Message from the CFO

Chapter 2

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Strategic capital policy and capital-efficiency improvements to enhance corporate value

Adapting to change in pursuit of further growth

In fiscal 2023, the second year of our Seventh Medium-Term Management Plan (the 7th Plan), net sales surpassed the ¥5 trillion mark to reach ¥5.2 trillion and operating income totaled ¥440.2 billion, or a record ¥393.6 billion excluding actuarial differences in retirement benefits. It is deeply rewarding to have arrived, ahead of our 70th anniversary in 2025, at the halfway point of founder Nobuo Ishibashi's dream of achieving group-wide net sales of ¥10 trillion by our centenary. I feel gratitude toward every one of our employees, and I am proud of these results, a fruit of never being satisfied with the status quo and continuing to take on various new challenges in the "doing things because they will be of service to society" spirit of Daiwa House's founder.

Turning to the market environment, companies and people in Japan will likely have to get accustomed to positive interest rates as the Bank of Japan ends its negative-interest fiscal policy. As CFO, I believe building a solid financial foundation resistant to rising interest rates is a crucial issue. This includes a risk management perspective, especially now when Daiwa House is taking on new challenges in diverse businesses and moving into new business areas.

In this context, in anticipation of rising rates we raised our IRR hurdle rate in February 2023. We are also constantly exploring multiple financing options depending on the situation, including direct and indirect finance, and fixed and variable interest rates. Our investment rating is currently AA, and maintaining a sound rating is crucial to ensure stable procurement of funds. In our discussions with rating companies, the main theme is how to achieve a debt-equity ratio (D/E ratio) of around 0.6 times at a time when the real estate development business is expanding. We are working on maintaining financial soundness by combining investing for growth with strict management of turnover rates and occupancy trends of real estate holdings.

Further, securing human capital and labor management

Takeshi Kosokabe

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Executive Vice President, CFO

will likely become even more challenging amid the shrinking population and number of households and severe labor shortage in Japan. We must ensure that we respond to the cap on overtime work (the "2024 problem") and do even more to raise our awareness of governance so that we can continue to meet society's expectations as the industry leader amid a social environment that is constantly in flux.

In the overseas business, which is our growth pillar, we are pushing ahead with a management framework and risk management geared for supporting sustained growth. To this end, regional corporate (RC) functions have been established in the US, Australia, ASEAN, China, Europe, and elsewhere to provide structures best suited to the businesses, subsidiaries, and projects in each locality and concentrating local business customs, risks, and know-how in RC functions. As well, having clearly defined the roles and responsibilities of overseas headquarters, RC functions provide monitoring closer to our business locations (in terms of business content and physical distance) and offer appropriate support.

Progress on the 7th Plan

We acted to counter profit margin deterioration on rising construction costs due to steel and other building materials prices, which began spiking around 2021, and rising labor and other costs. Each business has taken steps to pass on higher materials prices to customers, but negotiations for projects whose contracts were concluded before the increases began did not progress as well as expected. This has impacted the Logistics, Business & Corporate Facilities and Commercial Facilities businesses, which have relatively long construction periods. More recently, however, at contract time we explain to customers about passing on higher materials prices and have added a rider to contracts to that effect. We therefore expect profit margins to begin improving.

Also under the 7th Plan, we are reducing costs through centralized Group purchasing. Joint purchasing of supplies that used to be purchased by individual Group companies by major group companies in Japan (Daiwa House, Daiwa Lease, Fujita, etc.) has made it possible for all participating Group companies to benefit from the most advantageous pricing. We also expect cost reduction from economies of scale, and this initiative is tracking well toward the fiscal 2026 targets of ¥1 trillion in Group purchasing value and ¥100 billion cost reduction effect. Overseas, the Group's three US single-family house builders Stanley Martin, Trumark, and CastleRock have made progress shifting to off-site construction (prefabrication) and launched joint purchasing initiatives.

Investment and recovery

Regarding development properties, progress toward the 7th Plan investment target of ¥2.2 trillion was approximately 30%. Of the ¥2.2 trillion target, we plan to invest ¥1.5 trillion in Logistics, Business & Corporate Facilities. The pace of investment has been slower than planned due to intensifying competition to purchase land for logistics facilities and and a lull in large-scale tenders for land purchases, although solid demand from tenants has been confirmed. Sales of development properties (mainly logistics facilities in Japan) have been stable, and we therefore plan to continue going forward. The US investment property market environment (including rental housing) has deteriorated, due in part to rising interest rates. We held off on property sales in fiscal 2023 for this reason but will continue to operate and develop investment properties while seeking to improve NOI yields so that they can be sold with better conditions when the market environment improves.

