

Daiwa House Industry Co., Ltd.

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

Date and time: From 14:30 to 15:30, Monday, November 11, 2019

**Speakers: Keiichi Yoshii, President CEO and COO
Takeshi Kosokabe, Executive Vice President and CFO
Yuji Yamada, Managing Executive Officer and General Manager of
Finance and IR Departments**

【Q1】

Could you explain why the trend of orders received for your Rental Housing Business has been weak since April? And what measures are you drawing up to deal with the recent situation?

【A】

- We have seen a decline in the occupancy rate for rental housing—a factor that has negatively impacted the market in the past—and the situation has also been affected by a tight credit policy being followed by financial institutions, as a result of which rental housing construction starts have been down by around 16 percent year on year. Daiwa House has been impacted by this market situation.
- Orders received by the Company in the 2019 first-half period (April-September) have been down by 20.8 percent year on year, which appears to be a larger decrease than seen for other companies in the industry. However, if we look at the situation for fiscal 2018, while other companies' orders were declining, Daiwa House recorded a year-on-year increase of 16 percent. Thus, this year's apparent order decline is a comparison with last year's high figures, and the situation therefore seems worse than it actually is.
- To remedy this situation, we are putting more effort into marketing in urban areas. This business term, the average selling price of our low-rise rental housing has topped ¥100 million per single building for the first time. Low-rise rental housing properties are the Company's main earnings driver, and thus surpassing ¥100 million for the average unit price is a testimony to the success of our marketing efforts. With regard to mid- and high-rise rental housing properties, here too we have seen the price per single building rise by approximately ¥80 million over the past six months. We have thus succeeded in gradually raising the price per building. The sale of land plus a building or buildings erected on that land as a single package accounts for only a very small part of the Company's business.
- In addition, to strengthen our business capabilities in both major urban areas and regions outside the major metropolitan areas, we have begun selling products involving lower costs, which enable customers to draw up budgeting plans that more closely match the loans that banks are willing to extend. We aim to reinforce our marketing by having new products ready for immediate launch

whenever the tide changes.

【Q2】

How do you see prospects for next term? Do you expect to be able to recover an adequate earnings level driven by the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business in the event that the Rental Housing Business once again underperforms, as it has done this term? Please describe both your hopes and your concerns.

【A】

• The business performance figures of the Commercial Facilities Business and the Logistics, Business & Corporate Facilities Business are growing steadily. In the Single-Family Houses business, too, figures are within the scope of our plans despite the ongoing negative impact of the consumer tax hike. Consequently, next year we expect to be fully able to compensate for the current year-on-year negative trend in orders received by the Rental Housing Business.

• The Livness business, which has been a major focus of our attention, is performing strongly, and we forecast an increase in revenues this term. This breaks down to ¥12.2 billion from the purchase and resale of houses, ¥8.4 billion from the renovation business, and ¥1.1 billion from the real estate intermediary business. We do not as yet know how much this business will grow next term, but we have high expectations for further growth going forward.

• In the overseas operations, the American company Stanley-Martin Communities is performing smoothly, in line with our expectations. When this company became a member of the Group in 2017, annual net sales were roughly ¥60 billion, but this figure is forecast to exceed ¥100 billion in fiscal 2020. In Australia, the Rawson Group has been showing signs of a gradual recovery since July of this year, and we look forward to a good performance next year.

• We believe that a recovery by the rental housing market is not so far away, and thus we do not expect our current poor business performance to persist for very long. Even if the Rental Housing Business does not recover next term, this will be more than offset by our other businesses, and overall, we are confident of growth in both revenues and earnings.

【Q3】

Could you describe the current real estate investment environment and the future outlook? Things are proceeding in line with your plans at the moment, but what asset types are performing well?

