Message from the CFO

Working to enhance shareholder value by maintaining a good balance between growth and stability

<Our responsibility>

"What I want to say here is that we have responsibilities.

Our first responsibility is to our shareholders. Our second responsibility is to our creditors. Our third responsibility is to ensure the livelihoods of our employees and their families and to provide them with stable lives. Our fourth responsibility is to society. Accordingly, we are obligated to further grow and develop the company, raise profits and return those profits to society.

To develop, we must cultivate various qualities within ourselves, such as a positive attitude, the ability to take swift action and cost-consciousness. Therefore, sloppy management cannot be tolerated in any way."

The Future of the Daiwa House Group: Nobuo Ishibashi *(October 29, 1963)*

Takeshi Kosokabe

Takeshi Kosokabe
Representative Director and
Senior Managing Executive Officer and CFO

Through the provision of the goods and services that society needs, the management of the Daiwa House Group works to create value for its shareholders, customers, employees, business partners, and the community as a whole, and in this way to raise the Group's enterprise value.

To make this possible, in line with its motto of being "a group that co-creates value for individuals, communities, and people's lifestyles," we operate businesses that meet social needs across a wide range of fields. We therefore pursue excellent corporate governance so as to achieve and maintain the very highest level both in our contributions to society—through aggressive investment in innovation and the opening up of new businesses—and in our creation of shareholder value by generating economic value that reliably exceeds capital costs over the medium and long term.

The duties of a chief financial officer consist principally of the two aspects of protecting the company's existing assets and legal status—including operations such as overseeing the accounting and end-of-term settlement of accounts, and drawing up the company's tax declarations—and of making it possible for the company to grow its business operations and financial base through the drafting of business and financial strategies. While maintaining the level of quality of both these aspects and working toward greater efficiency, a CFO must also maintain a balance between the drafting and implementation of management strategies on the one hand and internal control on the other. From here onward, I intend to place greater emphasis on strategies to realize the Daiwa House Group's potential and grow its overall business. I will facilitate the Group management's decision-making by presenting a number of future scenarios that take into account my perception of the direction in which we wish to take the entire Group or particular businesses, the need to make our management strategies conform to financial realities, the unique characteristics of each business, and the likelihood of materialization of risks.

Aiming at a balance between active investment and financial stability

Achieving sustained growth is essential to raising shareholder value, and to realize this, it is vital for effective business management to balance active investment in growth on the one hand with ensuring that our financial base is solid on the other. To enable the stable procurement of the funds needed for investment in growth, we must secure and maintain a sound financial base. As the Company's credit rating is a high AA*, as long as we maintain this status, we should experience no problem with the procurement of funds even in the event of another emergency on the scale of the 2007-2008 financial crisis.

From this perspective, we have positioned ROE as a high-priority management indicator, and are working to ensure effective utilization of shareholders' equity. Simultaneously, we will aim to maintain an appropriate balance between shareholders' equity and interest-bearing debt, holding the debt-equity ratio—an important indicator of financial soundness—to around 0.5.

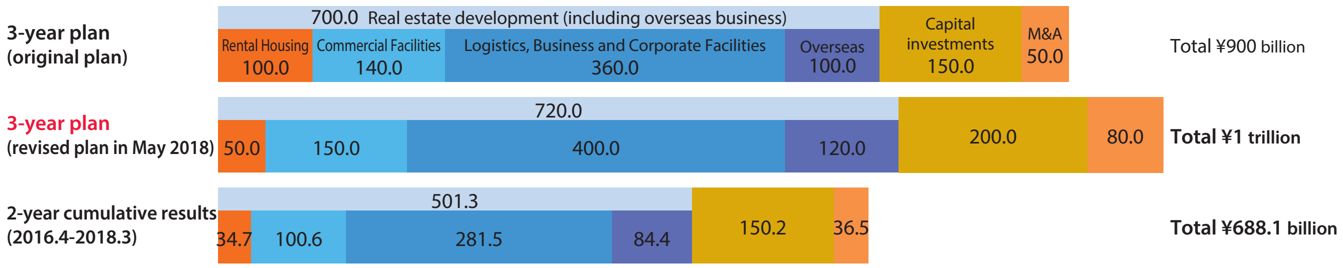
Under the Group's Fifth Medium-Term Management Plan (fiscal 2016-2018), we set the benchmark for ROE at a minimum of 10%, but in fiscal 2016 and fiscal 2017 we easily cleared this bar, reaching 16.3% and 17.0% respectively.

During the period of our Sixth Medium-Term Management Plan, starting from fiscal 2019, a number of changes are foreseen in the Group's operating environment, including the increase in the consumption tax rate planned for 2019 and a falloff in construction demand following the 2020 Tokyo Olympics and Paralympics. To be able to maintain the same high level of ROE that we have recorded hitherto, we will have to achieve further growth and increased earnings. Thus, we aim to

* (Long-term) Issuer Ratings: Rating and Investment Information, Inc. (R&I) AA-
Japan Credit Rating Agency, Ltd. (JCR) AA

The Fifth Medium-Term Management Plan (2016.4-2019.3) Investment plan

(¥ billion)



Progress of real estate investment development plan

(¥ billion)

	3-year original plan	2-year cumulative results	Progress (%)	Revised investment plan
Rental Housing	100.0	34.7	34.7	50.0
Commercial Facilities	140.0	100.6	71.9	150.0
Logistics, Business and Corporate Facilities	360.0	281.5	78.2	400.0
Overseas	100.0	84.4	84.4	120.0
Total	700.0	501.3	71.6	720.0

Status on sales of development properties

(¥ billion)

	FY2016 results	FY2017 results	FY2018 plan	3-year cumulative plan
Rental Housing	7.8	21.2	21.2	50.3
Commercial Facilities	7.8	12.1	17.3	37.3
Logistics, Business and Corporate Facilities	87.3	54.7	61.2	203.2
Total	103.0	88.1	99.8	290.9

continue the effective utilization of shareholders' equity and raise capital efficiency, and will work to enhance shareholder value.

