Daiwa House Industry Co., Ltd.

Q&A Session at Presentation on Management Policies (Summary)

Date and time: From 16:30 to 17:30, Monday, May 17, 2021

Speakers: Keiichi Yoshii, President and CEO

Takeshi Kosokabe, Executive Vice President and CFO

Yuji Yamada, Managing Executive Officer and

General Manager of Finance and IR Departments

【Q1】

Until now you have grown your profit steadily, but recently, and this is partly due to COVID-19, there is a slight sense of deceleration. What sort of profit growth do you intend to aim for during the 7th Medium-Term Management Plan?

【A】

- Results for FY2020 were affected by COVID-19, with both sales and profits recording a decline, but it is not my perception that our profit growth has slowed. My interpretation is that these are realistic figures achieved in a very difficult environment by steadily promoting a variety of realistic initiatives.
- For the 7th Medium-Term Management Plan, which begins next fiscal year, naturally we want to follow a growth path, and in order to achieve that we are actively investing in growth areas. This fiscal year will be an important one from the perspective of watching carefully to establish the direction taken by COVID-19, and considering strategies to deal with that. Vaccinations are already progressing in America, and life has begun to return to normal. Japan has also seen many different changes over the past year, including the emergence of work from home, but we need to carefully observe which elements go back to how they were before, and which stay as they are, when the COVID-19 pandemic starts to taper off.

【Q2】

About real estate development investments and sales, please give us an update on progress and the outlook going forward. From next fiscal year onwards will you continue to promote the same level of investment as now? If you could at the same time give us some information on the targeted areas for investment in each business that would be appreciated.

【A】

- Real estate investments over the three years of the 6th Medium-Term Management Plan were forecast to be ¥1 trillion, and over the past two years we have invested ¥660 billion. Things are proceeding as planned. As for using the remaining tranche of slightly more than ¥300 billion, if there are attractive investment opportunities we intend to seize them, so depending on the situation that figure could rise further.

- On the other hand, sale of development properties over those three years is forecast to be ¥670 billion, and we are making steady progress in this also. Rather than trying to force through sales to create short-term profits, we will keep the depreciation period in mind, sell to the right kind of buyer and for the right amount, and thus maximize profits. From a long-term perspective, I think that is the best approach both for the Company and for our stakeholders, including shareholders, so we will make judgments based on a comprehensive view of various conditions.
- Regarding the logistics facilities that are the core of investments in the Logistics, Business & Corporate Facilities Business, it goes without saying that we believe this is still an area where there is plenty of room for growth in the medium to long term, following the expansion in e-commerce, so we will take an active approach to that. We will also take a proactive stance on development of data center by leveraging our nationwide land-use information network.
- Also, and these are not real estate development investments, in the Rental Housing Business, in order to respond to demand for houses in development projects sold as a set with land for investment purposes, we are moving forward with land purchases. In addition, in the Single-Family Houses Business, the spread of work from home has led to robust demand for suburban housing. Recent orders for houses in housing development projects have been strong, and we are actively working on land purchases to meet this demand.
- In the Commercial Facilities Business, we believe that conditions for development of shopping malls has recently become slightly challenging. Conversely, there are some tenants who want a return to stand-alone suburban outlets in response to the COVID-19 pandemic, so in addition to matching them to landowners, we are also considering acquisitions of land on our own account.

【Q3】
On the subject of shareholder returns, what are the assumptions underlying your forecasts this fiscal year, and what are your thoughts going forward?

【A】
- In FY2021, we plan to pay a commemorative dividend of ¥10 to celebrate the hundredth anniversary of the birth of our founder, Nobuo Ishibashi. This commemorative dividend represents our intention to pass on the spirit of our founder uninterrupted, and to continue to be of use to everybody in society.
- There has been no change in our desire to continue to raise the dividend by enhancing EPS by investing in growth areas. As a manager, it is my intent to fully engage with the issue of enhancing shareholder returns.

