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

at Announcement of Financial Results for FY2019 2Q

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

Date & time: From 16:00 to 17:00, Friday, November 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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【Q1】

I have a question about the revision to the business performance forecasts for the Logistics, Business & Corporate Facilities Business. Please give us some more background detail on the significant upward revision to net sales in the sale of development properties, the downward revision to net sales in rental management, and the downward revision to the gross margin ratio in the construction segment. Also, please explain the reasons for the loss posted in relation to large overseas construction projects.

(Reference) Financial Highlights: p18 “Logistics, Business and Corporate Facilities Business”

【A】

・In terms of the reasons for the large upward revision to net sales in the sale of development projects, one is that we made a provision for losses in large overseas construction projects in the Logistics, Business & Corporate Facilities Business. Another is that in the Rental Housing Business, based on the business performance seen up to the end of the first half, we had no choice but to make a downward version to full-year plans. For these reasons, we increased sales of development properties in the first half as a preventive move.

・As for the decline in net sales in rental management, we sold additional properties that were not factored into the initial plan, which resulted in smaller income gains.

・With regard to large overseas construction projects, in relation to construction completed in the first half by a group company, we are currently negotiating about additional work with the company that placed the order. We have taken a preventive approach, in case the additional work doesn’t come through, and recorded the cost. Also, if you exclude this project, gross margins in the construction segment in 2Q will be 14.9%.

【Q2】

What has been the recent trend in orders received in the Rental Housing Business, and what is the outlook going forward?

(Reference) Financial Highlights: p15 “Rental Housing Business”

【A】

・Orders received in the Rental Housing Business in the first half were down 20.8%. On a single month basis, orders received in October, which were announced November 8, were down 18%. The order environment remains difficult due to the impact of factors such as the tighter credit policies that have been adopted by financial institutions. It is difficult to say when we will see the beginnings of a recovery.

【Q3】

In today’s press release, you announced measures to prevent a recurrence of the problem in China. What is the current situation with the project in question, and what is the outlook?

【A】

・There has been little change from the situation communicated to you previously. In December, the joint venture agreement is scheduled to expire, and when that point is past then the process of liquidation will begin.

・Construction work has been at a stop since March, when the problem was discovered, in order to preserve the state of the building site.

・Our investment is ¥27.8 billion, and we are considering the future sale of the property, which is 80% complete, to a third party, but because we do not have visibility into how much money might be recoverable, we have not factored additional losses into our plans for the current fiscal year.

【Q4】

Regarding the selling on of the Dalian property to a third party, do candidate buyers exist? Also, assuming that you are able to sell it, do you see the loss coming in at less than ¥27.8 billion?

【A】

・Currently we do not have a candidate to buy the property. If we liquidate the company, I believe that buyers will emerge, but it is possible that negotiations on price will be challenging.

・We have already received around ¥6.0 billion from customers who have entered into contracts. Even if we were able to sell the property to a third party for a price close to the book value of ¥30.0 billion, we think it's likely that there would be a loss of ¥2.0 billion to ¥3.0 billion.

【Q5】

I understand that the main factors behind the revision to business performance forecasts for this fiscal year were the increase in the sale of development properties, the downward revision in the Rental Housing Business, and the losses related to overseas projects in the Logistics, Business & Corporate Facilities Business. What is your view on next fiscal year?

【A】

・With regard to the Rental Housing Business, recent business conditions have been severe, and it is going to be difficult to piece together the picture for profits and losses for next fiscal year, but we think we can deal with the negative impact of the Rental Housing Business through such measures as continued expansion in the sale of development properties, and growth in business segments that are strong.

【Q6】

On the subject of weakness in orders received in the Rental Housing Business, are you struggling due to lack of competitiveness? Also, has there been an impact from the off-specification components issue?

(Reference) Financial Highlights: p19 "Orders Received by Business Segment (Non-consolidated)"

【A】

・Our view is that the main factor is that the market itself is weak. It may be that the reason for our negative figures being larger than those of other companies is that we are losing a little to the competition, but then again, we think there is some impact from the +16.6% we recorded previous fiscal year.

【Q7】

How was business performance in 2Q for overseas group companies Stanley-Martin Communities, LLC. and Rawson Group Pty Ltd., and what was the market environment like?

(Reference) Financial Highlights: p14 “Single-Family Houses Business”

【A】

・Stanley-Martin Communities, LLC (USA)

-Net sales ¥40.4 billion (YoY +6.5 billion yen)

-Operating income ¥3.0 billion (YoY +0.4 billion yen)

Sales have been strong and are ahead of plan. The profit margin deteriorated temporarily in 1Q, but in 2Q it improved, and we see it recovering in line with the full-year plan.