At the end of fiscal 2017, the aggregate total amount of investment in growth over the previous two years was ¥688.1 billion. Taking into account this investment record and current trends in the market, in May 2018 we took the decision to raise total investment over the three-year period of the Group's Fifth Medium-Term Management Plan from ¥900 billion to ¥1 trillion. Investment in real estate development made a contribution to business performance, as a result of which investment opportunities multiplied and thus progress was faster than had been projected. Investment in this category is therefore scheduled to increase by ¥20 billion to ¥720 billion—an all-time record—but this does not mean that investment in all sectors will increase. While increases of ¥40 billion in logistics facilities and ¥20 billion in overseas investment are foreseen, investment in Rental Housing is decreasing. In this way, with respect to investment in growth, we will continue to assess market trends and new business opportunities, and to follow a policy of flexible and efficient investment.

Risk management is an important element of real estate investment. At the Daiwa House Group, proposals that do not meet the criteria for a positive resolution by the Board of Directors are referred to the Real Estate Investment Committee, which evaluates their business feasibility and the risks involved. As an investment criterion, each proposal must pass the hurdle of offering a predetermined IRR (internal rate of return), and before a final decision on whether or not to make an investment, the proposal must first be checked from a wide variety of perspectives—by President Yoshii, the Committee Chairman, by the executives responsible for the Group's business divisions (who are qualified to assess the proposal's business feasibility), by the executives responsible for our technological divisions (who are qualified to assess the appropriateness of the projected construction cost), and, finally, by myself. Going forward, we are working to realize a system that will enable risk assessment with a high degree of accuracy.

Regarding mergers and acquisitions (M&A), we have revised upward our planned investment total from ¥50 billion to ¥80 billion. M&A activity is essential if we are to continue expanding our business scale, but for such measures we insist that the target of a merger or acquisition meets the important criterion of being a business or corporation that is and will remain necessary for society, and that we have good hopes of creating a win-win relationship. And in relation to making a decision on an investment proposal, or in the practical handling of the negotiations involved, to ensure that the confidentiality of information or data is protected while negotiations proceed smoothly, we entrust such work mainly to an independent unit of experts—the Investment Planning Section—which we have established within our Business Development Department. The Section staff undertake the necessary due diligence with respect to negotiations with the counterparty, as well as all related legal, financial and taxation-related matters.

The Role of the Finance & Accounting Department

Nobuo Ishibashi, our founder, often used to say that the financial and accounting sections constituted the linchpin of any company, and in line with this, we always ensure that the staff of every one of our 81 branches throughout Japan includes an accounting and administration manager with experience working in the Finance & Accounting Department. For this reason, unlike the general run of companies, the working environment within the Finance & Accounting Department of Daiwa House gives its staff excellent motivation because they know that they can voice their opinions on risks likely to impact the Company, or on the Company's strategies.

The accounting and administration managers are expected to play a difficult role. They must not only be fully acquainted with the attitude to business operations held by the branch office managers, and the policies in place there, and be ready to provide assistance, they must also be ready to explicitly make known their opinions in cases where these differ from the decisions of branch management, in order to provide a hedge against risks. For this reason, it is important for the accounting and administration managers to possess both knowledge of the Company's business strategies around which decisions are being made and knowledge relating to the pursuit of operations on the front line. To foster personnel capable of performing these tasks within the Finance & Accounting Department, we implement job rotation programs that enable staff to gain experience both at the Company's Head Office and at branch offices. I believe that it is one of my most important roles as CFO to maintain this form of finance- and accounting-related organization.

Shareholder Return

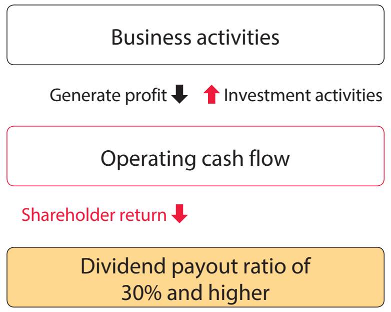
Daiwa House Industry follows a basic policy of working to raise shareholder value by increasing EPS through investment in growth funded by the profits we create by our business activities. Profit return to shareholders, in the form of the Company's dividend payout ratio, is linked to business performance to the extent of 30% or more of net income attributable to owners of the parent, and we intend to maintain a steady level of dividends going forward. Through investment in growth in conformity with this policy, and by other means, we have been able to steadily grow profits and increase the EPS, and our dividend has risen to ¥107 per share for fiscal 2017, representing the eighth consecutive term of increase since fiscal 2009. In the event that opportunities for growth investment decrease henceforward as a result of changes in the investment environment, we will examine options including the purchase of own shares for retirement in treasury and reducing the dividend payout ratio, but as long as there are continued opportunities for growth we plan to keep the payout ratio above 30%.

