Q&A at IR Teleconference for Analysts/Institutional Investors (Summary)
at Announcement of Financial Results for FY2022 2Q
(For the fiscal year from April 1, 2022 to September 30, 2022)

Date & time: From 16:00 to 17:00, Thursday, November 10, 2022
Presenter: Yuji Yamada, Managing Executive Officer and General Manager of Finance and IR Departments

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【Q1】
In this current environment of intense uncertainty, please explain why you chose this timing to conduct an upward revision to your full-year plan. Conversely, what are your reasons for not revising plans for share buybacks or other shareholder dividends?
(Reference)
Financial Highlights P.21 "Business Performance Forecasts for FY2022 (1) Year on year change"

【A】
-We conducted an upward revision to full-year plan because we saw a difference in the rate of progress for segment-specific performance. A review of earnings projections for each segment resulted in the decision for an overall upward revision. In particular, the recovery in the hotel business is exceeding expectations.
-We are conducting growth investments, including for real estate development and inventories, resulting in an increase in interest-bearing debt. As a result, in consideration of cash flow, we are not planning to conduct stock buybacks at this time.

【Q2】
Why did you conduct an upward revision for net sales and operating income for the US Single-Family Houses Business? Also, please discuss the factors behind the downward revision to operating margin ratio as well as the state of orders received for this year and your earnings forecast for the next fiscal year.
(Reference) Financial Highlights P.27 "Single-Family Houses Business (2) Overseas Business"

【A】
-The upward revision to net sales and operating income were mainly due to foreign currency rates.
-The operating margin ratio is due to sudden interest rate hikes resulting in a decrease in refinancing for the mortgage business, which has a high gross margin ratio. It is not the case that the gross margin ratio for sale of houses with land business declined.

-The environment for orders received has become difficult but total units from orders received for January through October is only down roughly 2% compared to the previous fiscal year. At the same time, our rate of progress is roughly 60% compared to initial full-year plans. As such, we recognize that it is difficult to take an optimistic view towards earnings for next fiscal year.

【Q3】

The ratio of overseas business is increasing. What is your foreign currency sensitivity?

(Reference) Financial Highlights P.41 “Overseas Business”

【A】

-We revised our assumed foreign current rate from 116 yen to 138 yen per USD. In terms of operating income, this equates to an impact of roughly 7 billion yen. At present, we expect that 1 yen depreciation will lead to roughly 400 million yen increase in operating income.

【Q4】

Please tell me the details of the revised full-year forecasts for the sale of development properties.

(Reference) Financial Highlights P.20 “Sale of Development Properties: Results and Forecasts”

【A】

-The sale of four logistic facility properties to Daiwa House REIT planned for September was cancelled. In terms of income, this had an impact of roughly 10 billion yen. While we did lower our forecast for the Logistics, Business & Corporate Facilities Business due to the restructuring of properties slotted for sale, overall income plans actually increased compared to initial plans by 900 million yen to 70.9 billion yen.

-We are now planning to sell the four properties for which transactions were cancelled next fiscal year or beyond. The tenant that led to the cancellation originally occupied a total of 10 properties but they currently continue to occupy eight properties.

【Q5】

Regarding real estate development investment, what properties are included in the "Completed" category of “Not being rented”?

(Reference) Financial Highlights P.17 “Breakdown of Investment Real Estate (1)”

【A】

-This includes properties for which construction was recently completed and properties still in their free rent periods.

【Q6】

Please discuss the factors behind the improvement in the gross margin ratio for construction in the Commercial Facilities Business compared to the first quarter. Also, is profitability for new projects at the time of order received on an improvement trend?

(Reference) Financial Highlights P.33 “Commercial Facilities Business (1)”

【A】

- Yes, profitability for new projects at the time of order received is on an improvement trend.

-With commercial facilities, owners focus on property yields. As such, negotiating for additional amounts to reflect spikes in material prices is not easy with properties where the contract has already been concluded. In light of soaring material prices, at present we are focusing further on profitability at the time of order received, so this is improving. Additionally, we are also seeing improvement in demand for new store openings, so we expect that gross margin ratio will trend towards recovery.

【Q7】

Please discuss the factors behind the deterioration in the gross margin ratio for construction in the Logistics, Business & Corporate Facilities Business compared to the first quarter. Also, what is the state of profitability for new projects at the time of order received?

