Nomura Real Estate Holdings, Inc.
Briefing session of the FY25/3 2Q financial results (held on October 25, 2024)
Q&A Summary

Date and time : Friday, October 25, 2024, 5:00 p.m. - 6:00 p.m.
Attendees : Satoshi Arai, President and Representative Director, Group CEO
Daisaku Matsuo, Executive Vice President and Representative Director, Group COO
Toshihide Tsukasaki, Executive Officer, Group CFO

[Consolidated operating results, full-year forecast]

Q. Steady progress has been made in profits up until the second quarter, so please tell us why you have not revised the full-year forecast? The figures appear to indicate strong results in areas such as overseas and housing. The share price is also weak, so I think conveying a bullish message would have been a good idea.

A. The Overseas Business Unit made progress with a cumulative business profit of 4 billion yen to the end of the second quarter. However, the full-year forecast is unchanged at 2 billion yen. This is mainly due to the future payment of incentive compensation to JV partners caused by the strong sales for the Ecopark in Vietnam and plans to record construction costs for common areas within the district. Steady progress is being made relative to the full-year forecasts in other units. (Tsukasaki, CFO)

[Shareholder returns]

Q. The focus of the shareholder returns policy was said to be on dividends at the beginning of FY25/3, but the recent additional shareholder returns were the purchase of treasury shares. Was this decision due to the drop in the recent share price to 3,700 yen levels? Or was it due to resistance in setting a dividend payout ratio of at least 40%? In addition, was the decision to undertake a stock split at a ratio of five shares for one share due to a desire to increase individual shareholders?

A. At the beginning of the fiscal year, we indicated a dividend payout ratio of 40.7% based on a dividend-focused approach. We have not changed our stance on shareholder returns, but we decided to purchase treasury shares on considering the recent share price. The share price at the beginning of the fiscal year exceeded 4,000 yen and the PBR was also more than 1 times, but the PBR had also dropped below 1 at the recent share price and we considered the share price to be undervalued. We decided to conduct a stock split to create an environment that is more conducive to investment by individual investors. Our aim is to attract investors who will appreciate the business model of a real estate developer undertaking developments over extended periods of time and who will hold shares long term. We conducted the stock split to create an environment where it is also easy for individual investors to purchase through the new NISA. (Tsukasaki, CFO)

Q. I recognize that you are also being proactive about shareholder returns while earnings are strong. However, wouldn't it be a good idea to increase investment for business growth? I believe your company is also able to procure funds through various methods. What sort of discussion are you having ahead of the next mid- to long-term business plan? Is any thought being given to not being able to grow because of a lack of cash on hand?

A. We are having discussion about business growth and the use of cash ahead of the next mid- to long-term business plan. At present, our basic policy is for a total return ratio of 40 to 50%, and we are currently not anticipating that we would exceed this with a return of more than 50%. We believe it is a good idea to return half the profits to shareholders and invest the rest in growth.

Regarding business growth, we are not only thinking about things related to real estate, as has been the case to date, but also about the use of M&A. We have recently been seeking out and considering M&A much more than before, as was evident in the case of UDS. (Arai, CEO)

[Mid- to Long-term Business Plan]

Q. Although your intent under the current mid- to long-term business plan is to achieve annual average growth of 8% from Phase II as well, the consensus and analyst forecasts are below that, and investors think that this will be hard to achieve. What will be the driver of growth to achieve this? Construction costs are higher than when you formulated the mid- to long-term business plan, so will you continue to plan for 8% growth given this has become increasingly difficult to achieve?

A. We are currently in the process of deeply discussing the next mid-to long-term business plan within the company, so here I will respond concerning our approach. The external environment is definitely different from when we announced our current mid- to long-term business plan in April 2022 and our view is the same as yours. Although the recent surge in construction costs is a negative change, housing prices have risen sharply, and we have built a strong position in the housing sales market. Amid the clear inflationary trend, there has, for example, in the rent revisions for offices also been an increase in the number of contracts that rents have been raised. There are changes that have positive and negative impacts on our performance, and we would like to consider the extent to which we can maintain our high growth rate and convey the summary of our discussion to everyone. (Arai, CEO)
The short-term impact of higher construction costs is not large. We have revised the rules for setting reserve funds related to construction costs multiple times since last year and factored certain costs into our plans. On the other hand, we recognize there will be a certain impact over the medium to long-term particularly for large projects and for which construction be over an extended period of time. Nevertheless, many of these long-term projects are planned to be constructed in Phase III and beyond in the mid- to long-term business plan, and adjustment can be made for newly acquired projects as well as for plans for existing projects. We do not believe that growth will stall in a broad sense. (Matsuo, COO)

[Construction costs]

Q. The construction costs of the N tower of BLUE FRONT SHIBAURA, which will be ordered for construction in future, will be higher than for the S tower, which is currently under construction. To what extent will profitability decline? Could construction be delayed if you cannot ensure profitability?