Going forward, I intend to respond to the expectations of our shareholders and investors by fulfilling my duties as the CFO of Daiwa House and working to further enhance shareholder value. I hope you will continue to support our efforts to grow our business still further.

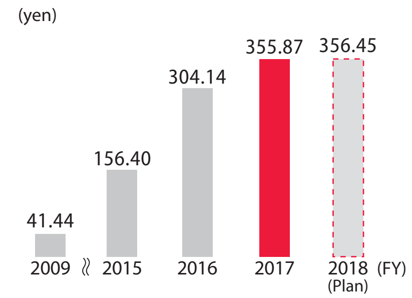
Basic Strategy for Capital Policy

Shareholder return policy

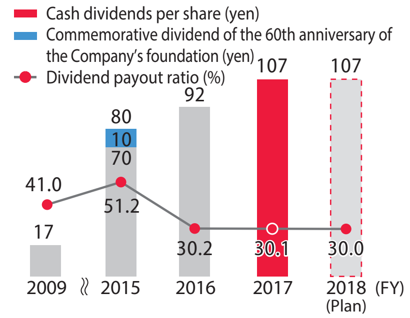
Profit allocation policy



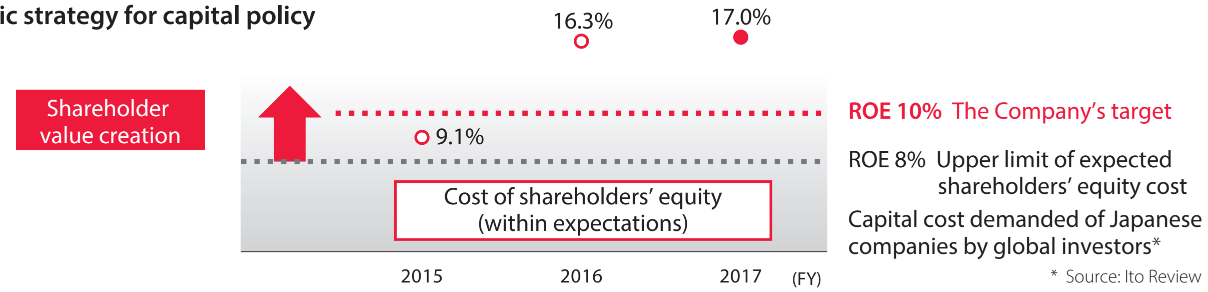
Net income per share (EPS)

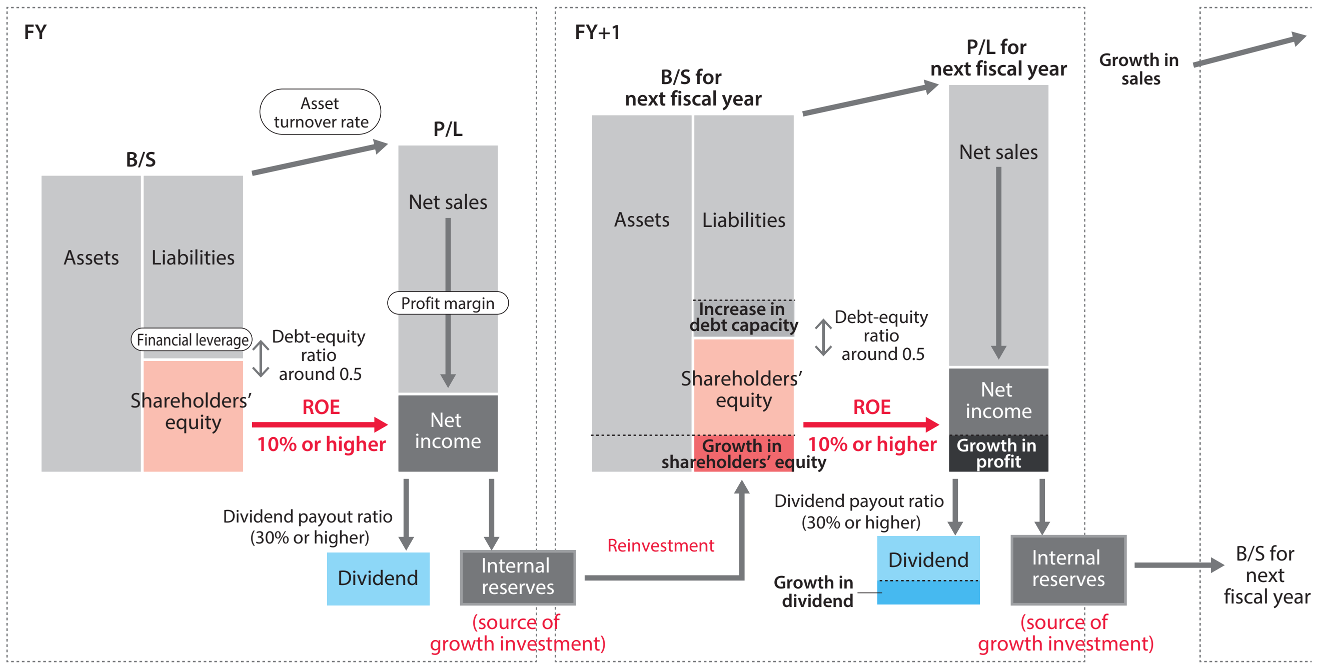


Cash dividends per share and Dividend payout ratio



Conceptual diagram of basic strategy for capital policy





FY

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.

Secure stable operating cash flow

FY+1

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 increase capital required for new growth investment.

