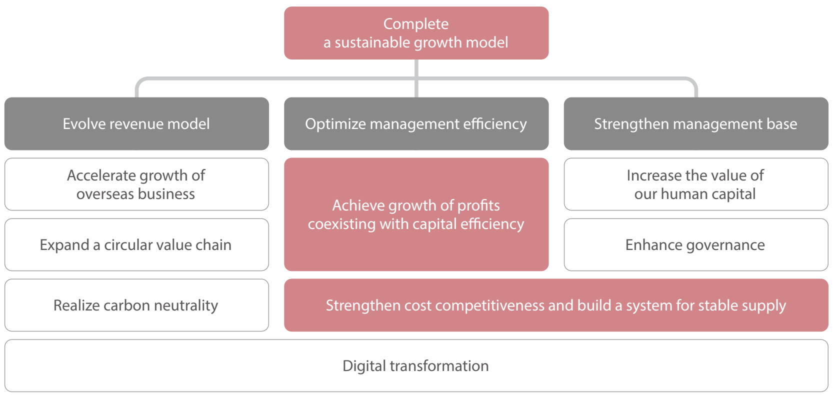
Message from the CFO

Chapter 4

Policies and focal themes of the Seventh Medium-Term Management Plan



Chapter 4 Message from the CFO

Takeshi Kosokabe
Executive Vice President and CFO

Maximizing corporate value through ongoing investment in growth and balancing profit growth and capital efficiency

Looking back on Sixth Medium-Term Management Plan

Despite solid results from our investments, ROE came in at 11.7% due to the pandemic

Our Sixth Medium-Term Management Plan starting in fiscal 2019 initially set out to generate ROE above the cost of capital while maintaining a sound financial position, driven by growth in the Rental Housing, Commercial Facilities, and Logistics, Business and Corporate Facilities segments to improve shareholder value. However, the onset of the COVID-19 pandemic prompted us to do a rethink of our plans in early 2020: Stay-at-home demand and burgeoning e-commerce led us to increase our planned logistics facilities investment by ¥300 billion in June, and we ploughed a cumulative ¥1,058.7 billion into property development between fiscal 2020 to fiscal 2022. Our plans to crystallize gains in line with our exit strategy also went smoothly, enabling us to recoup ¥716.9 billion from sales over the three years; we see this as a demonstration of our investment success.

In fiscal 2021, the last year of the plan, we were able to achieve a historical high of ¥4,439.5 billion in net sales, but fell short of our 13% ROE target as the impact of the pandemic on our hotel and sports club operations continued.

Debt-equity ratio was around 0.6 times due to upfront growth investment and pandemic

Our debt-equity (D/E) ratio came in at 0.61 times in fiscal 2021 (taking into account hybrid finance) vs. our benchmark of 0.5 times, due to upfront growth investments, in addition to the impact from the pandemic. Fundraising over the three years comprised ¥150 billion in 2019 through a hybrid bond issue and ¥100 billion from a hybrid loan in 2020. Despite the uncertain outlook, fund providers appreciated our robust financial position, enabling us to obtain funds to invest in growth sectors while maintaining our AA credit rating.

Bolstered overseas management systems; continued business investment

Overseas, we established regional headquarters and management divisions to reinforce the management structure. We also continued to invest in the business with the acquisition of a US housing company and preparations for condominium developments in China. Net sales from our overseas business reached ¥445.1 billion. We expect sales growth from next fiscal year onward due to the promise of the US business and anticipate earnings from our Chinese condominium developments. Still, in my CFO role, I am overseeing the overseas business with an eye on interest rate movements and the global situation.

Ongoing investments in work-style reform and technological platform

The way our employees work changed dramatically over the past three years through human resources investments focused on digitalization, education, and recruitment, to enable work-style reforms. In September 2020, we issued ¥20 billion worth of green bonds to develop eco-friendly facilities and leverage renewable energy to reduce our environmental footprint. We deployed some of the funds to develop our MIRAI KACHI KYOSO Center, which opened in October 2021. One of the largest training facilities in western Japan, it is a world-class sustainable building using cutting-edge technologies to optimally harness the sun, the wind, and even water to achieve sustainability. Hand-in-hand with society at large, we aim to develop human resources who can co-create future value. Featuring collaborative educational activities with local children, it is a popular place for people to socialize.