【A】

• Among the various asset types, logistics facilities are the most numerous. Regarding the acquisition of land, this time last year land prices were rising, and we made the most of our strengths as a

construction company to lower construction costs. Even so, considering the rent levels that tenants were prepared to bear, it has been very difficult to realize profitability. As a result, we refrained from acquiring land for a certain period. Recently, however, we have been able to acquire land at prices we consider reasonable, and have enjoyed a number of good investment opportunities. While competition continues to be fierce, we will leverage the expertise in the leasing business that we have accumulated over many years, and will take a positive stance on land acquisition.

- Regarding the logistics market, we expect a large number of needs to emerge over the medium-to-long term, notably in relation to e-commerce. We are speeding up the sale of development properties and taking steps to recover investments while firmly building up our inventory.

- In view of these circumstances, the ¥700 billion in investments in real estate development that we have projected over the three years of the plan may well expand, and we expect to have to reexamine the plan.

【Q4】

In relation to investment in overseas assets by Daiwa House Global REIT, Inc., a new private placement REIT whose establishment was announced just recently, what sort of assets are you considering acquiring? And with regard to the acquisition of properties in the Japanese market, where do you plan to position the new company, and how will you divide up the market with your existing investment company Daiwa House REIT Investment Corporation?

【A】

- We are actively engaging in real estate investment in overseas markets, too, and going forward, completed properties will be coming online one after another. We recently established the global REIT company as a way to increase the number of possible buyers for our sale of overseas assets. However, the ratio of investments overseas by this private placement REIT is only 30 percent of its total assets, and we believe that the sale of overseas assets will remain within that range.

- Daiwa House REIT Investment Corporation, which is listed on the stock exchange, is our No.1 pipeline for real estate investments, and has priority bargaining rights. As up to now, we will continue to assign top priority to achieving business growth by this company. The positioning of the global REIT, depending on circumstances, maybe as one more choice as a buyer in the event that a sale cannot be made to Daiwa House REIT Investment Corporation.

【Q5】

In the Logistics, Business & Corporate Facilities Business, you have posted losses on large-scale projects overseas. Going forward, in your pursuit of large-scale non-residential projects in Japan and overseas business, what sort of risk control measures will you be taking?

【A】

• Our Overseas Strategy Committee continues to examine overseas real estate investment proposals and new business proposals. In addition, real estate investment proposals that have received the Overseas Strategy Committee's approval are further examined by the Real Estate Investment Committee in the same manner as proposals for the Japanese market. In this way, we are exercising control over risk right from the initial stage. Moreover, large-scale construction projects undertaken by Group companies on a subcontract basis have come under the purview of the Overseas Strategy Committee since February of this year.

• And also, going forward we will set up dedicated management control companies for our overseas operations on an area-by-area basis. We will also set up a Management Administration Headquarters to strengthen our system of checks, and this will effect better risk management.

【Q6】

The issuance of hybrid bonds in September was apparently implemented to maintain financial soundness and to procure funds for use in your real estate development business. The 6th Medium-Term Management Plan also makes reference to the "flexible acquisition of own shares." What are your thoughts on these matters now?

【A】

• Our investment in real estate development has moved faster than we initially forecast. Considering the equity credit made possible by the hybrid bond issuance as well as the increased recovery of investment funds due to the sale of development properties during the current fiscal year, we expect the D/E ratio at the end of next March to be around 0.5 times.

• Once the current fiscal year has ended, we will conduct a detailed examination of our investment plan and revise the balance of investments and returns. On the basis of that, we plan to thoroughly review the return to shareholders.

【Q7】

Is the reason why the value of your investment in real estate development has risen beyond the earlier projections due to your estimation that demand for logistics facility development will grow from here onward, or is it that you expect the emergence of market needs for new types of assets?

【A】

• As we have sold more and more development properties, we are under pressure to complete the renting-out process for properties that have not yet started to draw rental income, and to turn them into properties that are being rented out and contributing to revenues. In addition, we have concentrated on

the development of build-to-suit logistics facilities, but recently, demand has been rising for multi-tenant facilities, as a growing number of potential corporate tenants need to move in right away. Consequently, we are now focusing on construction of properties on land already acquired.