Maintaining and improving ROE based on an optimal capital structure

Management's Discussion and Analysis of Financial Position and Results of Operations

[MD&A summary]

Note: This section analyzes the financial position and results of operations during the eight fiscal years from fiscal 2010 to fiscal 2017. For the list of financial data, see "Financial Highlights" on pages 91 and 92.

Ⅰ. Financial position

Financial condition Figure 1

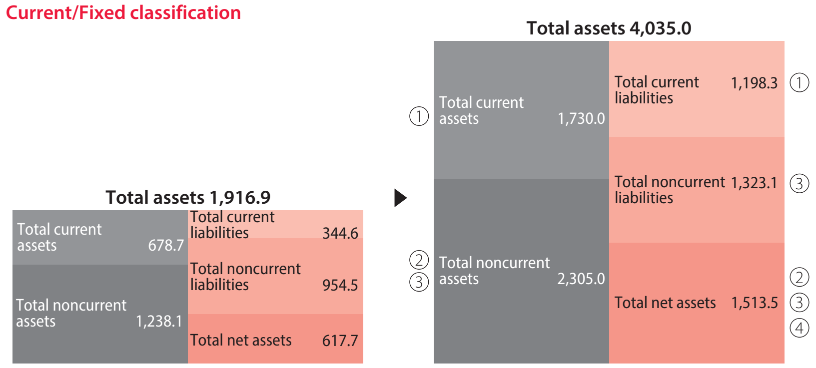
Total assets as of the end of fiscal 2017 increased by ¥479.1 billion from the end of the previous fiscal year to ¥4,035.0 billion. This was mainly due to the increase in inventories resulting from the large number of business opportunities obtained. Total liabilities increased by ¥295.4 billion from the end of the previous fiscal year to ¥2,521.4 billion. This was mainly due to financing obtained by the Company through the issuance of corporate bonds and loans.

Total net assets increased by ¥183.6 billion from the end of the previous fiscal year to ¥1,513.5 billion. This was mainly because a net income attributable to owners of the parent of ¥236.3 billion was recorded.

The balance of interest-bearing debt increased by ¥139.9 billion from the end of the previous fiscal year to ¥780.5 billion. Thanks to internal reserves and the fiscal 2013 capital increases, the debt-equity ratio improved from 0.74 at the start of fiscal 2010 to 0.53, close to the indicative target of 0.5. In terms of the breakdown of assets, the balance of real estate for rent was ¥978.3 billion and accounted for a large share in recent years. As assets are expected to grow in the future due to the acquisition of real estate for development and other factors, we will seek to maintain financial health by verifying the optimal capital structure.

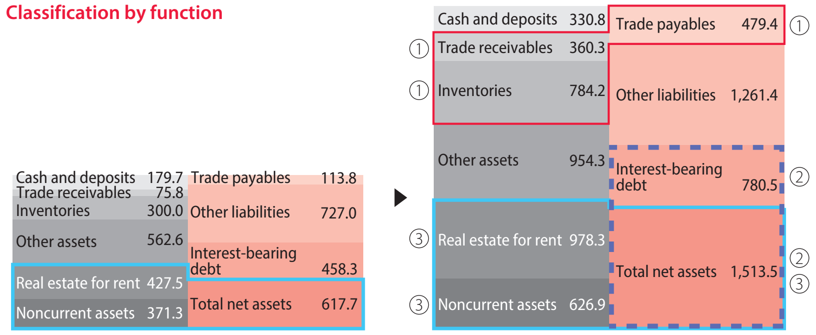
Figure 1 Comparison of balance sheets (¥ billion)

Current/Fixed classification



①The current ratio dropped from 197% to 144%.
②The fixed ratio dropped from 200% to 156%.
③The ratio of fixed assets to long-term capital rose from 78% to 82%.
④Net assets excluding non-controlling interests grew from ¥616.8 billion to ¥1,474.5 billion.

Classification by function



①Working capital (Trade receivables + Inventories - Trade payables) increased from ¥262.0 billion to ¥665.2 billion.
②Interest-bearing debt increased from¥458.3 billion to ¥780.5 billion, but the debt-equity ratio fell from 0.74 to 0.53.
③The ratio of real estate and noncurrent assets to net assets excluding non-controlling interests fell from 1.29 to 1.09 while real estate for rent increased.

Ⅱ. Cash flows

Basic approach

The basic approach to cash management is to invest in line with the amount of cash generated by business operations.

With regard to attractive investment opportunities, investment is structured to include externally raised capital because of the need to actively pursue such opportunities. While this will result in the debt-equity ratio sometimes exceeding 0.5, we seek to balance investment in growth with financial soundness by controlling the level of interest-bearing debt to maintain a ratio of about 0.5 over the medium to long term.

Cash flow condition Figures 2 & 3

Cash flows from operating activities during fiscal 2017 increased by ¥12.4 billion from the previous fiscal year to ¥300.1 billion. The ratio of cash flows from operating activities to net assets excluding non-controlling interests remained at a relatively high level, although it decreased by 2 points from 22% of the previous fiscal year to 20%.

Cash flows from investment activities were - ¥313.6 billion, due to the acquisition of real estate for rent, etc. and the implementation of the ¥220.6 billion investment into the real estate development business based on the investment plan under the Fifth Medium-Term Management Plan. As a result, free cash flows (cash flows from operating activities + cash flows from investment activities) were - ¥13.5 billion while cash flows from financial activities were ¥41.8 billion because of the response to demands for funds through bond issuance, loans, etc.