(Reference) Financial Highlights P.35 “Logistics, Business & Corporate Facilities Business (1)”

【A】

-Fujita gross margin ratio worsened due to some large-scale properties having poor profitability. However, they are working to improve their cost margin by using slide clauses to invoice for additional amounts. Many corporate customers now recognize the reality of cost fluctuations, and we are able to engage in negotiations for additional amounts to reflect jumps in material prices. As such, we think the cost margin will improve over the course of the full year. Also, the profitability for new projects at the time of order received is on an improvement trend.

【Q8】

You are forecasting urban hotels to post an operating income for the second half. What are current occupancy rates and ADR, and what is your forecast for next fiscal year?

(Reference) Financial Highlights P.33-34 “Commercial Facilities Business (1)(2)”

【A】

-The current occupancy rate is 80.7% for the past six months (compared to 40.4% for the same period last year). However, looking at the month of October, this improved to 87%. ADR is also gradually improving, and we have expectations of a recovery during next fiscal year.

【Q9】
How is the recovery of resort hotels going?

【A】
-As of the end of September, 24 resort hotels are conducting operations for a occupancy rate of 46.7% over the past six months (compared to 20.5% for the same period of previous fiscal year). Occupancy rates and ADR are also improving, and losses are gradually declining.

【Q10】
You indicated that the Commercial Facility Business is seeing an increase in tenant demand for new store openings, but what kinds of businesses are seeing favorable conditions?

【A】
-There is no major change in trends since the first quarter. The majority of orders received are for supermarkets, drug stores, and small-scale logistics facilities. Additionally, we are seeing initiatives related to medical and nursing care facilities with capacity for special care patients. Demand for car dealers has also increased little by little.
-As for hotels, while we are seeing a gradual increase in inquiries, we have yet to see a return to the large scale of orders received experienced prior to COVID-19. First half orders received were roughly 10 billion yen.

【Q11】
Please discuss the current environment and your forecast for the rental housing real estate sales market in Japan and the US.
(Reference) Financial Highlights P.20 “Sale of Development Properties: Results and Forecasts”

【A】
-In Japan, the desire to buy among investors is incredibly high right now, resulting in sales at prices that are higher than expected. Potential areas of concern include a drop in investment unit amounts for REIT and a future increase in the cap rate. However, we can mitigate risks through measures such as selling properties earlier than planned.
-On the US rental housing market, there are concerns about the financing environment due to factors such as rising interest rates but we can expect upside from higher rents. Next fiscal year, we will aim to realize income through the sale of multiple properties.

【Q12】

What led to the downward revision for the Environment and Energy Business and what is your future forecast?

(Reference)

Financial Highlights P.25 “Business Segment Forecasts for FY2022 (2) Operating income”

【A】

-With the transition away from FIT, we expected the decline in large-scale solar power generation construction projects, and both orders received and net sales from electricity retailing and power generation have grown.

-However, electricity retailing has seen higher-than-expected costs for procuring electricity from the market due to the impact of the Ukraine war and yen depreciation. Up to the previous fiscal year, the business mainly engaged in procurement based on OTC contracts but this fiscal year the company has been forced to purchase from the market, which is causing cost margins to decline.

-In the 7th Medium-Term Management Plan, we outline a strategy of installing solar power generation facilities on the roofs of the buildings we construct to increase profitability. However, as this will involve up-front investments over the next five years, we expect to see meaningful earnings contributions during the 8th Medium-Term Management Plan or later.

【Q13】

Is there room for further increases in our operating income rivision plans? What is the current status of actuarial differences for employees' retirement benefits?

(Reference)

Financial Highlights P.25 “Business Segment Forecasts for FY2022 (2) Operating income”

【A】

-Our plan for the sale of development properties only reflects properties with a finalized buyer so there is future room to include additional properties.

-As for actuarial differences for employees' retirement benefits, at present we are not including this in plans for the current fiscal year. Through the end of September, this has resulted in revenues of roughly 18 billion yen. Realized gains are roughly 5 billion yen, with the majority of that difference being due to valuable gains attributable to foreign currency rates.

【Q14】

With expectations that the overseas Single-Family Houses Business will slow down next fiscal year, what businesses do you expect to contribute to increased income?

【A】

-One promising segment is the Rental Houses Business. We plan to sell off multiple development properties overseas. As for business in Japan, we are maintaining a positive trend for monthly contracts, and the market feels firm. We also have high expectations for management as well. Not only have we been able to maintain high occupancy rates, but also have been able to increase rents by differentiating ourselves from other properties.