Regarding real estate for sale, investment has progressed faster than expected at the time of formulating the 7th Plan, because our businesses in Japan are aggressively expanding the built-for-sale business. The Single-Family Houses Business in particular has reformed its business model and strengthened its built-for-sale housing business in Japan. In the US, we are steadily acquiring high-quality land by harnessing the three local Group companies' strengths in land information and strong relationships with landowners and developers. In the Rental Housing Business, we purchase the land, build the apartments, and attract tenants, then sell them to investors and owners seeking tax-saving measures. The Commercial Facilities, and Logistics, Business & Corporate Facilities businesses also develop various assets and then draw on the Group's vast customer base and rich repository of land information to sell them.

Compared with the custom-build business, the built-for-sale business carries the risk of investing in land and buildings. However, by planning and undertaking land purchase, building specifications (and even attracting tenants depending on the asset), we can look forward to higher rates of return. We have been investing and will continue to invest efficiently by closely monitoring at each of our businesses turnover rates, stagnant listings, market prices, and other performance indicators.

Funds procurement

In January 2024, we issued convertible bonds with stock acquisition rights as part of strategic funds procurement to implement aggressive real estate investments under the 7th Plan. They are zero-coupon bonds amid an uncertain outlook for funds procurement (including a rise in interest rates), and we estimate a cost saving of ¥7–8 billion compared with the issue of straight bonds. The bonds have also been designed as a financial instrument that limits the possibility of conversion and share dilution by the addition of conversion restrictions and a cash settlement provision.

We also used funds procured at low cost by the issue of convertible bonds for a share buyback and are thus working on improving capital efficiency indicators such as ROE and earnings per share (EPS) to implement our capital policy. The cash settlement provision is an option for the issuer. In exercising this option, we will decide according to our financial position and capital policy at the time, including share price and D/E ratio levels and ROE trends.

Cost-of-capital– and share-price–conscious management

We always aspire to running the Company in a manner conscious of equity spread, but this is no easy task to maintain investments in growth businesses as well as ROE over 13%. Nonetheless, we are committed to achieve 13% or higher ROE through solid growth at existing businesses and generating additional profit from productivity

improvements, plus shareholder returns consisting of stable dividends and flexible share buybacks. Another way to reach our ROE target in our view is aggressive conversion of asset holdings into cash, such as the sale of the resort hotels business in July 2023, sale of part of our stake in Cosmos Initia in February 2024 to rebalance our business portfolio, and the sale of cross-shareholdings.

Our share price marked a record high at the beginning of 2024 as the Nikkei Average exceeded ¥40,000 at one stage, but turned down after we announced our full-year results in May 2024, because our fiscal 2024 forecasts announced at the same time fell short of the market consensus. We see room for improvement in our current PBR and PER levels and are working to meet the market's expectations with solid business performance throughout the year.

Improvement of PBR has recently been widely discussed. We believe it is essential to tackle this from two angles—improving ROE and reducing the cost of shareholder's equity. Further strengthening of governance and dialogue with shareholders and institutional investors through IR activities are key to reducing the cost of shareholder's equity. We will continue our efforts to explain the probability of achieving profit targets of the 7th Plan, and help shareholders and investors understand our earnings capability based on our strengths (extensive repository of information on land and ability to maximize business opportunities by leveraging our vast customer base, which encompasses local governments and companies) so that they reaffirm their awareness of Daiwa House as a company that achieves sustainable growth.

Aggressive investment in the environment and human capital

Regarding the environment, we aim to be carbon neutral by 2050. To this end, we install rooftop solar power generation equipment on newly constructed buildings in principle and are progressing initiatives to achieve 100% ZEH and ZEB rates in fiscal 2030.

Greenhouse gas emissions from business activities (Scope 1 and Scope 2) increased in fiscal 2023 as a result of making Hibikinada Thermal Power Station* a subsidiary. However, emissions reductions in the use of buildings sold (Scope 3, Category 11) progressed under our carbon neutral strategy as a result of steady increases in the rates of rooftop solar power generation equipment installation and ZEH and ZEB rates. Consequently, the rate of reduction of greenhouse gas emissions of our whole value chain surpassed our forecast at 35.6%. This result makes me realize how key actions with customers for achieving carbon neutrality are making headway.