As a result of the above, the balance of cash and cash equivalents at the end of fiscal 2017 (after bank holiday adjustments) was ¥243.8 billion, an increase of ¥30.5 billion from the end of the previous fiscal year.

Enterprise value/Ability to generate cash Figures 4 & 5

Our ability to generate cash steadily grew as earnings before interest, taxes, depreciation and amortization (EBITDA)*1 as an indicator of ability to generate cash were ¥411.3 billion. We will further enhance the ability to generate cash and improve enterprise value by continuing the policy of maintaining interest-bearing debt at a certain level and aggressively investing in favorable investment projects, as well as by developing new revenue streams.

The enterprise value (EV)*2 at the end of fiscal 2017 was ¥3,181.3 billion, a sum of the market capitalization of ¥2,731.5 billion and the net interest-bearing debt of ¥449.7 billion.

The EV/EBITDA ratio, as an indicator of enterprise value to the ability to generate cash, was 7.7 as of the end of fiscal 2017.

Figure 2 Cash flows

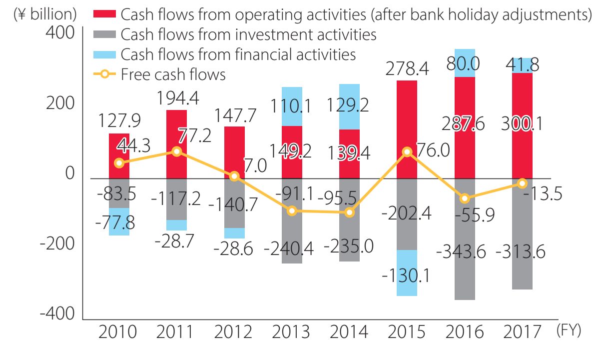


Figure 3 Indices to net assets excluding non-controlling interests (as a ratio where net assets excluding non-controlling interests is equal to 1)

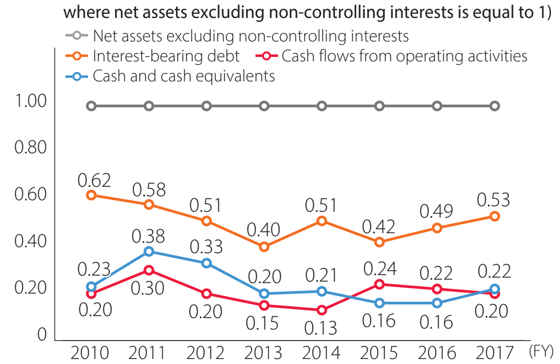
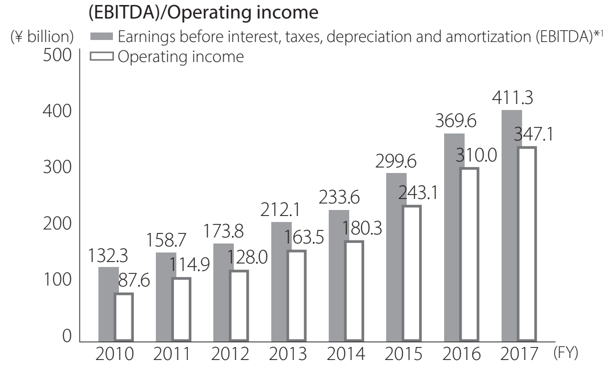
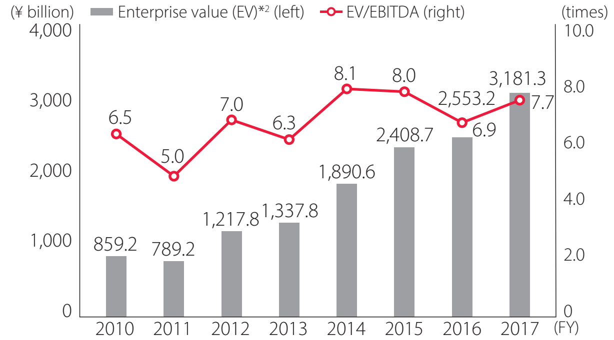


Figure 4 Earnings before interest, taxes, depreciation and amortization (EBITDA)/Operating income



*1 Earnings before interest, taxes, depreciation and amortization (EBITDA) = Operating income + Depreciation

Figure 5 Enterprise value (EV)/EV/ EBITDA



*2 Enterprise value (EV) = Market capitalization + Net interest-bearing debt

Management's Discussion and Analysis of Financial Position and Results of Operations

Ⅲ. Profits and losses

Net sales/Total asset turnover ratio Figure 6

Net sales amounted to ¥3,795.9 billion and the average growth rate for the period of eight years starting from fiscal 2010 was 11.7%.

In terms of the total asset turnover ratio*1, the period of five years from fiscal 2013 to fiscal 2017 shows a tendency of slight improvement in comparison to the performance in the period of three years from fiscal 2010 to fiscal 2012.

To further improve the turnover ratio, we will continuously seek to ensure the effective utilization of assets through measures that may include encouraging the sale of inventories and also selling investment properties and strategically held shares.

*1 Average during the fiscal year.

P.84 (Details of decision-making criteria for the sale of strategically held shares)

Gross profit/Operating income margin Figure 7

Gross profit amounted to ¥793.8 billion and the average growth rate for the period of eight years starting from fiscal 2010 was 12.7%. The gross margin increased by 0.4 points from the previous fiscal year to 20.9%. Operating income was ¥347.1 billion and the average annual growth rate for the period from fiscal 2010 was 24.3%. The operating income margin was 9.1%, an increase of 0.3 points from the previous fiscal year.