- Additionally, we are putting more effort into the development of multi-use facilities. Some examples include the GRANODE Hiroshima, a large-scale, multi-use facility located in the city of Hiroshima, an office-building project in Nishi-Shinjuku (Tokyo), and the D Tower Toyosu (Tokyo), a project that incorporates a training facility.

【Q8】

Is there any likelihood of Daiwa House becoming involved in the development of integrated resorts?

【A】

- We have no intention of owning casinos, but we may consider undertaking projects on the periphery of such resorts or collaborating in such projects.

【Q9】

In the revised plan, there is a significant upward revision to sale of development properties. Please comment on the likelihood of this continuing next fiscal year and beyond. In the event that it is difficult to continue selling at this level next fiscal year, I am concerned that we will get into a scenario whereby it becomes difficult to maintain profit growth by offsetting this through the Logistics, Business & Corporate Facilities Business and the sale of development properties, but what is your view?

【A】

- We are absolutely not expecting lower profits next fiscal year. If the Company consisted only of the construction business, then based on recent trends in demand it might be a bit challenging to grow both sales and profits next fiscal year. However, the Company has a broad business portfolio, with a variety of ways to generate profit, such as construction, rental management, and sale of development properties.

- For example, in logistics facilities business, while operating the construction business as a general contractor, at the same time we play the role of a developer that develops its own properties. When there is a rush of construction, we focus on the construction business as the main driver as we move forward, while on the other hand, when the environment changes, we are able to change the structure. We always aim to secure a certain level of profits, and we can take a flexible approach to altering the sales plan while keeping an eye on the overall balance.

- This diversity of portfolio is the strength of the Company. This fiscal year we were able to leverage that strength. We still do not know what shape the profit structure will take next fiscal year, but there

has been no change to our goal of growing both sales and profits, and we remain confident.

- With regard to the prospects for continued strength in sale of development properties, we have built up a balance of investment real estate, and the Company has been able to make a judgment on sales of real estate currently being rented, and control that aspect, so we are not concerned.

【Q10】

With regard to the order environment for Single-Family Houses Business, in October both you and other companies saw year-on-year declines of around 10%. What are your views on the impact of the increase in the consumption tax rate, and on whether additional policy support for housing purchases from the government is necessary?

【A】

- Looking back to the time of the previous increase in the tax rate, from 5% to 8%, April orders for all companies fell more than 20% year-on-year. For this most recent increase in the tax rate to 10%, the government has provided policy support in various ways, so for the Company the decline in October orders was about half that, at 10%.

- We need to pay careful attention going forward to establish whether the situation is positive or not, but we do not believe we are at the stage where we need to request additional support.

【Q11】

In relation to the recent announcement of policies to strengthen corporate governance, please give us some background on the decision to adopt a mandatory retirement scheme for directors. Also, it says “as a rule,” but what is the intent behind this?

【A】

- With regard to the mandatory retirement scheme for directors, this had been an internal rule for some time, and was put in place before the retirement age for employees of the Company was raised to 65. Accordingly, reasoning that it would be possible for somebody to be promoted to director near retirement age, we took the opportunity to prescribe a clear system that better fits the spirit of the times.

- By making the mandatory retirement system clear, we intend to further advance our preparations for the future, including the nurturing of successors. We believe it is a necessary system for the continued existence of the corporation over the long term.

- The case not covered by the application of these new rules is that of the chairman, Takeo Higuchi. We believe it is necessary for management to be able to leverage the spirit of the founder, and for directors to benefit from his opinions. We also expect him to pass on the spirit of the founder to following generations. Mr. Higuchi’s continued work on the Board of Directors and elsewhere is not

expected to have any negative consequences.

【Q12】

You say that there are abundant opportunities for growth investments, but what factors would cause you to go ahead with purchases of treasury stock?

【A】

• To be frank, given that we have achieved growth in both sales and profits, I am dissatisfied with the way our share price has fallen today. I interpret recent conditions as representing the return of a period of investment opportunities, and we want to put the priority on ensuring that we do not miss any chances for investing for growth.