・Rawson Group (Australia)

-Net sales ¥17.7 billion (YoY +4.2 billion yen)

-Operating income ¥0 billion (YoY -0.7 billion yen)

The market has been weak, and they have continued to struggle, but I hear that the tide of the market started to turn from around July, and we hope that there will be a recovery for the Rawson Group towards the second half.

【Q8】

Your plan for orders received for single-family houses in Japan has been left unchanged. How do you view the impact of the rise in consumption tax?

(Reference) Financial Highlights: p19 “Orders Received by Business Segment (Non-consolidated)”

【A】

・Orders received for single-family houses fell 9.2% year on year in the first half, but as we had originally factored in negative figures for the first half, results came in above expectations.

・As for the effect of the rise in consumption tax, the number of customers visiting our housing showrooms has fallen year on year from April onwards. When you consider that visitor numbers rose for eight consecutive months between August 2018 and March 2019, we think there was probably a last-minute rush of demand.

・The government has been providing pretty good policy support for housing, and for some customers there is actually an advantage in buying after the increase in the consumption tax. However, from the customer's perspective there is plenty of time, and no particular reason to hurry, so we think there are probably lots of people who are waiting to see how things develop.

【Q9】

The balance of your investments in China stood at ¥107.6 billion at the end of September. Has there been any change in the company's overall stance towards its business in China? For reasons of risk control, do you intend to reduce your exposure going forward?

(Reference) Financial Highlights: p23 "Overseas investment balance"

【A】

・Our condominiums in China enjoy a very good reputation among local customers.

・Currently we have started work on projects in Nantong and Changzhou. These two projects are being financed entirely by us, and we believe that we are able to control the risk. From our standpoint, if there are good projects available going forward, we would like to continue our business in China.

【Q10】

Gross margins in the construction segment of the Logistics, Business & Corporate Facilities Business have deteriorated in year-on-year terms, and plans have also been revised down. Is this related in some way to construction work in the domestic business for the Olympics and Paralympics?

(Reference) Financial Highlights: p18 "Logistics, Business & Corporate Facilities Business"

【A】

・Construction work related to the Olympics and Paralympics received in the domestic business is measured in tens of billions of yen, and because the margins are not as high as for usual construction work, I believe that is one of the reasons for the fall in gross margins.

【Q11】

Please give us some detail on the order environment and the outlook going forward for the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business.

(Reference) Financial Highlights: p19 “Orders Received by Business Segment (Non-consolidated)”

【A】

・We believe that we can expect the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business to continue to grow. Orders received remained firm in October, and we have plenty of projects in hand, so we expect that robustness to continue.

【Q12】

Due to the rise in sales of properties I think the outlook for cash flow is not bad, but can you share your thinking on how you will spend the excess funds? It seems that investments are also proceeding smoothly, but is this due to an increase in construction costs, or because investment opportunities were more plentiful than expected?

(Reference) Financial Highlights: p21 “Status of Business Investment”

【A】

・Our investment plans are progressing more quickly because we are pushing ahead with construction investments in logistics facilities, etc. for which the land has already been acquired. This is not caused by construction costs rising sharply.

・Looking at the current state of progress, we think that real estate investment will probably be higher than originally planned. We have also issued some hybrid bonds, but we need to look very closely at investment plans while moving ahead with sales of development properties. Accordingly, the current situation is not one that would immediately lead us to boost shareholder returns.

【Q13】

Is the large overseas project for which you made a provision a public works project or a construction project? If it is a project with a long construction period, is there a possibility that losses will occur again in future?

(Reference) Financial Highlights: p18 “Logistics, Business & Corporate Facilities Business”

【A】

・The project for which we preventively made a provision on this occasion is a construction project. This was already completed in July, and we are at the stage of discussing final settlement with the company that placed the order, so there will be no additional losses.

【Q14】

With regard to orders received overseas by affiliates, including subsidiaries, what is your view on corporate governance by the parent company going forward?

【A】

・With regard to large overseas projects, these have for some time been the subject of discussion on the Overseas Strategy Committee by the executives and others involved. Since February the scope has been broadened, and the Committee now also discusses projects that group companies are working on, so we have put in place a system that will allow us to apply the brakes.

・Going forward we will further strengthen corporate governance by the parent company.

(End)