This is because we succeeded at maintaining a steady cost-of-sales ratio through investments in production facilities and rationalization of production to deal with soaring construction material and labor costs.

Return on invested capital (ROIC)/Return on equity (ROE) Figures 8 & 9

Net operating profit after tax (NOPAT)*2 was ¥240.1 billion and return on invested capital (ROIC), a ratio of NOPAT to the invested capital (= Net assets excluding non-controlling interests + Interest-bearing debt) of ¥2,102.0 billion*3, was 11.4%. One of the Company's business objectives is to earn an ROE of 10% or more. Since we are expanding our businesses by means of loans and the like where the debt-equity ratio of 0.5 is used as a guide, we make a conscious effort in our business investments to ensure that the return on the total invested capital will exceed the weighted average cost of capital (WACC), which is the weighted average of the cost of shareholders' equity and cost of liabilities. We will seek to maintain and improve the return on equity (ROE), a ratio of net income to shareholders' equity by maintaining and improving the ROIC.

*2 Net operating profit after tax (NOPAT) = Operating income × (1 - Effective corporate income tax rate)

*3 Average during the fiscal year.

P.87 (Details of the criteria for adoption of investments in real estate development)

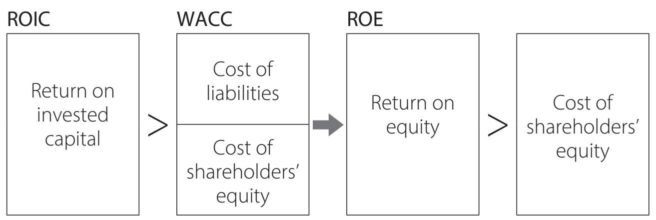


Figure 6 Net sales/Total asset turnover ratio

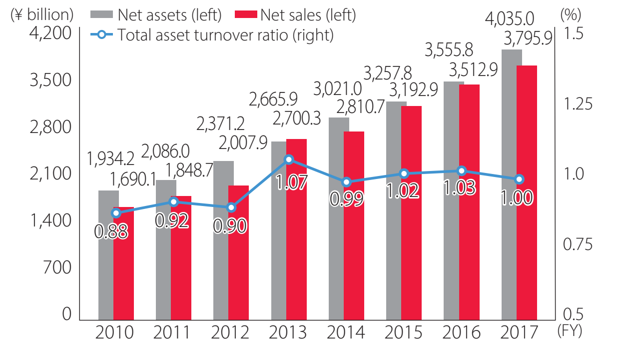


Figure 7 Gross profit/Operating income margin

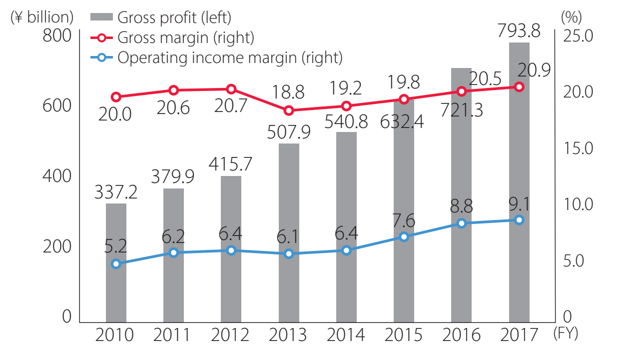


Figure 8 Return on invested capital (ROIC)

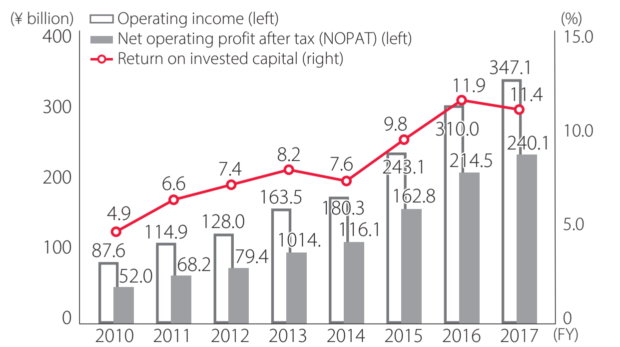
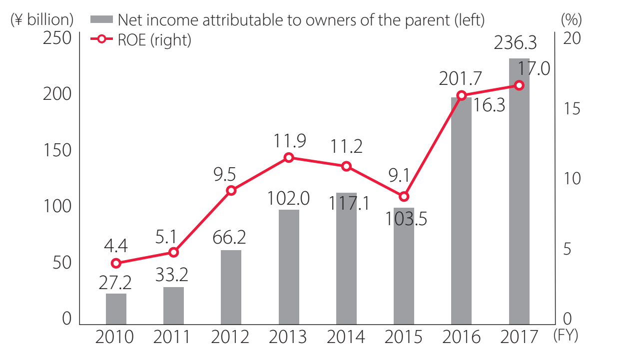


Figure 9 Net income attributable to owners of the parent/ROE



Note: By changing the discount rate used to calculate retirement benefit obligations from 1.7% to 0.8% in fiscal 2015, the Company posted extraordinary losses of ¥84.9 billion. As a result, the ROE dropped by approximately five points.

