Q&A at IR Teleconference for Analysts/Institutional Investors (Summary)
at Announcement of Financial Results for FY2020 3Q
(For the fiscal year from April 1, 2020 to December 31, 2020)

Date & time: From 16:00 to 17:00, Tuesday, February 9, 2021

Presenters: Takeshi Kosokabe, Executive Vice President, CFO

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

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【Message from Vice President Kosokabe】

During the first nine-month period under review, our Group made steady progress towards our earnings forecast. Despite the relatively significant impact of COVID-19, as a construction business, we were able to process existing orders received as planned and had steady success with the sale of real estate for investment. Also, net sales and income grew thanks to an extremely favorable housing market in the United States.

However, I must admit to feeling a sense of frustration in the fact that this performance has not been reflected in our stock price to the extent I had hoped. For the first nine months of the period under review, both ordinary income and net income exceeded earnings forecast figures. While I imagine there are expectations for us to conduct an upwards revision to plans, we have decided to maintain our existing forecasts in light of various market uncertainties. Needless to say, one of these uncertainties is the COVID-19 pandemic. Even now, we are currently operating under a state of emergency declaration and it is impossible to forecast the impact on businesses like hotels, sports clubs, and commercial facilities, or what impairment losses will be attributed to those facilities. One extraordinary factor is the business related to properties in Dalian, China, which is currently being liquidated. The first auction procedures for this business will be initiated on March 20. There is a possibility that earnings for the current period could be impacted depending on the auction prices for those properties. In light of these factors, we will maintain our existing earnings forecast but we hope to be able to revise our forecast as soon as these matters are settled.

Overall, we are relieved that conditions were not as severe as our initial projections. However, current conditions will continue for time being so we must remain cautious.

【Q1】

You explained the reason for maintaining your existing full-year earnings forecast as being due to uncertainties in the operating environment and the possibility of future impairment losses for hotels and sports clubs as a result of a resurgence of the COVID-19 pandemic. What about the contracting construction business? Are you concerned about increased uncertainty due to a resurgence of the COVID-19 pandemic?

【A】

-The Single-Family Houses Business will see irregularly high percentage of sales for houses in housing development projects, which will be recorded at the end of March. This does present a certain level of uncertainty but there is nothing to warrant concern about a sharp decline in the fourth quarter for the contracting construction business overall.

-At present, I cannot provide specific numbers. However, as for our forecast for the current fiscal year, depending on the results of asset management for retirement benefits, I think operating income will be in the range of 300.0 billion yen.

【Q2】

On the subject of retirement benefits, your full-year plan reflects -15.0 billion yen as actuarial difference but what is the status of asset management gains and losses?

(Reference) Financial Highlights: P.16 “Business Performance Forecasts for FY2020 (1) Year on year change”

【A】

-As of the end of December 2020, we have recorded approximately 28.0 billion yen as gains on asset management.

【Q3】

The NOI yield of real estate available for sale for Logistics, Business & Corporate Facilities Business is declining. Is logistics facility leasing taking longer than normal?

(Reference) Financial Highlights: P.14 “Breakdown of Investment Real Estate (2)”

【A】

-There is no change in the status of leasing for logistics facilities. The NOI yield for logistics facilities alone is 5.5%, which represents a 0.3pt improvement compared to the end of March 2020.

-Factors behind the declined in NOI yield include two newly corporate facilities opened. One is a multifunction facility that comprises an office building and rental housing while the other is a multifunction facility that comprises a hotel and sports facility. These facilities are not yet running at full speed.

【Q4】

Looking at orders received by Daiwa House (non-consolidated) for the Logistics, Business & Corporate Facilities Business, can you provide background for why more than half of orders received are concentrated in the third quarter (October to December)? Also, there was the order received for a data center in October but have there been any additional orders received since then?

(Reference) Financial Highlights: P.30 "Orders Received by Business Segment (Non-consolidated) (1)"

【A】

-Including TMK, in the third quarter we recorded 101.0 billion yen in sales of properties. It is not the case that there was a new large-scale contracting construction order received.

-As for data centers, we recorded two orders received in the third quarter. Construction has started for both with completion scheduled for next fiscal year.

【Q5】

Please discuss Fujita net sales, operating income, and trends for orders received.

【A】

Net Sales: 300 billion yen (YoY -76.9 billion yen)

Operating Income: 7.4 billion yen (YoY -1.4 billion yen)

- Orders received totaled 236.4 billion yen. While this does suggest that that progress is sluggish relative to its full-year forecast of 460.0 billion yen, it recorded multiple orders received as it headed into March last fiscal year so I do not think it is at a point where we can say it cannot achieve its plan.