A. We are currently in discussion with the general contractor concerning the construction of the N tower. We think the construction costs will be higher than for the S tower. Nevertheless, we see the entire district, combining the S tower and the N tower, as a single project. The order for the S tower was for construction costs that were lower than the current market, and we expect to be able to secure adequate profit for the project as a whole. We also forecast an increase in office rents over the medium-term, so the outlook is not necessarily negative. This is a project that is large in scale with a long construction period making it hard to predict future construction costs, but we currently plan to complete construction according to the forecast schedule. (Matsuo, COO)

Q. According to your securities report for FY24/3, the planned investment amount for the S tower of BLUE FRONT SHIBAURA is 228.1 billion yen for the land and buildings combined. Thinking about the current circumstances, the investment amount for the N tower could be more than 100 billion yen higher. Would you start construction of the N tower even in that case?

A. In light of the forecast office rent from the N tower when completed and the profitability from the integrated project for the S tower and the N tower, we can withstand a certain degree of increase in the construction costs for the N tower. Nevertheless, the start of construction is still some way into the future, and we are currently discussing the estimates of construction costs. We expect construction to be completed on schedule in FY31/3, and we will continue to discuss with the general contractor about construction costs and the timing to start construction. (Matsuo, COO)

Q. What are the criteria when deciding whether to start construction on large-scale long-term projects such as the N tower of BLUE FRONT SHIBAURA? Although profitability is forecast to decline due to higher construction costs, if the construction of many new buildings in Tokyo stall, we could also expect rents to rise due to constraints on supply. What does your company think about this?

A. We make our decisions on starting businesses while monitoring the outlook for construction costs and rent. Although higher construction costs due to inflation are negative, we believe signs of future rent increases are positive factors for BLUE FRONT SHIBAURA as well as for existing buildings. (Matsuo, COO)

Q. How will higher construction costs affect the number of future development projects? If there is an assumption to maintain profitability, won't there be a decline in the number of projects that can proceed during the next 5 to 10 years?

A. When acquiring land, we already act by adequately forecasting the reserve fund for construction costs, so even if construction costs rise, we are not concerned about a decline in the number of projects for which we can maintain profitability nor are we concerned about a large decline in profitability. In addition, while there are also concerns about not being able to acquire new land, we have been able to steadily acquire land through the effective use of public real estate such as the redevelopment of the university's properties utilizing our high proposal capabilities. We also utilize the highly regarded PROUD brand to acquire business opportunities through the equivalent exchange scheme. We have been able to control the risk of higher construction costs and we believe we have scope to increase the volume for development at the company as a whole. (Matsuo, COO)

[Interest rates]

Q. In theory, the cost of equity should also rise when interest rates rise. Aren't you thinking about bringing forward the achievement of the ROE targets for Phase II and Phase III?

A. We believe the impact of higher interest rates on the cost of equity is still limited. We have set the ROE target at 10% considering the spread relative to our recognized cost of equity of 7 to 8% and we do not believe we are at a stage for adjustment of our medium to long-term targets for ROE. Nevertheless, if the external environment changes and the risk-free rate rises further, we may revise our cost of capital. (Tsukasaki, CFO)

[Residential Development Business Unit]

Q. The full-year plan for housing sales in FY25/3 has been reduced from 4,000 units to 3,800 units, and the gross profit ratio forecast has been lifted from 25% to 26% levels. In light of this, would you please explain your forecast for the next fiscal year and beyond? Will the gross profit ratio be higher than the previous forecast from the next fiscal year and beyond or will there be a change in the forecast number of units sold?