[Business segments]
Single-Family Houses / Rental Housing / Condominiums / Existing Homes Business / Commercial Facilities / Logistics, Business and Corporate Facilities / Other Businesses

Ⅳ. Business results by segment

Growth potential analysis Figure 10

The profit growth rate for fiscal 2017 over fiscal 2010 showed an over eight-fold increase in the Other Businesses segments, and an over seven-fold increase in the Logistics, Business and Corporate Facilities segments, an over three-fold increase in the Existing Homes Business and Commercial Facilities segments. Since the Rental Housing segment had been already at a high level of profit eight years ago, its profit growth rate over fiscal 2010 was relatively low, but remained at a high profit rate.

One of the Company's strengths is its ability to make business proposals with no gap between business segments. As society changes at an accelerated pace, we anticipate that multiple products and services held by individual business segments will be combined in order to cope with diversified construction needs and that there will be a further increase of new business opportunities through business development in peripheral areas. In order to ensure that these new markets will lead the company-wide growth rate, we will make an effort to grow in view of a balance with overall profitability.

Profitability analysis Figure 11

In terms of operating income, three segments, Rental Housing, Commercial Facilities, and Logistics, Business & Corporate Facilities, accounted for 81% of the total. The Existing Homes Business segment constituted 2.9% of net sales, but its profit rate and capital efficiency were high (Figure 12). We are making active use of "Livness", the new group-wide brand that we launched primarily for the Existing Homes Business, a sector where market growth is anticipated. In terms of the Single-Family Houses and Condominiums segments, we will seek to improve their profit rates by selecting areas and clarifying targets as new housing starts are decreasing in number due to falling population.

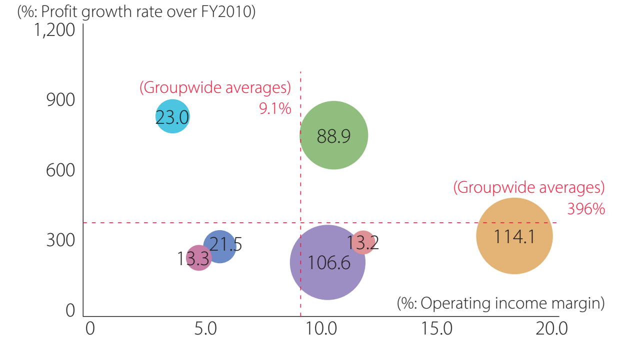
Operating income margin to segment assets Figure 12

The Existing Homes Business, Rental Housing, and Commercial Facilities segments showed higher operating income margins to segment-specific assets. The current return on assets in the Logistics, Business and Corporate Facilities segment is at a low level because we are making aggressive investments to address the rapidly growing market for logistics facilities. However, this segment is expected to significantly contribute to cash flows at the time of payback in the future.

Investments in businesses Figure 13

With regard to investments in businesses, we are aggressively investing in the Logistics, Business and Corporate Facilities segment, which is highly profitable and shows a high growth rate. We are also investing in the Commercial Facilities and Rental Housing segments, both of which are the second-most profitable. In addition, investments in the Other Businesses segment (overseas business, etc.) are being made to develop new revenue streams through the use of funds generated by the above-mentioned core segments.

Figure 10 [Business segments] Operating income*1/Operating income margin/Profit growth rate over FY2010



*1 The size of the circle depends on the relevant amount of operating income (¥ billion) for FY2017.

Figure 11 [Business segments] Operating income margin/Net sales ratio by segment (FY2017)

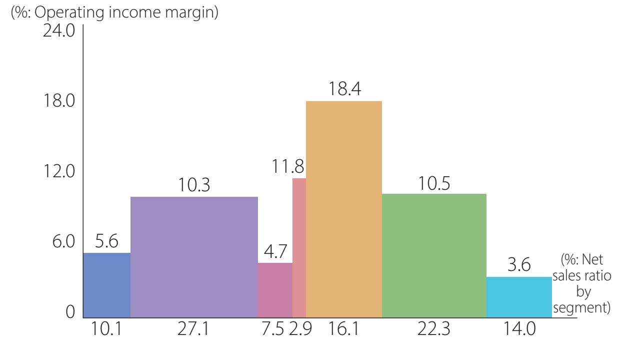
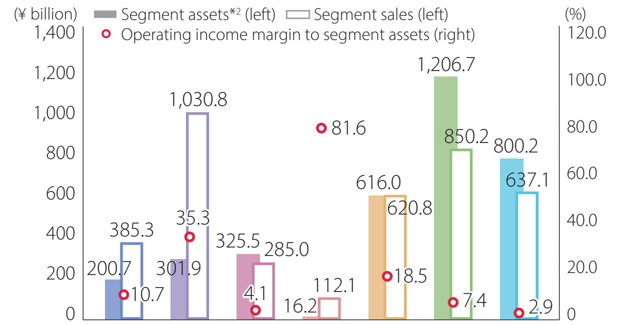
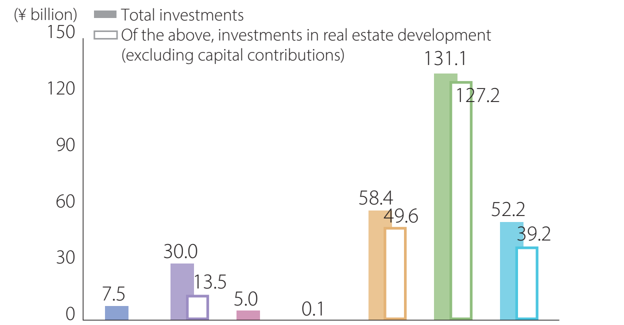


Figure 12 Operating income margin to segment assets (FY2017)



*2 Segment assets are averages during the fiscal year.