【Q6】Regarding the Daiwa House Logistics Core Fund, what are affiliations of the investors, who is the asset management company, and what is your future outlook for the fund?

(Reference) Financial Highlights: "FY2020 3Q Topics"

【A】

- This fund receives long-term investment capital from corporate pensions and financial institutions. In the third quarter, the fund sold four logistics facilities to start off with assets on a scale of approximately 58.0 billion yen. Next fiscal year, we plan to sell roughly 30.0 billion yen in properties with the goal of growing the fund to an asset scale of 300.0 billion yen within three years. This is a fund created by Daiwa House specifically for logistics facilities. The asset management company is Daiwa House Asset Management.

【Q7】Which business present concerns regarding impairment losses and what is your outlook in terms of the scale of losses?

【A】

- At business, this would be hotels, sports clubs, and commercial facilities. We are forecasting roughly 20.0 billion yen.

【Q8】

Will there be any extraordinary factors in the fourth quarter that impact operating income for the Logistics, Business & Corporate Facilities Business? Also, the operating margin for contracting construction excluding gains on sales appears to be on a recover trend. Please discuss the factors behind this improvement and your thoughts on the sustainability of this trend.

(Reference) Financial Highlights: P.29 “Logistics, Business & Corporate Facilities Business”

【A】

-In a year-on-year comparison of nonconsolidated performance, the cost-of-sales ratio for contracting construction improved by 3.3pt and Fujita also improved by 2.8pt. Our view is that while the cost-of-sales ratio for contracting construction has improved, it is not a strong environment for orders received. The postponement or cancellation of projects due to the COVID-19 and an overall decline in large-scale construction projects throughout the industry has driven the super general contractors to target smaller budget projects. This is increasing competition in the orders received environment.

【Q9】

Operating income for the Other Businesses was 13.2 billion yen through the third quarter but your full-year plan outlines operating losses of 2.0 billion yen. Can you explain your outlook for the Other Businesses?

(Reference) Financial Highlights: P.21 “Logistics, Business & Corporate Facilities Business”

【A】

-Our outlook is that, as is outlined in our plan, the Other Businesses will result in an operating loss. Conditions are severe for businesses like resort hotels and sports clubs, while show no signs of a recovery yet continue to incur fixed expenses. Looking at the environment & energy business, electricity demand stressed due to cold weather in January, which drove up market prices. As a result, the retail electricity business recorded a loss for January. And considering conditions will continue to give cause for concern in February onward, we are forecasting a full-year operating loss of 2.0 billion yen with the potential that losses could swing even lower.

【Q10】

Please discuss the status of hotels after the state of emergency declaration.
(Reference) Financial Highlights: P.28 “Commercial Facilities Business”

【A】

-The impact of the state of emergency declaration has been significant. Conditions improved thanks to the Go To Travel Campaign but now the market is seeing an adverse impact. Currently, occupancy rate of the resort hotel is less than 10%. Certain facilities are limiting days of operation while others have suspended operations altogether.

【Q11】

The January highlights for orders received noted that custom-built houses were -3% but are they showing signs of shifting into positive numbers? Also, the highlights indicated that the order environment for the Commercial Facilities Business, and the Logistics, Business & Corporate Facilities Business were unfavorable but what is your view on current conditions?

【A】

-The published figure for orders received is a leading indicator but another indicator is contracted received. Our standard for recording orders received is to record projects for which a contract has been concluded, financing has been finalized, and the start of construction is projected to begin within two months.
-Looking at contracts received, Single-Family Houses have been trending towards positive figures since July with October being the only month in which numbers were down. Although the figures are not yet significant, our view is that we are gradually building a base of results.

-As for the Commercial Facilities Business, there were a significant number of hotel projects in the first half while the second half has seen a concentration of orders received on logistics facilities and nursing care facilities. However, this is not yet enough to offset the drop-off in orders received for hotels.
-Conditions are difficult as we have been unable to get orders received on a positive trajectory. Competition is intensifying for contracting construction of Logistics, Business & Corporate Facilities Business. Fujita is also struggling. In the Commercial Facilities Business, the more than 100.0 billion yen in orders received in the pipeline for hotel projects has run dry. As we look to forecast figures for the upcoming fiscal year, I envision a scenario in which net sales increase by 5% compared to final net sales for the current period but this may be difficult if conditions continue on their current trend.

【Q12】

Even if income eventually outperforms the November upward revision, the dividend payout ratio is already largely exceeding 30% so is the possibility of a dividend increase low?