Turning to human capital management in pursuit of sustained growth and to realize Our Hopes for the Future, diverse human capital performing well and every employee feeling fulfilled in their work will lead to improved productivity. We are fostering human capital so that employees have pride and fulfillment in their work and every individual can harness their strengths and personal qualities, while providing workplaces that are fair and equal. In particular, we are strengthening education of middle management personnel who play crucial roles in fostering human capital and running organizations on worksites. As well as labor management, we provide education support to improve awareness, knowledge, and literacy to create a virtuous cycle of management that maximizes human potential and management that improves business performance.

Amid rising prices, we provide an environment where employees can work with confidence and ensure we can hire and maintain employment of human capital in the medium to long term by continuously revising our pay structure as an investment in our employees. We will also invest to move digital transformation in construction and other new technologies forward as a means of dealing with the construction industry's 2024 problem and improve productivity by reducing on-site workloads.

* Until its shutdown in March 2024, the Hibikinada Thermal Power Station burned a combination of coal and biomass (wood pellets), with room for to reduce it annual CO_2 emissions to 30% less than those of an equivalent coal-fired plant. The station is being converted to fire 100% biomass and is scheduled to resume operation in April 2026. With its shutdown, the company is set to achieve its greenhouse gas emissions targets again from fiscal 2024 onward.

Continue delivering stable shareholder returns

Our Basic Policy on Shareholder Returns entails returning profit generated through our businesses to shareholders in tandem with growth investments in real estate development, overseas businesses, M&A, R&D, and production facilities, to maximize longer-term corporate value while growing earnings per share and working to improve shareholder value. In fiscal 2023, we paid an annual dividend per share of ¥143, with a dividend payout ratio of 35.1% excluding actuarial differences in retirement benefits. We plan an annual dividend per share of ¥145 in fiscal 2024, increasing the dividend for the 15th consecutive fiscal term. In May 2024, we modified our shareholder-returns policy outlined in the 7th Plan, raising the minimum dividend from ¥130 to ¥145 for stable dividends.

Our basic approach to share buybacks is to conduct them dynamically, weighing the pros and cons carefully amid prevailing market, capital-efficiency, and other circumstances. During the 7th Plan's two years to date, buybacks have totaled ¥87.1 billion, and in August 2024 we announced our intention to buy back up to another 22 million shares for up to ¥100 billion as part of our ongoing work to achieve the capital policy goals of the 7th Plan.

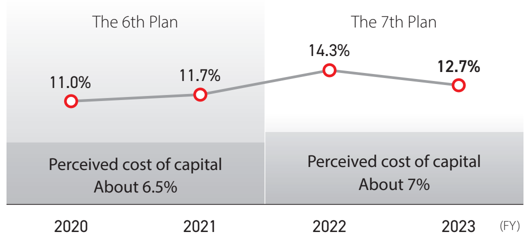
Together with stakeholders toward Our Hopes for the Future

The Daiwa House Group aims to enhance its corporate value, which requires both profit-generating business value and social value derived from our approach of service to society.

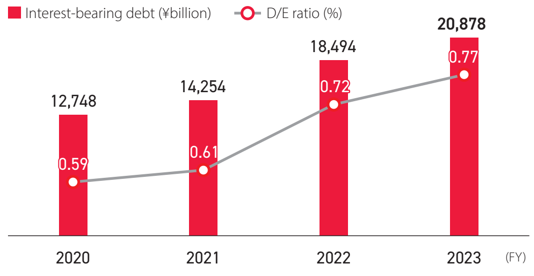
Since our founding, we have created a succession of new products and businesses to resolve contemporary societal issues. These began with the Pipe House, a steel-pipe structure developed to address the lumber shortages after the Second World War, and the Midget House, which became the proto model for prefabricated houses. We also began offering Japan's first housing loans and in the 1970s launched the Commercial Facilities Business to utilize land along major trunk roads. We remain similarly focused on creating new businesses as we look ahead to the next stage, launching corporate venture capital (CVC) fund and an in-house entrepreneurship program to provide co-creation opportunities to entrepreneurs and intrapreneurs and a framework for trying out new businesses. We are excited about the possibility that these programs will produce new services and added value that will be societal utility.