Figure 13 [Business segments] Total investments (FY2017)



Management's Discussion and Analysis of Financial Position and Results of Operations

V. Investments

Investments and returns for employees Figures 14 & 15

One of the essential elements for sustaining growth is to invest in the development of human resources and to maintain and improve the living environment of employees. The human resources development costs*[1] for fiscal 2017 were ¥540 million (on a non-consolidated basis), 115% up from fiscal 2010 (Figure 15). Employee salaries on a non-consolidated basis increased by ¥43.4 billion from fiscal 2010 (an average increase of 25% or ¥1,788,000 per employee).

Meanwhile, the ratio of employee salaries to operating income*[2] decreased from 62% in fiscal 2010 to 37% in fiscal 2017, and the growth rate of profits significantly exceeded the rate of increase in personnel costs. As a result, we have successfully secured funds for growth investments and increased returns to shareholders, and will actively promote investments in human resources, which are the most important source for growth.

*1 Personnel costs on training, etc. + Transportation costs on training
*2 Employee salaries/(Operating income + Employee salaries)

P.67-68 (Details of our human resources development)

Investments in research and development (R&D) Figure 15

R&D expenditures in fiscal 2017 were ¥8.7 billion, of which ¥5.0 billion was for the housing business, ¥2.8 billion for the business construction business, and ¥0.8 billion for other businesses. Our research and development activities range from basic and applied research to the development of new technologies and new products, and further to utilization and verification of these new technologies in architectural structures and urban development.

P.72 (Details of our research and development)

Capital investments Figure 16

Capital investments of ¥73.0 billion (excluding investments in real estate development) were mainly for replacing production lines in plants to increase production efficiency and for renovating plant facilities. Well-planned investments in production lines are carried out based on market trends, order trends, and other factors. With regard to major assembly processes in particular, which are a significant element affecting the cost-of-sales ratio and quality improvement, we will work on further increasing the rate of automation.

P.71 (Details of our technology and manufacturing base)

IT-related investments Figure 17

IT-related investments involve significant elements that may lead to revenue increases and cost reductions in the future, such as through the enhancement of added value in products and services, through utilization in marketing, and through the achievement of higher efficiency in production processes and operations. Therefore, we will actively work on such investments by combining the injection of more funds with the improvement of the organizational structure.

P.72 (Details of strategically utilizing IT and information capital)

Figure 14 Ratio of employee salaries to operating income (non-consolidated)

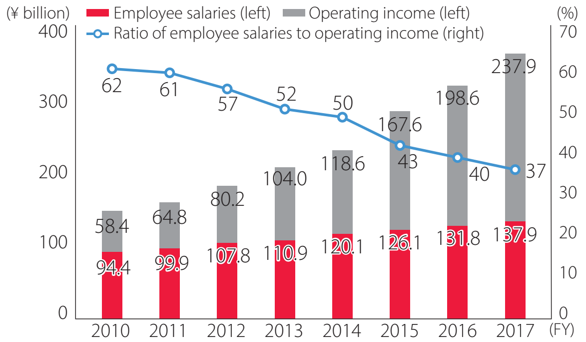


Figure 15 Research and development expenditures/Human resources development costs

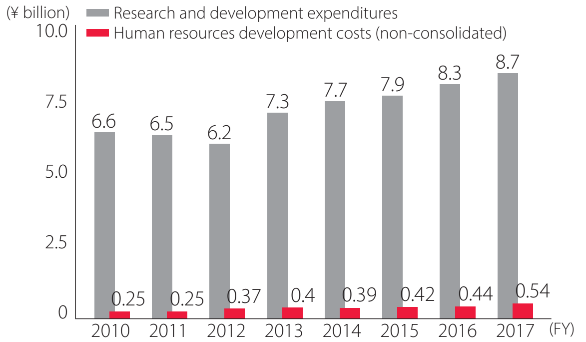


Figure 16 Capital investments (excluding investments in real estate development)

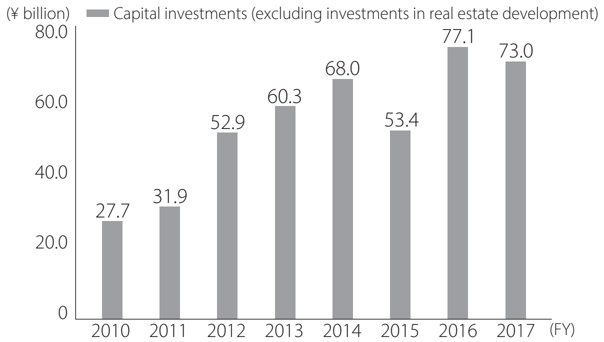
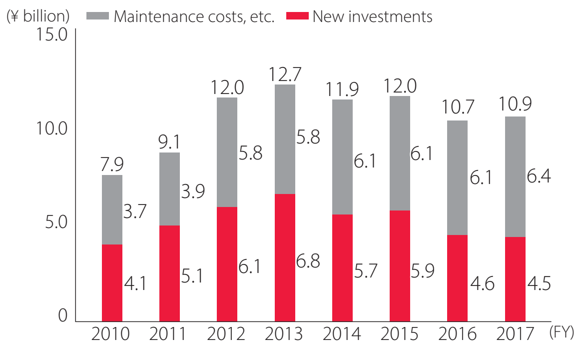


Figure 17 IT-related investments



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