A. We forecast the gross profit ratio will be the 26% levels this fiscal year. Regarding future years, while it will depend on the product line-up, we have already secured an adequate land bank, and we forecast being able to secure profitability in line with the profit plan set in the mid- to long-term business plan. (Matsuo, COO)

Q. What types of strategies and measures are you planning for the hotel business, which is a growth area?

A. We transferred the hotel business to the Residential Development Business Unit in April 2024. In addition to the existing NOHGA HOTEL and Hotel Niwa, we have added UDS Ltd. from this fiscal year. UDS is a unique company, and we already have proposals to promote collaboration between that uniqueness and our company's own strengths. We believe we will be able to implement initiatives that demonstrate our Group's strength in the hotel business as well. (Matsuo, COO)

[Commercial Real Estate Business Unit]

Q. Is there any progress in the leasing of S tower of BLUE FRONT SHIBAURA? In addition, what are the projections for leasing of the Shinjuku Nomura Building after the Nomura Real Estate Group relocates?

A. There is no change to the rate of progress for the S tower of BLUE FRONT SHIBAURA of around 70%, and we are not concerned about the progress with strong inquiries, and a policy to lease while maintaining rent levels. We have started partial leasing of the Shinjuku Nomura Building, and already have inquiries, so we have a sense that we will be able to move in a successor tenant without difficulties. (Matsuo, COO)

Q. You have already acquired lands for two offices and three logistics facilities this fiscal year. What types of lands have you acquired and are you able to expect similar profit ratios to the past? There was previously an explanation that the gross profit ratio in the housing sales business would be around the 20% levels from FY26/3, and unable to be maintained at current levels. Will the gross profit ratio on property sales similarly decline?

A. For offices, we are mainly developing PMO and H^1O, and demand is strong for H^1O, especially from startup companies. Leveraging the feature of the small office space in each room, and since there is a trend for an increase in land burden, we have recently increased acquisition in H^1O. The vacancy rate for logistics facilities rose in 2023 due to a temporary large supply, but we forecast ongoing logistics demand, especially for EC businesses, as well as increased logistics needs at intermediate bases for the Tokyo metropolitan area and regional areas due to the so-called "2024 Issue" of driver shortages. We will also continue to strengthen the acquisition of logistics facilities. Regarding the forecast for future profitability, in addition to the upward trend for rents and the low and stable cap rate, we have been selectively progressing land acquisition premised on ensuring profitability even if construction costs rise, so we believe we can maintain a certain degree of profitability. (Matsuo, COO)
(See the PMO official website)
(See the H^1O official website)
(See the Landport official website (in Japanese))

Q. To what extent have you been able to raise office rents? My impression has been that there were not any particularly positive comments as of the first quarter of FY25/3. Has the market changed?

A. The percentage of office rents raised were about 20 to 30% of tenants who were due for revisions. Overall, there was a lot of activity such as relocations and expansions. During the past few years, the focus had been on filling empty floors, but recently there is a sense that rents are rising for both existing and new tenants. (Matsuo, COO)

[Overseas Business Unit]

Q. The Ecopark in Vietnam has done well this fiscal year, but what is the status of other countries including countries other than Vietnam?

A. In Vietnam, the Grand Park project continues as a large-scale project. In addition, apart from Ecopark and Grand Park, we are also participating in highly profitable new buildings and growth is likely to remain strong in future. In the Philippines, we created a joint venture company with a local conglomerate, which will undertake development over 30 years and has already acquired the land. These are forecast to contribute to profit in Phase II and III of the mid- to long-term business plan. In Thailand, the size of the business is not as large as in other countries, but our policy is to steadily proceed with the business. For Asia as a whole, we think there will be growth in the short term in Vietnam and in the medium to long term in the Philippines. In addition, we started the rental apartment business in America, and we are engaged in housing-related business in London leveraging our company's strengths. (Matsuo, COO)
(See the Press Release "Nomura Real Estate Joins 'The Senique Hanoi' Project")

[Nakano 4-chome Shin North Exit Station Front Area Redevelopment]

Q. There were reports that Nakano Ward would revise the plans before the end of FY25/3. I think the profit impact of the Nakano redevelopment project is limited, but this could be seen as symbolic of the future direction of redevelopment. As options for the future response, there could be an increase in subsidies, an increase in floor area ratios, or an increase in the percentage of condominiums for sale with fast fund recovery, etc. What types of options are possible?

A. We are currently in discussion with Nakano Ward and the specific details will be firmed up in future. It is important for the business to be able to ensure profitability even with the higher construction costs, and that is what the discussions are for. (Matsuo, COO)