Livness Town Project is a case study in the creation of social value. It is a typical Daiwa House initiative in the sense that the Company's relationship with the customer does not end with the delivery of a building but stays close to customers' lives afterward. Although financial results are important, we will not make only that our focus, but instead take our business forward to realize people's hopes for the future while always asking ourselves what is best for all our stakeholders.

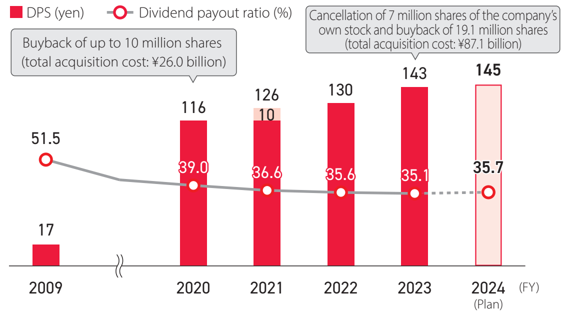
ROE Advance ROE-conscious management aimed at exceeding shareholders' expected rate of return
Target: Over 13%



D/E ratio Guide: Approx. 0.6 times



Dividends, dividend payout ratio
Plans dividend increase for 15th consecutive period
Dividend payout ratio: Over 35%; minimum dividend per share: ¥145
Flexible share buybacks



Note: The fiscal 2021 dividend includes a ¥10 commemorative dividend to mark the centenary of the birth of company founder Nobuo Ishibashi. The dividend payout ratio from fiscal 2022 onward is calculated excluding actuarial differences in retirement benefits.

Basic Strategy for Capital Policy

❶ Secure cash flow required for growth investment

- Generate operating cash flow via steady profit growth
- Secure investment cash flow by reducing strategic shareholdings and inefficient assets

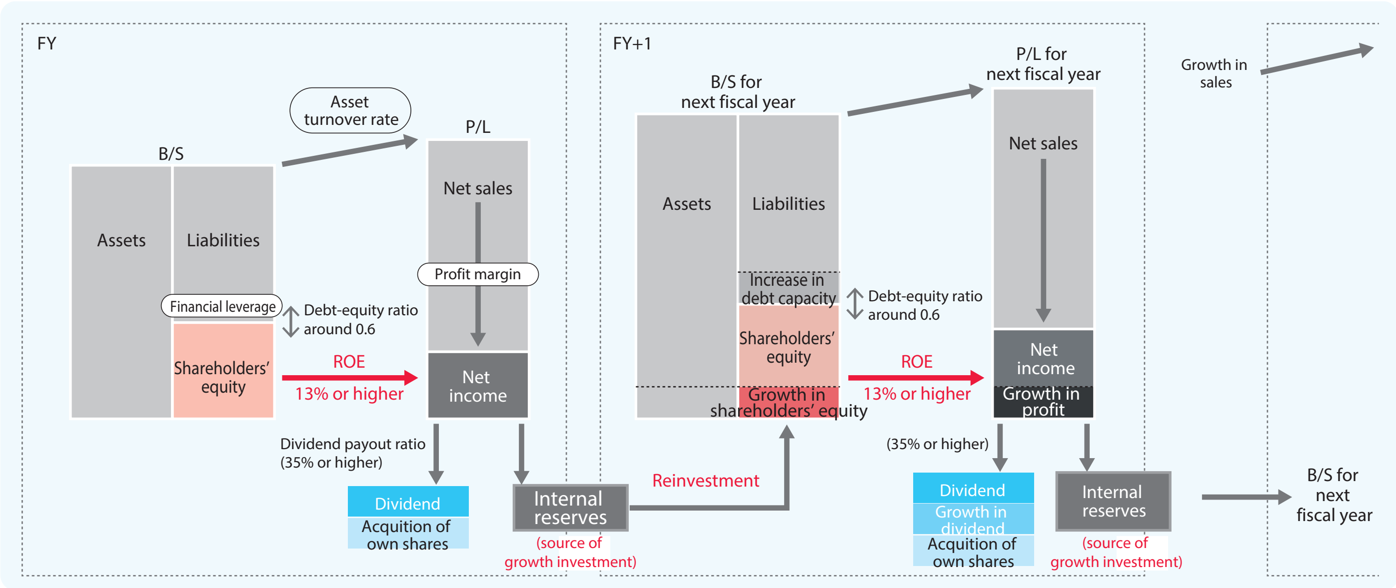
❷ Reinvest in growth areas while maintaining a D/E ratio of about 0.6 times

- Draw on internal reserves to reinvest in growth areas while vigilantly maintaining appropriate level of financial leverage

❸ Achieve ROE of at least 13%, profit growth and dividend payout ratio of 35% or higher

- Realize return on reinvested capital with capital efficiency that exceeds the expected rate of shareholders in order to achieve growth in profits and dividends, as well as increased capital required for new growth investment.