【A】

-It is not set in stone that we won't reevaluate dividends. If income increases, we will respond accordingly. However, this will involve very careful analysis. It would be one thing to increased dividends based on income increases due to gains from pension asset management. However, if income increases are due to substantive improvements, then it would be warranted to evaluate an increase in dividends.

【Q13】

Please tell us your full-year forecast for SG&A expenses. Through the third quarter, although expenses did increase due to new companies being added to the scope of consolidation, you did make progress with cost reductions. Do you forecast the fourth quarter progressing as planned? Also, what is your general policy concerning SG&A margin?

【A】

-SG&A expenses decreased by 3.4 billion yen year on year and our rate of progress is 70% relative to the full-year plan of 503.0 billion yen.
-Overall, we are advancing cost reductions and do not expect costs to exceed the full-year plan. We can improve on these numbers even more by adding gains from asset management for retirement benefits.

-Our SG&A margin for the current period is just over 11%. For next fiscal year onward, this may change depending on net sales but, in general, we want to maintain the 11% range of the current period.
-Next fiscal year, recording the double-digit income growth we achieved prior to COVID-19 will be difficult but we will achieve increased income simultaneously making progress with cost reductions.

【Q14】

Please tell us the book value of retained assets in the hotels and sports facilities.

【A】

Resort Hotels（Royal Hotel: 28 locations）29.4 billion yen
City Hotels（Roynet Hotel: 61 locations、D-CITY: 8 locations）45.4 billion yen
Sports Clubs (71 locations）6.1 billion yen

-This fiscal year, Roynet Hotel was profitable before shifting into unprofitability due to the COVID-19 pandemic. As a result, we think impairment risks are limited. D-CITY has a lot of rental properties and the book value is 4.8 billion yen, so risk is not very high.
-As for other commercial facilities, while it is not the case that all facilities are down due to the COVID-19 pandemic, due to the large number of facilities retained, there is a possibility of impairment for some properties. However, these numbers are not that significant.
-During the previous fiscal year, we recorded 17.0 billion yen as impairment losses but approximately 9.0 billion yen of that was goodwill amortization so it is not the case that all noncurrent assets are producing impairment losses. As such, excluding the possibility of extraordinary circumstances, we think the possibility of recording impairment losses exceeding 20.0 billion yen is low.

【Q15】

Please discuss the orders received environment for the Rental Housing Business. Monthly orders received have been positive since December but what are most recent conditions like and what is your outlook moving forward? Do you think the dip has bottomed out?
Also, did you engage in mid-career recruitment in order to increase staff for once the impact of COVID-19 subsides?

【A】

-The orders received environment has not changed significantly since the first state of emergency declaration was lifted. There remains a strong demand among customers seeking proposal to address inheritance taxes and we are receiving some good inquiries. However, at present, the resurgence of the COVID-19 pandemic has resulted in reduced opportunities for face-to-face meetings. As a result,

orders received has not shifted into the positive.
-Moving forward, we will work to generate demand by promoting the retroactive application of the Green Home Points System by the Ministry of Land, Infrastructure, Transport and Tourism.

-As for sales staff, we conduct very little mid-career recruitment and instead develop staff in-house through new graduate recruitment.

【Q16】

The hotel business is responding to the state of emergency declaration through measures such as establishing business holidays. In such cases, are personnel expenses being transferred to extraordinary losses like what was done for the first quarter (provisional expenses related to the COVID-19 pandemic)?

【A】

-Expenses at facilities that implement a long-term shutdown are recorded as extraordinary losses. However, at present we have no hotels in that category so we think almost no such transfers will occur.

【Q17】

Assets increased by 361.0 billion yen compared to the end of March 2020. Please provide a breakdown of this figure.

【A】

-This is largely due to cash and deposits, and an increase in real estate.
-Factors behind the increase in cash and deposits include executing a hybrid loan to increase capital on hand due to increase need for operating capital among Group companies due to COVID-19. Looking at the state of capital demand, we wanted to execute the hybrid loan based on a slightly later timing but decided on October 2020 in light of the procurement environment.
-There are multiple factors behind the increase in real estate for sale but this is mainly due to increased real estate overseas. For example, in the Single-Family Houses Business in the United States, Stanley-Martin increased by 20.9 billion yen and Trumark increased by 11.3 billion yen. In the Condominium Business, the inventory of completed properties in Japan increased and this also reflects ongoing condominium development in the United States and China. Moving forward, we intend to accelerate sales and reduce real estate holdings.

End

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