【Q4】
In the data center business, you mentioned total project size for Chiba New Town of ¥500 billion. What is the background to this figure? I would also like a comment on the outlook for the data center business going forward.

【A】

- At first, we were thinking in terms of figures that assumed only the construction of buildings, but if the Company becomes able to develop projects that include the facilities, we think we could aim for about 6-7 times the unit price per square meter of a multi-tenant logistics facility. The total floor space of the data center park we are in the process of constructing in Inzai City (Chiba Pref.) is around 330,000m^2, so we provisionally calculate that the total project size will be close to ¥500 billion.
- We are currently only working to capture simple construction work, but we are considering we how to develop ourselves going forward. We will think about the scheme needed to maximize profits, including to which buyers we should sell, hope to develop it into another “D project*” following logistics facilities.
- In addition, it is said that another five or six large-scale data centers will be required in Japan going forward. We expect this to become quite a large market, so while cooperating with Group company Fujita, which already has a track record in this area, we will move forward with a variety of measures.

*A business model unique to Daiwa House, enabling the Company to respond to diverse customer needs that include not only design and construction, but also everything from proposals for locations, and operations, to maintenance.

【Q5】

With regard to your forecasts for FY2021, please share your views on where you expect an overshoot, and where there are points that concern you.

【A】

- This fiscal year we are forecasting operating profit of ¥320 billion. The situation varies depending on the segment, but my perception is that these figures represent the absolute minimum we want to achieve.
- We are forecasting higher sales and higher profits for the Single-Family Houses Business. In addition to America, where strong performance has continued since last fiscal year, we are also seeing robust orders in Japan. This time last year our sales activity had come almost to a stop, as a result of such actions as closing our model house exhibitions, and accordingly orders in April 2021 were up 45% year on year. We are starting to feel the strength of the recovery, and we also expect good figures for orders in May, so there is plenty of potential for an overshoot of the full-year forecasts.
- For the Rental Housing Business, we are forecasting higher sales and lower profits. Bearing in mind that the order backlog at the beginning of the fiscal year had declined by around ¥10 billion year on year, we set a conservative forecast. But orders in April 2021 rose 62% year on year, so I feel there is plenty of room to make up for the shortage at the beginning of the year. Although orders for the previous fiscal year declined by 12% year on year, from July onwards there were months in which orders were positive year on year, and we are sensing strength in resilient demand from landowners, so we expect a recovery going forward.

In addition, in rental management, the occupancy rate remained at a high 98.2% at the end of March 2021. Going forward it is possible that the occupancy rate will fall slightly due to the impact of COVID-19, but we believe that

there is still plenty of growth potential to be realized through strengthening cooperation between members of the Group and raising the involvement ratio of Daiwa Living.
- In the Logistics, Business and Corporate Facilities Business, there is the possibility of the segment being affected by an intensification of bidding competition for land acquisitions and by rises in material prices, but we have an adequate stock of land already acquired, and of land that has been developed for industrial parks, and so we will move forward with our plans to develop properties. However, in relation to general construction work, because some companies have been affected by COVID-19 and are delaying their capital expenditure plans, and because competition between general contractors is intensifying, we are watching the situation carefully.
- Our concerns are focused, as you might expect, on the accommodation business and the sports club business, which are the areas that have been most affected by COVID-19. In FY2020, the Group’s accommodation business and sports club business between them recorded an operating loss of approximately ¥30 billion. Looking at occupancy rates, Daiwa Roynet Hotel (urban hotels) saw an occupancy rate of 87% in FY2019, but that fell to 34% in FY2020. At Daiwa Royal Hotels (resort hotels) it was 60% in FY2019, and 28% in FY2020. We assume that occupancy rates for the current fiscal year will not return to normal levels. A recovery in these businesses is dependent on when the COVID-19 pandemic is resolved, so we believe that careful monitoring is required.

