Q&A at IR Teleconference for Analysts/Institutional Investors (Summary)
at Announcement of Financial Results for FY2022 3Q
(For the fiscal year from April 1, 2022 to December 31, 2022)

Date & time: From 16:00 to 17:00, Friday, February 10, 2023
Presenters: Takeshi Kosokabe, Executive Vice President, CFO
Yuji Yamada, Managing Executive Officer and General Manager of Finance and IR Departments

---

【Q1】
Please discuss the impact of BOJ monetary policy changes on the real estate market and the impact on gains on sales of development properties between this fiscal year and next fiscal year. Also, your strategy of using leverage to gradually increase inventory slated for revenue generation has resulted in your D/E ratio increasing to 0.87 but is there any change in your capital procurement strategy?
(Reference) Financial Highlights
P.15 “Consolidated Balance Sheets (3) Liabilities and Net Assets”

【A】
- Currently, we do not think any major changes have occurred on the real estate transaction market. We have already accounted for the YoY decrease in gain on sale of development properties, and are considering adding that portion to forecasts for next fiscal year.
-As for our procurement strategy, we forecast that the D/E ratio will drop to a level below 0.8 during the current fiscal year. Our policy for the upcoming period is to continue investments with no plans for any significant slowdown in investment activities. However, we did raise our IRR hurdle rate, our internal criteria for investment decisions, from 8.5% to 10% to account for potential interest rate increases in the future.

【Q2】
Please discuss sales price increases for single-family houses and the state of relative costs amid soaring prices for steel and housing fixtures.
Also, the gross margin ratios for Rental Housing Business, Commercial Facilities Business, and Logistics, Business & Corporate Facilities Business construction declined compared to the second quarter. Please indicate the factors behind this decline and your future forecast. Is profitability at time of order received improving?

【A】

-We raised prices for steel-framed single-family houses, our mainstay product, back in October 2021, enabling us to transfer increased costs onto sales prices. We maintained those prices for the following year or so but implemented price increases in January of this year. We have continued to reflect costs increases in prices, raising sales prices by a total of roughly 5% since FY2021. We expect to see the benefits of those changes from next fiscal year onward. We believe margins will improve if there are no further increases in material prices or labor costs.

-As for rental housing, thus far we have revised prices to reflect cost increases twice, once two years ago and once last year. The ratio of orders received placed after these price revisions is increasing, and we expect margins to improve.

-With commercial facilities and logistics, business & corporate facilities, as these are not panel products, meaning there is significant volatility for each project due to the fact that we create estimates and negotiate prices on a per-project basis. While this makes it difficult to analyze trends, it is not the case that conditions are worsening. Looking at cost margins for construction projects contracted between October and December, compared to the same period of the previous fiscal year, Commercial Facilities Business improved by 1.2pt and Logistics, Business & Corporate Facilities Business improved by 2.8pt.

-With Commercial Facilities Business, we are not yet in a phase of increasing tenant rents. We are working with owners and receiving their understanding about the need to reflect cost increases in our prices. Tenants are also showing increased desire for new store openings, so any trend towards an increase in rents can be expected to result in further improvements.

-As for Logistics, Business & Corporate Facilities Business, we are seeing an increase in capital investments for plants and other facilities, so the orders received environment is not bad at all. We also have projects such as an industrial park development that includes land, so we do not expect any further decline in conditions.

-Regarding Fujita, although margin did decline at the end of the third quarter, they are in negotiations to receive additional compensation upon completion of construction, so we expect their margin will improve towards year-end accounting with the progression of those negotiations.

【Q3】

Please discuss your company’s future wage increases. Will wage increases impact personnel cost increases?

【A】

-We plan to increase initial wages for new graduates by roughly 20,000 yen next fiscal year. Subsequently, we will also raise the wages of younger employees. As a result, we are evaluating an overall increase in base pay. Last year, we also revised wages by 3.5% on average so we do not think personnel cost increases resulting from the increase in wages next year will have a significant impact on revenues.

【Q4】

Inventory assets are increasing in each segment. Is this a reflection of your company's aggressive investment approach or is inventory increasing due to a slowdown in the speed of sales? Please provide background information and discuss your inventory forecasts for next fiscal year and beyond.

(Reference) Financial Highlights

P.14 "Consolidated Balance Sheets (2) Assets"

【A】

-This is due to aggressive investing activities. We are strengthening investments in the Single-Family Houses Business in the USA and in the built-for-sale business in Japan. With Rental Housing Business and Commercial Facilities Business, this is due to the aggressive promotion of the built-for-sale business. Turnover is quick and conditions are favorable. With the Logistics, Business & Corporate Facilities Business, a significant number are represented by transfers from noncurrent assets designated for property sales. Condominiums Business is increasing due to business expansion overseas.

-Furthermore, this also includes the impact of foreign currency rates, with some 100 billion yen of the roughly 600 billion yen increase being due to foreign currency rates.

【Q5】

Regarding the full-year plan, please indicate the probability of success, including your forecast for pension actuarial differences and the progress of your development property sales plan for the fourth quarter. Also, can we expect increased profits next fiscal year?

(Reference) Financial Highlights

P.20 "Business Performance Forecasts for FY2022 (1) Year on year change"

【A】

-We forecast sufficiently being able to achieve full-year plans, even if excluding pension actuarial differences. Pension investment gains were roughly 6 billion yen as of the end of December. Sales of development properties, including sales scheduled for the fourth quarter, are proceeding according to plans.