• As for purchasing treasury stock, one point to bear in mind is whether we can achieve the target established in the 6th Medium-Term Management Plan of ROE of 13% or higher. Then, while I cannot give you a specific figure, the state of the share price is also something to consider.

【Q13】

With regard to strengthening governance, what sort of percentage of outside directors do you consider to be appropriate? Also, you say that candidates for director will include those with overseas experience. What kind of knowledge are you looking for in such people?

【A】

• We are thinking of a ratio for outside directors of one in three.

• In terms of directors with overseas experience, we are not seeking to appoint foreign directors at this point in time. There are external people who are close to the business of the Company, and those who work within the Company but who have experience overseas, so we are considering candidates without narrowing our options.

【Q14】

Please let us know the status of leasing for the office building in Nishi-Shinjuku (Tokyo) on which you are currently working. Also, what is the Company's strength in this field?

【A】

• There is only one floor left to lease in the office building in Nishi-Shinjuku.

• The office building field is not one of our areas of specialization, so we will move the business forward prudently, after deliberating the issues fully in the Investment Committee, and taking steps such as leveraging the strength of partners in some cases, and putting conditions on leasing before

starting construction.

【Q15】

You mentioned consolidating organizations and functions in relation to overlapping businesses within the Group, but in the past, you have taken the approach of focusing on growth, even with such overlaps. Going forward, what sort of roadmap are you drawing up?

【A】

• We are not thinking of consolidating everything at once. Moving ahead with consolidation is meaningless if it does not result in synergies. We will consider very carefully how to proceed, keeping in mind the lineup of businesses we want to put together, and how to best link them. We are not yet at the stage where we can share more specific thoughts with you.

【Q16】

On the subject of construction for the Commercial Facilities Business, the sales price per property has been rising for the past few years. Do you see this trend continuing? Also, do you see demand for hotels continuing over the medium term?

【A】

• Over the past year, the sales price per property has risen by around ¥110 million. We expect large facilities such as hotels and commercial complexes to contribute to further increases in the sales price per property going forward.

• When you include outlying regions, we still think there is substantial remaining demand for hotels. In some regions, there are places that have seen a slight slowdown, but we are not involved in those areas.

【Q17】

With concerns that labor shortages could continue into the future, what measures are you taking to secure construction capacity?

【A】

• In the housing business we have accelerated digital transformation and have already begun some initiatives. Currently we believe that we have secured sufficient construction capacity.

【Q18】

Please share your thoughts on the background to the drawing up of these policies to strengthen corporate governance, and the extent to which they have taken root in the awareness of officers and employees.

【A】

• Our view is that if we don't have a governance structure in place and functioning, we cannot talk about growth. We are aware that, for the Group to take the next step, strengthening governance is important.

• I do not think this is the kind of thing that I explain to officers and employees and it immediately sinks in, so the key issue is how we can get it to take root. We will continually review whether these measures are proceeding as planned, and whether we have been able to optimize them, while taking advice from third parties as we go and making adjustments as needed. It may take time, but we will convey these ideas carefully to all officers and employees and put this strengthening of governance into effect.

【Q19】

Currently, you appear to have a system in place in which the head of each business division is also a director, and this system is due to the Group's wide-ranging business portfolio. While we fully appreciate the need to increase the number of outside directors, going forward, we wonder whether this system will allow effective final-stage decision-making based on an accurate grasp of the situation at the business operation sites.

【A】

• As we have shown in our recent moves to reform the Group's governance system, we hope to facilitate more effective decision-making at the front line of business by delegating authority to the heads of business divisions, who have a firm grasp of the situation at the worksite. By contrast, we see the board of directors as functioning as a body composed of the representatives of each business area that will be responsible for oversight and decision-making at the level of the Group as a whole.

(End)

Disclaimer:

This English translation has been prepared for general reference purposes only. The Company shall not be responsible for any consequence resulting from the use of the English translation in place of the original Japanese text. In any legal matter, readers should refer to and rely upon the original Japanese text released on November 20, 2019.