Technological platform investment included the development of building information modeling (BIM), a platform for efficient end-to-end construction workflows spanning sales, design, and production through construction, maintenance, and management. We also invested in digital construction using information and communications technology (ICT), the Internet of Things (IoT), and robots to boost productivity and ameliorate on-site labor shortages.

Financial and capital strategy in Seventh Medium-Term Management Plan

Ongoing investment in human capital, intellectual capital, and the environment

Capital management in our Seventh Medium-Term Management Plan (the 7th Plan) aims to maximize corporate value through investment in future growth while striking a balance between profit growth and capital efficiency. Our key performance indicators remain a target ROE of at least 13% and revised targets of a D/E ratio of about 0.6 times and a dividend payout ratio of at least 35%.

We will carry on from the previous medium-term plan with active investment in real estate development and have earmarked ¥2.2 trillion over the plan's five years. We plan to cash flow of ¥650 billion in strategic investments, including overseas businesses (a growth area) and the environment, to achieve carbon neutrality.

We plan capex of ¥370 billion to build a next-generation business platform to be shared by our housing areas, bolster production sites in our business areas, develop an IT platform to facilitate digital transformation, and progress digital construction innovation. This of course includes investment in the human and intellectual capital that will carry our business forward.

Our first priority is investment in a sustainable growth model while increasing operating cash flows via steady profit growth and providing stable returns to shareholders.

ROE of at least 13%

We see the run of the 7th Plan as a growth investment phase. We will need to boost capital efficiency to achieve ROE of at least 13%, with an eye on growth under the 8th plan to come five years hence. To that end, we have a range of initiatives designed to use capital better. They include optimizing our business portfolio, enhancing governance at acquired businesses, overhauling low-margin businesses, and paring back inefficient assets.

Striking a balance between growth investment and capital management policies will be a challenge, but we plan to invest at the appropriate time with an eye on funding conditions so we can take advantage of growth investment opportunities as they arise.

Logistics facilities, data centers, and regeneration of commercial facilities drive growth among real estate development investments

Our focus in property development investment remains logistics facilities, with data center developments also on our radar. As part of our plans to diversify our investments, we intend to be proactive in developments rooted in regeneration such as value-adding regeneration of existing commercial facilities, neighborhood shopping centers in particular.

Our investment real estate portfolio already exceeds ¥1.3 trillion. In particular, properties not being rented in our real estate available for sale are increasing, but the majority are under construction. We will proceed with developing properties not being rented under the 7th Plan and intend to maximize income streams at occupied properties and sell them at the optimal timing to maximize profit. We envision our investment property portfolio standing at ¥2.1 trillion five years from now.

To enhance our exit strategy, Daiwa House Logistics Trust listed on the Singapore Stock Exchange in November 2021. We are aware that our investors have high expectations and plan to use the knowledge gained from developments in Japan to build logistics facilities in ASEAN countries. We intend to procure funds nimbly as well as build a cyclical business model, primarily plowing funds recovered from earlier development projects into new ones.

Real estate investment ▶ P.61

Improving ROIC and ROE through better asset turnover ratios

Total assets increased by 30% over the past three years, from ¥4.3 trillion at end-March 2019 to ¥5.5 trillion at end-March 2022. The increase is partly due to the acquisition of a housing company in the US and higher inventories associated with the ongoing development of condos in China. Going forward, we intend to continue deploying funds toward carefully selected earnings sources and generate stable cash flows by disposing of real estate for sale with an eye on asset turnover ratios.

Under our business division-based organizational structure, fully implemented in April 2021, we adopted ROIC as a key indicator. This is based on our strategy to enhance corporate value by increasing business efficiency and social value in addition to growing sales and profit. We plan to review our businesses and instill a management approach that emphasizes capital efficiency. Division heads will be responsible for balance sheets (including those of group companies) and we plan to strike a balance between one-time and recurring revenues in individual business divisions while increasing asset turnover ratios as required by the specific attributes of each business.

To improve business efficiency, we plan to enhance cost competitiveness and develop stable supply arrangements. The Group anticipates ongoing increases in resource prices and sees addressing this as a key priority. Currently, Daiwa House Industry (non-consolidated) spends some ¥400 billion annually on centralized purchases, and we intend to leverage the scale benefits of being No.1 in the building industry in centralized group procurement, aiming for 10% cost cuts from the elevated levels.