Basic Strategy for 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

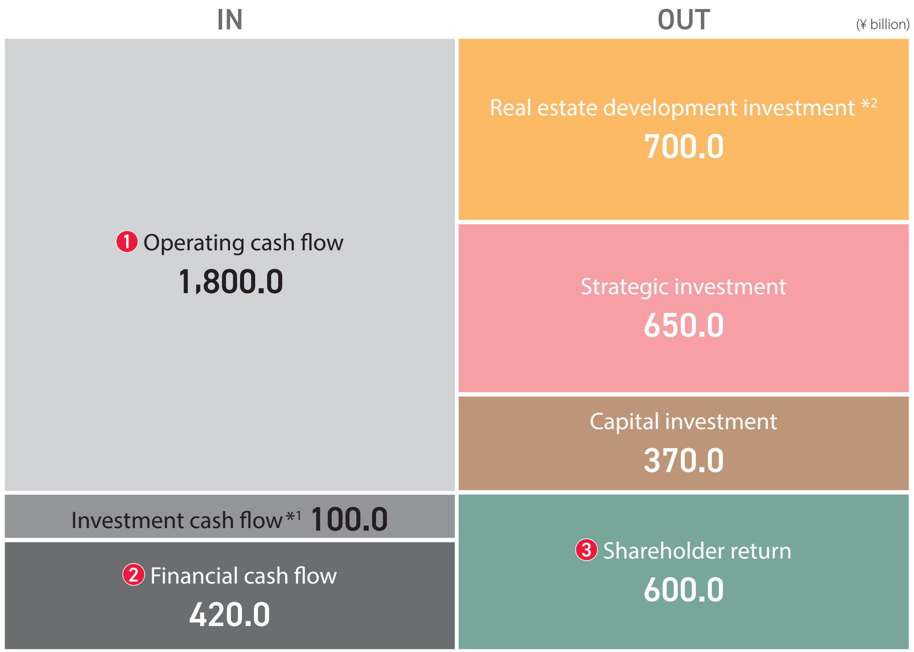
The Company will realize return on reinvested capital with capital efficiency that exceeds the expected rate of return (cost of shareholders' equity) for shareholders in order to achieve growth in profits and dividends, as well as increased capital required for new growth investment.

Achieving ROE target based on an optimal capital structure

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. Looking back over the previous two years of the Seventh Medium-Term Management Plan, ❶ operating cash flow accumulated owing to steady profit growth. ❷ Regarding financial cash flow, approximately ¥700 billion in interest-bearing debt has been accumulated due to upfront strategic investments. However, ahead of fiscal 2026 which is the final year of the plan, we have been conducting activities such as selling development properties, and we expect to arrive at a D/E ratio of 0.6 times as a financial benchmark. ❸ With regard to shareholder returns, over the past two years we returned approximately ¥173.3 billion in dividends and conducted a share buyback of roughly ¥87.1 billion. In fiscal 2024, we are strengthening shareholder returns by revising the minimum dividend amount per share from ¥130 to ¥145, and in addition, we plan to newly acquire up to ¥100 billion (22 million shares) of our own shares.

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 development investment

- In addition to the profit driver of logistics facilities, investment in new fields (data centers, semiconductor-related facilities, public wholesale markets, etc.)
- Investment that covers inbound demand and the Livness business (hotels, revitalization of aging facilities, etc.)
- Investment to gradually increase stock assets for profit-earning real estate

Strategic investment

- Priority investment in the overseas single-family houses business, with a focus on the US.
- Investment to fundamentally overhaul the single-family houses business in Japan
- Strengthen the built-for-sale business for rental housing and commercial facilities
- Investment into onsite/offsite PPA toward the realization of carbon neutrality

Capital investment

- 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 ¥145*3 or more
- Flexible acquisition of own shares

*3 The initial ¥130 changed to ¥145 from fiscal 2024