-We also think a future recovery in the hotels and sports club management business will begin contributing to earnings.

【Q15】

Looking at the decline in the gross margin ratio for construction business, when do you expect this decline to bottom out?

【A】

-Gross margin ratio is impacted by not only rising material prices, but also the environment for orders received.

-With single-family houses, since the price increases we implemented last fiscal year, we have not made additional price increases due to market conditions. As such, we expect to remain at the current gross margin ratio for the time being. On the other hand, we have been able to reflect cost increases in the prices of rental housing both last year and this year, so the gross margin ratio is showing signs of improving. In business field, although sentiment among companies towards facility investments is improving, it is difficult to forecast a specific period.

【Q16】

The business environment has changed dramatically since you drafted the 7th Medium-Term Management Plan. Are you considering revising performance goals for FY2026, the final year of the plan?

【A】

-At present, we do not feel any need to revise plans. It is a five-year period, so changes in the environment are to be expected. As for the Single-Family Houses Business in the US, we have confirmed that there is latent medium- and long-term demand, so we are working to secure land based on our goal figures for the final year of the medium-term plan.

【Q17】

As for changes in plans to sell development properties, have you considered shifting to Commercial Facilities instead of Logistics, Business & Corporate Facilities?

(Reference) Financial Highlights P.20 “Sale of Development Properties: Results and Forecasts”

【A】

-This restructuring was within the scope of Logistics, Business & Corporate Facilities. We are acting on Commercial Facilities according to plans, and depending on conditions we may be able to add additional properties.

【Q18】

Hotel occupancy rates are improving but is there the possibility of personnel shortages, a concern within the industry, creating a bottleneck to business recovery?

(Reference) Financial Highlights P.33 “Commercial Facilities Business (1)”

【A】

-At present, we have yet to experience personnel shortages. We continued to operate even during COVID-19, meaning we had almost no closures or staff reductions. In this post-COVID-19 environment, we are simultaneously opening new hotels so there is the possibility of future difficulties securing personnel but we do not think this will be on a level that interferes with operating.

【Q19】

The ratio of US business as a percentage of overall business is increasing. In light of recent changes in the US business environment, are you considering any changes in future investment policies or a review of strategy?

(Reference) Financial Highlights P.41 “Overseas Business”

【A】

-The orders received environment for the US Single-Family Houses Business is becoming severe but at present we do not think conditions require a major review of strategy.

【Q20】

As interest-bearing debt increased this fiscal year, are you considering changes to forward-looking investments or recovery policies?

【A】

-To address risks, including rising interest rates, we are focusing on increasing profitability lines at the time of the investment, so we are considering raising investment hurdle rate. The pace of investments to increase real estate for stock business in line with the 7th Medium-Term Management Plan is ahead of schedule, so we will implement controls to prevent any rapid increase in interest-bearing debt. We are focused on making good investments based on good timing.

【Q21】

What drove October monthly contract totals to outperform the same period of the previous fiscal year for both Rental Housing Business and Commercial Facilities Business? Also, what is your future forecast?

(Reference)

Monthly Contracts for FY2022 (from April 2022 to March 2023) (YOY Comparison)

Financial Highlights P.29 "Rental Housing Business (2)"

【A】

-As a market, rental housing has seen the number of new construction starts rise for 19 consecutive months. The market has recovered from its decline and is returning to a normal number of units for sale. Amid these conditions, the trust owners have in us for maintaining high occupancy rates for managed properties is reflected in our contract numbers. We can further continue this favorable trend by using building quality to differentiate our managed properties. Built-for-sale apartments targeting affluent owners and investors are also firm. Turnover is quick and this is also leading to new owner relations.

-For commercial facilities, roadside development represents a high share of our business so our contract numbers are linked to the recovery in economic trends and the tenant recovery. As a new initiative, we also started office development and sales in core regional cities, which have latent office demand but a lack of supply. We are also aggressively pursuing redevelopment, which targets properties we supplied in the past around the time of their lease contracts expiration.

【Q22】

What is the status of rental housing for sale in the US and what level of sales will you pursue next fiscal year and beyond?

【A】

- We have five rental housing properties in operation with 250 to 660 units per property. We also have started construction on three other properties. The properties in operation have high occupancy rates, so we project being able to sell these properties.

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