The thinking behind 0.6 times D/E ratio

We previously set a D/E ratio of about 0.5 times as a financial benchmark, thinking that maintaining our AA rating would be necessary to underpin stable fundraising capabilities amid the uncertain social and economic climate. We use our own balance sheet for investments such as real estate development that require time to recoup funds, and also thought that this would impose internal discipline to ensure that we stay focused on investments meeting capital efficiency criteria.

Interest rates are currently in an uptrend, and we face risks such as increasing material and labor costs. We have a particularly diligent approach to overseas investment decisions. We are also keenly aware of growth in the 7th Plan and beyond: The Group's business used to be primarily construction contracting, which did not entail investment, but areas that require upfront investment such as real estate development are increasing their share of the overall total. In light of this, we thought it important to maintain an optimal investment level enabling us to finance growth while complying with self-imposed guidelines, so we reset our financial yardstick at about 0.6 times (including hybrid finance). In the 7th Plan, we may exceed this benchmark temporarily due to frontloaded investment in growth; but think it will move back toward the benchmark in fiscal 2026, the final year of the plan. Note that, if we increase investment in line with progress, we also intend to sell investment properties and recoup more funds from our investments as well.

Shareholder returns

Looking for sustained growth in shareholder value through efficient use of equity

To return to shareholders the value it has created through its business activities, the Company's basic policy on shareholder returns is to enhance shareholder value by maximizing corporate value over the medium to long term. The Company invests in growth areas such as real estate development, overseas businesses, M&A, research and development and production facilities in a bid to augment earnings per share (EPS). In fiscal 2021, we increased our dividend for the twelfth year running, paying an annual dividend of ¥126 (including commemorative dividend of ¥10) and achieving a payout ratio of 36.6%.

Our policy is unchanged, and we will work to maintain steady dividends in the 7th Plan and beyond, with a payout ratio of at least 35% and a minimum annual dividend per share (DPS) of ¥130.

Turning to share buybacks, in fiscal 2020 we purchased 10 million shares for a total cost of ¥26 billion. We will nimbly execute share buybacks in line with on market conditions and capital efficiency.

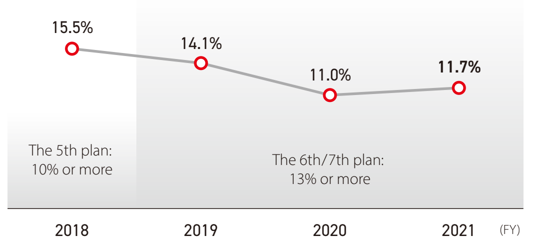
To our stakeholders

Aware of our position as industry leader, we will move to be everyone's first preference

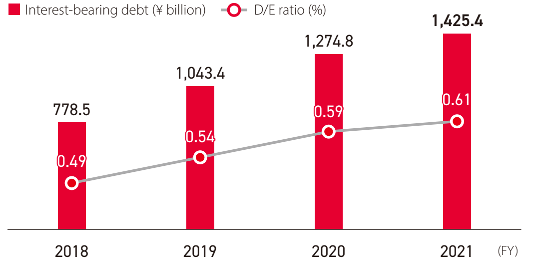
One other concept I think is crucial, is for us to become a preferred company in the wider community with full awareness of our position as an industry leader. To that end, we will update the way we evaluate performance of business sites and manage in a way that emphasizes full legal and regulatory compliance, quality technology, an accurate grasp of sound business practices, and human resources development. We are certain that our enhanced investment in people to improve motivation and accelerated work-style reforms to maximize results and establish healthy workplaces will become huge drivers of sustainable growth.

We at Daiwa House Group will work to maintain the trust of our stakeholders and continue to produce value as we strive to achieve Our Hopes for the Future (our Purpose) through co-creation. We trust you are as excited about this future as we are.

ROE Target: 13% or more

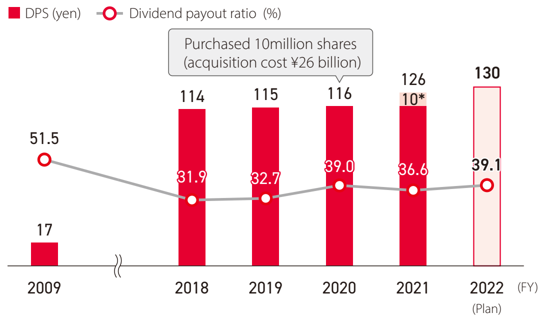


D/E ratio Target: about 0.6 times



Dividend, dividend payout ratio

Forecasting 13th consecutive year of dividend increase
Dividend payout ratio: at least 35%, minimum DPS of ¥130
Flexible share buybacks



