OBAYASHI

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Obayashi Group Medium-Term Business Plan 2022
Summary of the Briefing for Investors and Analysts (Zoom Conference)
and Main Questions and Answers

- Date & Time: Monday, March 14, 2022, 10:30 a.m. to 12:00 p.m.

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1. Obayashi Group Medium-Term Business Plan 2022

An explanation was provided based on the Obayashi Group Medium-Term Business Plan 2022.

2. Main Questions and Answers

(1) Performance Indicators

Q Your operating income target of 100 billion yen as the bottom line for the Medium-Term Business Plan 2022 period seems conservative. What made you present only a minimum target, when you could have set a clear numerical target, such as 120 billion yen or 130 billion yen, for consolidated operating income for the five years under the Plan? Did you make this decision considering downside risks such as uncertainty about the future business environment?

A Your question was about whether or not our operating income target of 100 billion yen or more is ambitious enough. We want you to consider 100 billion yen as the bottom line. Our results between the fiscal years 2015 and 2020 benefited from the growing construction demand and the special condition created by recovery and restoration efforts from the Great East Japan earthquake. Given the Obayashi Group's long-term track record, generating stable profits, with a consolidated operating income of 100 billion yen as the bottom line, during the Medium-Term Business Plan 2022 period is a higher level target. We cannot achieve this unless we strengthen our business foundation for the domestic construction business and accelerate the transformation of our earnings structure. In addition, megaprojects such as urban redevelopment projects have positive factors that cannot be simply measured based on profitability calculated when accepting an order. We will carefully consider these factors, make strategic decisions about the orders we receive, and create a balanced project portfolio in terms of size, purpose, the ratios of new and renovation projects, and other factors, without excessively focusing on highly competitive large-scale projects. By doing so, we aim to ensure that our consolidated operating income reaches the bottom line of 100 billion yen.

Q What is the level of gross profit margin you expect to achieve in the non-consolidated domestic building construction business and civil engineering business as you aim to post at least 100 billion yen in consolidated operating income? Is it difficult to increase profit in the domestic building construction business due to large projects?

A In the non-consolidated domestic building construction business, we have information on construction plans worth 1 trillion yen or more for each year until the fiscal year 2024. This figure only includes large projects. With this abundant information on construction plans, we estimate the value of completed construction to slightly exceed 1 trillion yen as we focus on profitability and consider our construction capacity based on our response to the overtime work hour regulation under the revised Labor Standards Act which will be applied to the construction industry from the fiscal year 2024. This figure could fluctuate depending on whether we receive an order for any ultra large construction project. Although competition remains severe and the low profitability trend continues for large construction projects, we will create an optimum portfolio by increasing the ratio of small- and medium-sized projects and renovation and other projects that are expected to be relatively more profitable in our total business portfolio to secure a gross profit margin of around 8 to 9%.

A Non-consolidated net sales of the domestic civil engineering business will depend on the orders we receive from now on, although we expect them to be stable supported by solid domestic construction investments. We want to organize a structure that can stably maintain net sales of around 300 billion yen within about five years. Considering the productivity improvement to be achieved through digital technologies and the greater application of precast components, the progress in workstyle reforms based on the overtime work hour limit to be placed from the fiscal year 2024, and the impact of the widespread adoption of closing construction sites eight days out of every four-week period, we will operate our business with attention to our construction capacity. In the last few years, our gross profit margin remained high due to the steady progress in lucrative large construction works, cost reduction, and the greater-than-initially-expected additional contract amount paid in large construction sites. Going forward, these special factors are unlikely to recur. We therefore estimate a gross profit margin of around 15%, which is below the level recorded in the past few years. Against the backdrop of solid domestic construction investments, however, we expect to maintain stable profits by organizing a structure that can consistently post around 300 billion yen in sales.

Q The graph on page 13 of the presentation slides has a bar at the furthest right that says, "Further Growth." Although no specific number is written on it, it seems the bar represents around 130 billion yen. Does this mean that you project consolidated operating income to be around 130 billion yen in the future?

A Our consolidated operating income target of at least 100 billion yen is not a conservative target. However, we believe that we can further increase profits through productivity improvement using DX and enhancing human resource management. We have presented the graph on page 13 to express such hope for growth.

(2) Business Strategy for Each Segment

Q Page 13 of the presentation slides has the following statement: "…earning over 30% of operating income in diversified profit source other than the domestic construction businesses." Specifically, which business segment will become the main source of earnings? In addition, please explain your growth strategy for the overseas construction business, real estate development business, and green energy business.