【Q6】

Stanley-Martin has performed well since it was acquired, and you say that in FY2020 it was chosen as one of the “Builder 100.” What is the background to these strong results, and what is your opinion on the sustainability of this growth going forward?

【A】

- Our approach to M&A is to respect the other party, and to consider how becoming a Group company might lead to growth for them. This is the most important thing. My understanding is that the growth we see today is the result of Stanley-Martin having stayed true to their values, and having diligently followed their own path. The Company has steadily built its business, while purchasing land in Washington, over the course of more than 50 years, and their approach to manufacturing is extraordinarily similar to our own. Rather than implementing a simple M&A strategy it has worked to ensure full transfers of business, and has gradually increased the number of states in which it does business to expand its operations.
- If there are conservative elements to Stanley-Martin’s forecast for the current fiscal year, one of them might be its housing loan subsidiary. Last fiscal year saw demand for refinancing generated by low interest rates, and the subsidiary recorded approximately ¥7 billion in profits, but this year they have only incorporated ¥1 billion into the forecast. However, even taking this into account, I think Stanley-Martin will grow its earnings further.

【Q7】

You said that the progressive obsolescence of public wholesale markets is creating demand for redevelopment. What level of potential do you think there is in this area? If you could also comment on the state of competition that would be appreciated.

(Reference) FY2021 Presentation on Management Policies p.14: Future growth are in the Logistics, Business & Corporate Facilities Business (2)

【A】

- For the redevelopment of the Toyama public wholesale market, we have leveraged our unique strengths in being able to combine both commercial facilities and retail outlets to obtain the right of preferential negotiation. There are around 200 municipal wholesale markets nationwide but the so-called targets, where we can expect demand for rebuilding, come to just under 100 locations.
- In urban area such as the Tokyo metropolitan area and the Kinki area there may be some competition, but in the suburbs, we believe that the ability to use our nationwide network of offices and to provide proposals that make best use of local features is a strength. Accordingly, we have positioned this is a growth area. For example, during the course of redevelopment we may be asked by a client to build a hotel, and we believe we can leverage our varied portfolio to provide such multi-purpose project proposals. By having each business division work together in response to such demand, we will steadily take advantage of such business opportunities.

【Q8】

Going forward, what is the outlook for each area in the overseas business?

(Reference) FY2021 Presentation on Management Policies p.15: Overseas Business Status and Future Outlook

【A】

- In the overseas business, we are planning sales of ¥400 billion for FY2021, but I think there is room for us to improve our plan.
- In America, in addition to Stanley-Martin, FY2020 acquisition Trumark Companies, LLC will begin to contribute to sales according to plan, so we have expectations in that direction.
- In Australia, we faced serious difficulties last year, due to an economic slump caused by COVID-19, but the housing market is heading towards recovery, helped by governmental policies to support housing purchases. Meanwhile, in the Box Hill Project residential housing development is currently under way in the suburbs of Sydney, the approximately 1,500 blocks of land are selling better than expected. Group company Rawson Group is building houses for housing developments in part of the site, which has led to the generation of synergy effects. Earnings this fiscal year are expected to improve on those of the previous fiscal year.
- The condominiums business in China is extremely strong, with projects in Nantong and Changzhou having already sold out completely. Nantong will contribute to earnings starting from this fiscal year, and Changzhou to those of next fiscal year. We are also engaged in condominium management business in China, and the number of condominiums under management is expected to exceed 10,000 units, including those to be completed. Going forward we expect the management business to also contribute to earnings.
- In ASEAN, we faced a serious situation due to COVID-19, but leasing of logistics facilities that we are developing in Indonesia is moving forward.

- As our first step into Europe, in December 2020 we acquired Flexbuild Holding B.V., which is involved mainly in the sale and rental of modular building products in the Netherlands. We have heard that during the COVID-19 pandemic demand for unit housing has been rising in various forms, and we will follow their growth strategy with interest going forward.