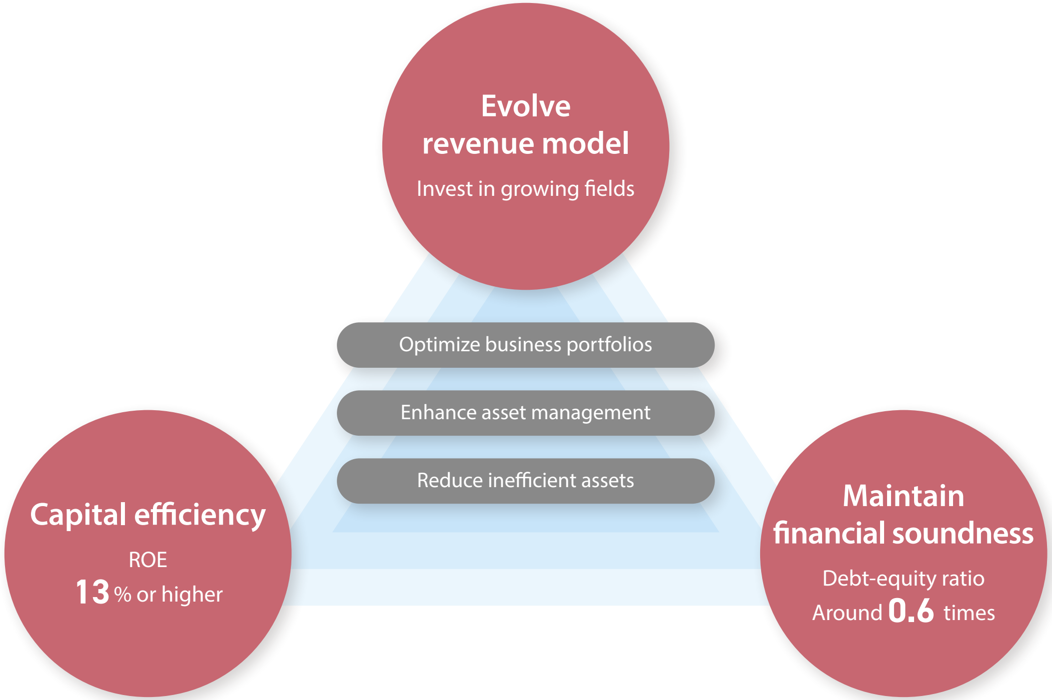
* Commemorative dividend to mark the 100th birthday of founder Nobuo Ishibashi

Management policy:
Optimize management efficiency

4 Achieve growth of profits coexisting with capital efficiency through portfolio optimization

We maximize corporate value by actively investing in growing fields and pursuing growth of profits coexisting with capital efficiency.