A We will not choose the main source of earnings from the overseas construction business, real estate development business, or green energy business. We will instead focus on all these businesses. In the overseas construction business, with the growth of the existing subsidiaries, we will conduct M&As if there is any acquisition candidate that matches the Obayashi Group's strategy in the local market. The real estate development business is expected to grow steadily as we make investments as planned. In the green energy business, we will conduct R&D and proof-of-concept experiments for the commercialization of hydrogen-related businesses in the next five years to add to the renewable energy business which has so far been the main pillar of the segment.

Q You have explained that you expect to sell assets in the real estate development business as part of your investment plan. Do you plan to make a certain amount of sales each year, or do you determine what you sell based on the profit situation each year?

A There are two types of property sales in the real estate development business: one is to sell properties to reshuffle our portfolio based on the age and location of properties, while the other is to sell the properties we have developed after we have secured tenants. For instance, the latter may include the sale of logistics facilities. As the timing of sales depends on the economic environment, we do not have total control. However, we consider it undesirable to make an excessive number of sales during one fiscal year from the viewpoint of corporate management.

(3) Financial Efficiency Indicators

Q I understand that you are going to adopt ROIC instead of ROE. Given that the asset-light construction business and the real estate leasing business that owns many assets have different levels of capital efficiency, isn't ROIC not suitable for the Obayashi Group's business model that aims to expand business areas from the peripheries of the construction business? Can you explain how you are going to use the indicator for different business segments and what is the purpose of using ROIC?

A We decided to use ROIC because, instead of focusing on return on equity, we considered it necessary to improve capital efficiency based on the entire invested capital regardless of its source.

ROIC is directly connected to a company's earnings power. It is also an indicator that is sensitive to the capital market. In addition, the use of ROIC will encourage the disposal of assets with lower profitability to improve balance sheet efficiency. What we are required to do as a company is to increase the return on the invested capital and to achieve an ROIC exceeding the level of the weighted average cost of capital (WACC). We thus considered ROIC as an effective indicator to measure improvement to capital efficiency. ROIC is especially effective in the real estate development business that owns many assets. We also consider it sufficiently useful in the asset-light construction business because incorporating ROIC's perspective into the existing approach of trying to increase operating income through reductions in the cost of sales and selling, general and administrative expense will give rise to an awareness about turnover rates of operating capital and fixed assets. For instance, it may promote efforts to expedite the collection of accounts receivable from completed construction contracts to raise the turnover rate of operating capital or efforts to reduce shares that we own in our customers' businesses to increase the turnover rate of noncurrent assets.

Q What is the level of the WACC you envisage?

A I cannot give you a specific figure. What I can say is that we expect it to be lower than 5%, which we have presented as our target for ROIC.

(4) Policy on Shareholder Returns

Q I understand that you aim to achieve the dividend on equity (DOE) ratio of about 3% as the benchmark for your shareholder returns. Why did you not include share buybacks in your shareholder return policy?

A The introduction of DOE and our plan to improve shareholder returns through dividends reflect our desire to improve equity through the accumulation of profits and to focus on making shareholder returns based on medium- and long-term improvement to equity. While a share buyback is one of the options of shareholder returns, we currently have no specific plans for it.

Q You have explained that the Obayashi Group will make stable dividend payments at around DOE of about 3% as a benchmark. Is there any possibility that you may raise or lower the target level of DOE during the Medium-Term Business Plan 2022 period?

A We have set our target DOE at around 3%. This is in line with our shareholder return policy of making stable dividend payments, while factoring in future performance targets and the level of dividend payments we made during the Medium-Term Business Plan 2017 period. We are committed to providing shareholder returns in accordance with this level of DOE during the current Medium-Term Business Plan period. We will not lower the level of DOE unless we face extraordinary circumstances such as keeping this level of DOE materially impairs our net assets or our business environment dramatically changes. As for the possibility of raising the level of DOE, we plan to identify the appropriate level of dividend based on our business results and the business environment during the Medium-Term Business Plan 2022 period and our dialogues with shareholders. While we may raise the level of DOE if our results improve, we currently do not have any specific plans for reviewing it.

Q As an investor, I appreciate that the Obayashi Group is adopting DOE based on the stable dividend policy. Based on the current BPS, we can probably expect a stable dividend payment of nearly 50 yen per share. I understand that this level of dividend is appropriate as equity cost to be paid to shareholders regardless of profits, based on the assumption that the Obayashi Group will post a consolidated operating income of 100 billion yen as the bottom line. Can you explain your view on the distribution of profits to shareholders, other stakeholders, and growth investments, if ROE exceeds 8% due to the improved capital efficiency or stronger business results? Conversely, what do you plan to do if your business results do not meet your expectations?