-As for next fiscal year, although I cannot provide specific details at present, we think we can increase profits. Although we forecast the overseas business will see a decline in income from single-family houses and condominiums, we also see signs of growth, including a higher order backlog in Japan and the recovery of hotels. We also expect contributions from the sale of rental housing in the USA.

【Q6】

The gross margin ratio for construction for the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business is below your revised plans. Do you forecast being able to achieve your full-year operating income plans by increasing net sales?

(Reference) Financial Highlights P.4 "Topics (1)"

【A】

-Even if the gross margin ratio for each segment transitions at a rate that is below plans, based on the status of current progress, we are still within range that will be covered by increases in net sales.

【Q7】

Please indicate the status of orders received for the US Single-Family Houses Business and how the number of unit orders received last year compares to two years prior. Also, as an unfavorable market environment for housing in the US continues, what strategies are you considering regarding sales inventory and the handling of bare land?

【A】

-Looking at orders received for the most recent month of January, orders received for all three US companies is outperforming plans. Housing loan interest rates peaked at 7% last year, and have since dropped by roughly 1%. We do believe this has had an impact. While the market has not fully recovered, the start recorded in January was a positive one. In America, contracts for all three companies totaled 4,514 units for January to December of 2021. By comparison, this increased on 4,590 units for January to December of 2022, which was also due in part to M&A. However, this is an achievement rate of 67% compared to initial plans for 2022.

-As for already completed properties, while we have implemented discounted prices for certain properties, we have also confirmed there to be latent demand. As such, we expect the market will recover once interest rates settle.

【Q8】

Please discuss the status of progress towards the sale of overseas rental housing for next fiscal year.

【A】

-Next fiscal year, we are thinking of selling three or so rental housing properties in the USA. While the Japanese transaction market is currently not being subjected to the influence cap rates, the US market lacks clarity compared to the Japanese market, so at present we do not have any properties for which sales have been finalized.

【Q9】

You explained that the transfer of stock in Daiwa Resort decreased tax expenses by 15.7 billion yen this fiscal year due to the impact of tax effect accounting. Do you forecast the gains on transfer recorded next fiscal year will exceed this 15.7 billion yen?

(Reference) Financial Highlights P.5 “Topics (2)”

【A】

-We forecast gains on the transfer of Daiwa Resort will exceed this 15.7 billion yen.

【Q10】

Regarding Daiwa Resort, did you decide on the sale of the business amid an environment where inbound traffic is expected to recover because the offered sale price was high? Please provide details on decision.

【A】

-While inbound traffic will increase, even prior to COVID-19 resort hotels were not a significant contributor to profits. We made the decision to transfer the business to a sponsor with the expertise and knowhow related to hotel asset management and hotel operations needed to promote further growth for Daiwa Resort, and which would lead to greater motivation for Daiwa Resort employees.

【Q11】

As you aggressively pursue investments while also maintaining awareness of your D/E ratio, your standard for financial discipline, you are also facing an environment of rising interest rates. Are you considering increasing capital as a form of capital procurement?

【A】

-We are in no way considering increasing capital.

【Q12】
With the transfer of Daiwa Resort, how much do you expect to see in profit improvement next fiscal year?

【A】
-Overall for facilities significantly impacted by COVID-19, including resort hotels, urban hotels, and sports clubs, we are forecasting losses of roughly 9 billion yen for this fiscal year. Prior to COVID-19, these businesses generated profits of roughly 6 billion yen in total. With urban hotels expected to return to profitability in the future and with the elimination of resort hotels, which generated significant losses, we expect to see a significant improvement in profits from next fiscal year onward.

【Q13】
During the 7th Mid-Term Management Plan, one area of focus was the reconstruction/restructuring of businesses facing issues related to future growth potential and capital efficiency. With the transfer of Daiwa Resort, does this complete your efforts related to reconstruction/restructuring, or will you target other businesses moving forward?

【A】
-Our portfolio evaluations are not simply a matter of eliminating businesses based solely on a lack of profitability. We believe we must evaluate various businesses from the prospective of being the best owner, and we will continue to apply this approach.

【Q14】
Please indicate what impact raising the investment hurdle rate will have on investments.

【A】
-This change was made effective February 1, 2023 so there is no impact on investment results for the third quarter. And based on a survey of past large-scale properties, the majority of properties cleared the newly revised investment criteria at the time of planning, so we do not expect to see any significant decrease in investments moving forward.

【Q15】
With changes in domestic interest rate trends, what is your approach to capital allocation and financial strategy?

【A】

-Since the beginning of this fiscal year, we have issued 200 billion yen in corporate bonds. In light on rising procurement costs, we are beginning to lean towards prioritizing returns. However, there is no change in our stance to invest if opportunities for good properties appear. As of the end of December, interest-bearing debt was 2,130.5 billion yen but we plan to reduce interest-bearing debt by roughly 200 billion yen by promoting securing returns on investments during the fourth quarter. As for capital allocation, there is no change in the composition for the final fiscal year (FY2026) as indicated in our 7th Mid-Term Management Plan.

【Q16】

Please discuss the status of evaluations concerning stock buybacks.

【A】

-We assess stock price trends as we evaluate the acquisition of treasury stock. However, at present, we are not considering implementing buybacks in the immediate future.

End