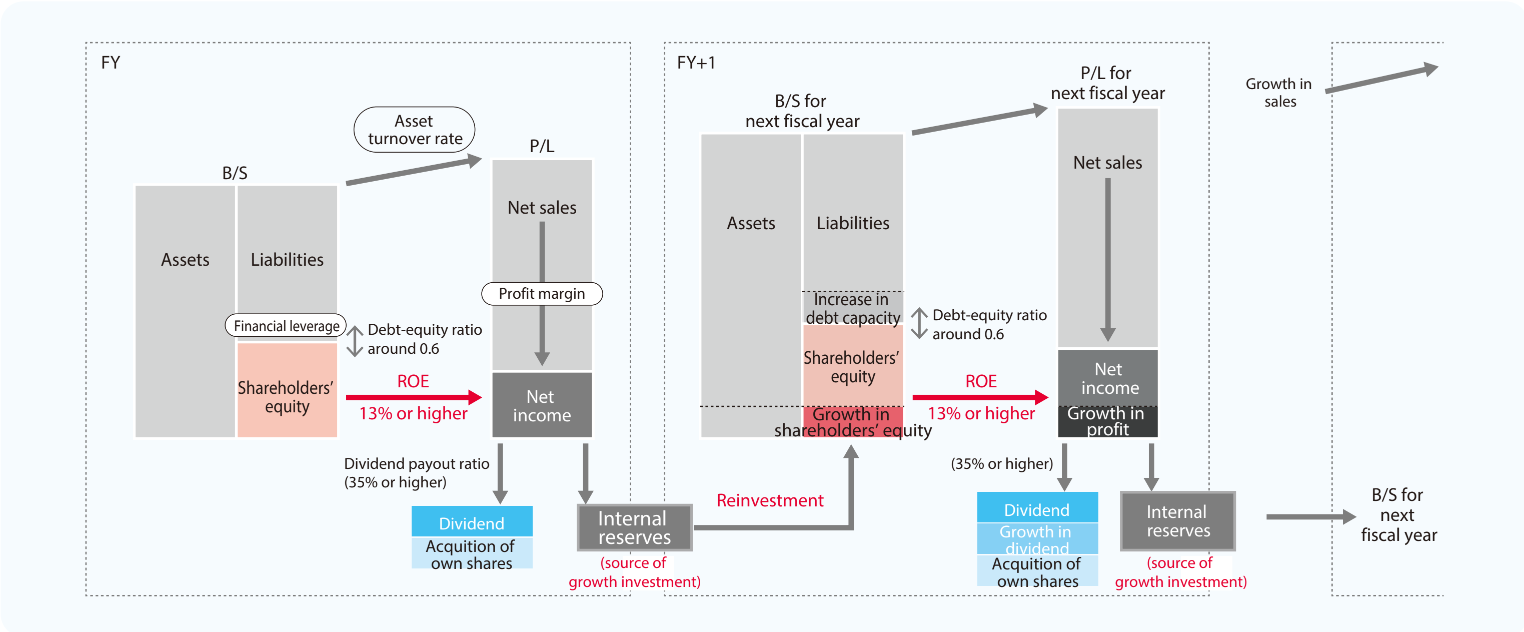
We implement management reforms to improve capital efficiency, while maintaining financial soundness with the debt-equity ratio of around 0.6, which is our financial discipline benchmark. Our aim is to achieve an ROE of 13% or higher to exceed the capital costs. With regard to a portfolio, we will focus our investment in businesses that drive the company's growth, and expand the size of such businesses. Meanwhile, businesses with problems in terms of growth potential and capital efficiency are subject to optimization. Reconsidering growth scenarios, we look into a restructuring or reorganization. In addition, we work to enhance asset management and reduce inefficient assets.



Management indicators	FY2021 (results)	FY2026 (targets)
ROE	11.7%	13% or higher
Debt-equity ratio (taking into account hybrid finance)	0.61 times	Around 0.6 times
Operating income margin (Excluded amortization of actuarial differences)	7.5%	9.1%

Basic Strategy for Capital Policy

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

Efforts to Improve Return on Invested Capital (ROIC) at Sites

To realize return on invested capital with capital efficiency that exceeds the expected rate of return (cost of shareholders' equity) for shareholders, we strive to improve ROIC at the frontline of business, with an attitude of being complete in small things. Through various initiatives at sites, we will achieve the target of 13% or higher in ROE.

Management's Discussion and Analysis of Financial Position and Results of Operations ▶ P.102

ROIC		WACC*		ROE		Cost of shareholders' equity	
Return on invested capital	>	Cost of liabilities Cost of shareholders' equity	➡	Return on equity	>	Cost of shareholders' equity	(Our shareholders' equity cost: 7.0%)

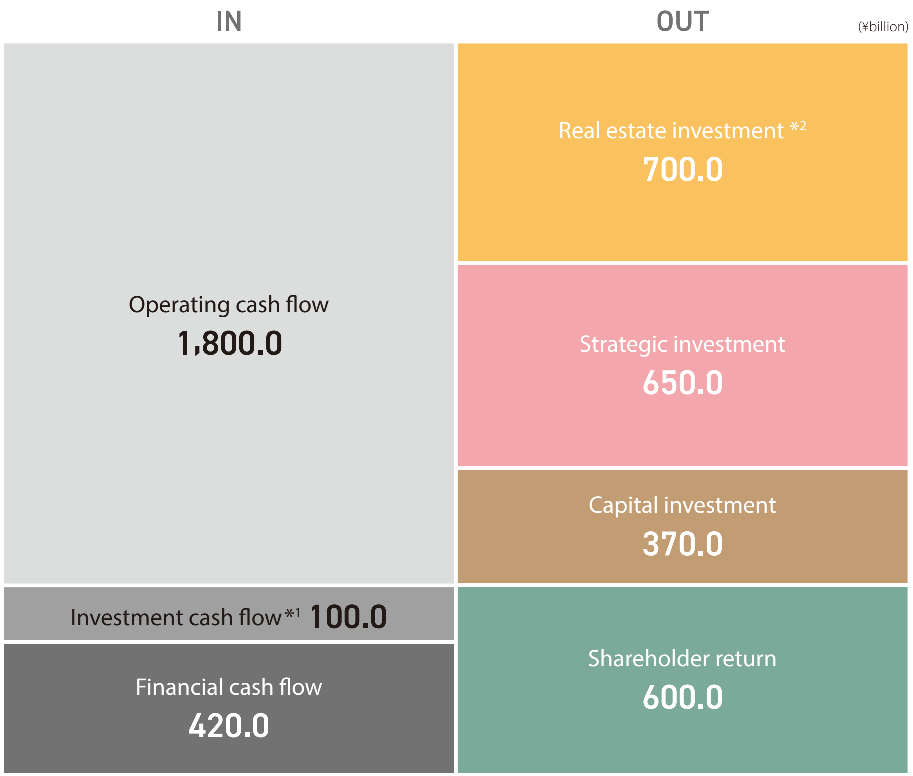
* WACC is the weighted average cost of shareholders' equity and liabilities.