【Q9】

In the 7th Medium-Term Management Plan the main theme is "maintain a good balance between vigorous growth and stability." Please tell us what you mean when you use the terms "vigorous growth" and "stability."

【A】

- First, by "stability" we mean strengthening governance. As a prerequisite for conducting our business activities, it is essential that we have put in place a system of legal compliance. We came up with the message "management for a balance of growth and stability" back in President Murakami's time in office, and we have returned to it once again, because we must become, even more so than ever, a company chosen by others.
- As for "vigorous growth," this expresses our intention that the introduction of the business division-based system will strengthen cooperation between Group companies under their respective divisions, leading to maximization of profit for the Group as a whole. As I used this as an example at the previous presentation of management policies, as a result of these changes in organizational structure, Group company Royal Home Centers has been incorporated into the Commercial Facilities Division. Through cooperation between Royal Home Centers and non-consolidated Daiwa House's Commercial Facilities Division, which has constructed many home centers over the years, we plan to seize opportunities to expand the business. In the Rental Housing Business, as I said earlier, by raising the involvement ratio of Daiwa Living, we will open a path to growth for the entire business division.
- We will also cultivate new areas to drive growth, such as data centers, the overseas business and other business.

【Q10】

Given current conditions in the real estate market and financial policy as it is today, I do not necessarily think that you need to rigorously adhere to this benchmark debt-equity ratio of 0.5 times, but I would like to hear your opinions on capital policy going forward.

【A】

- Going forward we intend to maintain fiscal discipline. Our total assets in FY2020 exceeded ¥5 trillion. The debt-equity ratio is a brake on our activity, and as an indicator we believe it encourages each business division to think about management, and not only investment but also what it needs to do to properly recover that investment.
- The next Medium-Term Management Plan will also incorporate an awareness of return on invested capital (ROIC). We want to create not only investment real estate, but a highly asset-efficient balance sheet. We have not yet decided specific figures, but we are moving forward with discussions about what level of growth is required, and what level of shareholder returns are desirable, in order to achieve the ROE target that we have promised to you while simultaneously maintaining the fiscal discipline of the debt-equity ratio.

【Q11】

In terms of the order environment for the Commercial Facilities Business, with decline in desire for opening new hotels, and the impact of declines in capital investment by some companies that you noted, will we see an increase in small outlets in the short term? Or, will we continue to see a shift towards larger formats such as NSC and power centers?

Please also share your thoughts on the state of competition in the Commercial Facilities Business.

【A】

- During the COVID-19 pandemic, outlets operating within shopping malls have operated under restrictions such as opening hours, and measures to prevent infection, and one issue that has emerged is that they are unable to move forward in the way they want. We are also seeing some slight changes in consumer behavior, such as consumers making their way to one store instead of taking time to enjoy shopping in large-scale commercial facilities. Among certain tenants there is a trend towards returning to stand-alone suburban outlets, and we too have received orders for such new store openings.
- In other areas, what has been covering the decline in hotel construction are facilities such as small-scale logistics and nursing care, so we believe there is still room for future growth. In this way, the breakdown of orders to the Commercial Facilities Business by tenant is changing along with changes in society as a whole. As well as this, there is the revenue from commercial complexes and hotels that we ourselves own, so we will work to ensure that we cover this properly.
- There have been almost no changes in the competitive environment. As has been the case in the past, it is Daiwa House, with our nationwide land-use information network, that has an overwhelming advantage in this environment.

【Q12】

You mentioned that data centers have a higher unit price per square meter than logistics facilities. Is there a difference in the gross margin ratio?

【A】

- With regard to data centers, currently we are only involved in building construction, so we will not benefit from incremental profit as a result of higher capacity utilization rates. However, if in the future we can realize a scenario of developing the project ourselves, performing tenant leasing and building management ourselves, and finally selling it ourselves, then we feel we could raise the gross margin ratio to the same level as that of logistics facilities.

(End)