does not mean that the order environment for single-family houses is staging a positive turnaround. The increase in orders received in July is due to contracts signed with the increased number of customers who visited our model house sites in the Jan.-March period being gradually booked as orders.

・As for the impact of the off-specification components issue, the process of confirmation of the safety of our products by the third-party organization is scheduled to be completed by the end of September. Thus, from October onwards, our sales force will once again be able to focus their whole efforts on marketing.

(End)