- **Return on invested capital ROIC**
  - **Increase profit margin**
    - Increase profits through sales expansion
      - Increase orders received
      - Expand overseas sales
    - Improve cost-of-sales ratio (gross profit margin)
      - Strengthen appeal of products and solution-formulation capabilities, and create added value
      - Improve quality
      - Improve operational efficiency
      - Secure an accurate construction period, mitigate seasonal fluctuations (concentration at the end of terms)
      - Promote centralized purchasing for the Group
    - Reduce selling, general and administrative expenses
      - Improve productivity
    - Improve NOI yield of developed (owned) real estate
      - Begin operation of unutilized real estate as soon as possible
      - Strengthen leasing
  - **Improve asset turnover rate**
    - Accelerate recovery of funds
      - Collect receivables early
      - Increase the ratio of advances
    - Improve turnover rate of inventories (real estate for sale)
      - Sell land early with a turnover rate in mind
      - Shorten the time from land purchase to sale
    - Maximize profits from real estate we invested/developed
      - Shorten the time from land purchase to commercialization
      - Sell idle real estate

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

- Build a next-generation platform common to the housing field and 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

Management policy:
Optimize management efficiency

5 Strengthen cost competitiveness and build a system for stable supply

The Daiwa House Group consolidates and integrates purchasing processes and systems to achieve cost competitiveness, fully leveraging the industry-leading economies of scale. We reinforce in-house production systems and build a more robust system for stable supply.

The Group expects material prices to stay high and views it as one of the important management challenges. The present amount Daiwa House Industry (non-consolidated) allocates to centralized purchasing (cost pool) is approx. ¥400 billion per year, but in the future, we will promote centralized purchasing for the Group, fully leveraging the construction industry-leading economies of scale. By consolidating and unifying the orders for parts and materials, which have been placed individually by each Group company, the cost pool will reach approx. ¥1 trillion. Our target is 10% cost reduction against soared costs. Meanwhile, toward stable supply of materials, we reinforce production systems by utilizing our strengths of having in-house steel fabrication capabilities. In the housing field, we plan to build a common next-generation platform, while in the business field, we increase production capacity by rebuilding the Chubu factory, which would also mitigate outsourcing risk. In addition, we actively promote standardization and unification of parts.

Centralized purchasing for the Group

Consolidate and integrate organizations, ordering process/authorities and systems
Streamline ordering and management operations across the Group

Daiwa House Industry (non-consolidated) cost pool
Approx. 0.4 trillion*

Cost increase due to soaring material prices
Focus on stable procurement of parts and materials

Daiwa House Industry | Fujita | Daiwa Lease | Daiwa House Reform | Daiwa Living | ...

Centralized purchasing for the Group Approx. ¥ 1 trillion*

Target is 10% reduction vs. soared costs

Integrated system

* Amount allocated to centralized purchasing by Daiwa House Industry (non-consolidated) in fiscal 2020

Reinforce production systems

Sharpen the advantage of purchase with steel fabrication capabilities
Increase the rate of in-house production to mitigate outsourcing risk

Housing field: Build a common next-generation platform
Business field: Increase production capacity by rebuilding the Chubu factory

New Chubu factory (image)

Standardization/unification of parts

Set standard specifications by property category

e.g. Sashes for logistics centers: Limit to 2 or 3 standards and ensure that designs are in accordance with standard specifications

Expand the scope of initiatives by increasing the types of property/construction