A We consider that making stable dividend payments in accordance with DOE is consistent with the equity cost. Although we have no specific policy on what we may deliver as shareholder returns in the event of the better-than-expected business results, one option is to raise the DOE ratio. We can also provide shareholder returns in the form of special dividend. We need to determine these issues based on the details of our earnings at the time. I cannot therefore provide an answer here. For our employees who are our stakeholders other than shareholders, we will naturally consider distributing profits in the form of salaries or bonuses if our profits keep improving stably. Meanwhile, we will not instantly lower our dividend even if our results deteriorate. We will try to recover our business results and meet our shareholders' expectations while maintaining the target level of DOE.

Q Do you have any vision that you seek to achieve with respect to balancing the desired concept of equity improvement and the concept of improving capital efficiency?

A If our business grows steadily posting a minimum of 100 billion yen in operating income, our equity will improve and dividends grow even if we make dividend payments at the DOE ratio of 3%. If we raise the DOE ratio, we will be able to make further distributions to shareholders. We consider that if we improve equity through the generation of profits, our dividend payments will improve together.

(5) Investment Plan

Q Your investments in the green energy business have fallen compared with the Medium-Term Business Plan 2017. Is it because you have reviewed the offshore wind power generation business?

A In the offshore wind power generation business, a consortium formed around a trading company made a successful, low bid at the end of last year in all public tender projects concerning three waters in Japan, including a project in the general waters off the northern part of Akita Prefecture in which the

Obayashi Group made a bid. We had spent several years for the environment assessment and seabed analyses; unfortunately, however, we did not win a bid. We have been trying to expand the green energy business with the offshore wind power generation business in general waters as one area of the business. We will not stop our efforts because of the recent result. Instead, we are exploring business potentials in a market where the prices that are lower than our expectations have become a benchmark. Meanwhile, the offshore wind power generation projects in the Port of Akita and the Port of Noshiro, in which we are participating as a business operator, will commence operation at the end of this year. This means that we will reach one of the major milestones we have been aiming to reach. Going forward, in the offshore wind power generation business, we also want to participate in projects as an EPC contractor, utilizing our experience as a business operator in the Port of Akita and the Port of Noshiro, while exploring the possibility of participating in projects as a business operator.

Q You expect to invest 25 billion yen in "M&A, etc.," but you have explained that this estimated figure does not include large-scale M&As. Will you execute a large-scale M&A if an opportunity arises? Please explain your M&A strategy.

A The 25 billion yen for "M&A, etc." is a budget for acquiring or forming capital or business alliances with Japanese or overseas companies we may come across through open innovation and other opportunities. As shown in the cash allocation graphs on page 16 of the presentation slides, we will have a capacity to make investments boldly when opportunities arise to further improve our corporate value. We can handle large M&As as well.

Q Page 6 of the presentation slides shows the projected results of the investments made under the Medium-Term Business Plan 2017. Please tell us your evaluation of this return on investments. In addition, can you explain the expected return on investments under the Medium-Term Business Plan 2022?

A As shown in the right-hand side of page 6 of the presentation slides, the investments made under the Medium-Term Business Plan 2017 are projected to contribute to operating income by approximately 5 billion yen or more a year in the real estate leasing business and approximately 4 billion yen or more a year in the renewable energy business during the period of the Medium-Term Business Plan 2022. We therefore consider that we have achieved a certain degree of investment impact. During the five years under the Medium-Term Business Plan 2022, we plan to invest 600 billion yen. In the real estate development business, we expect to invest a net amount of 160 billion yen, aiming to achieve the level of profit contribution that exceeds the contribution of the investments made under the Medium-Term Business Plan 2017. Returns in the green energy business and M&As will depend on how much investment we can make during the period. We want to secure appropriate returns and meet our shareholders' expectations.

(6) Other Questions

Q You have explained that you prepared the Medium-Term Business Plan 2022 based on a review of the Medium-Term Business Plan 2017. Can you please explain if any major change has been made from the Medium-Term Business Plan 2017? Your results against the performance targets of the Medium-Term Business Plan 2017 fizzled out, but am I correct in understanding that this was mainly due to the impact of changes in the business environment and strategic receipt of orders and there is no need to drastically change the direction of businesses?

A Our approach under the Medium-Term Business Plan 2022 has not changed much from the Medium-Term Business Plan 2017. During the period covered by the Medium-Term Business Plan 2017, we experienced dramatic changes in the business environment such as the spread of COVID-19 infections. In response, we prepared the Corporate Transformation Program in the fall of 2020 to address management challenges. We prepared the Medium-Term Business Plan 2022 based on our understanding of the risks existing in the dramatically changing business, economic, and social environments including the ongoing inflation and Russia's invasion of Ukraine, asking what we should do to see them as business opportunities and to turn them into improved earnings. We have explained that our target is to post 100 billion yen in consolidated operating income as the bottom line. The basic approach of the Medium-Term Business Plan 2022 is to take whatever measures available to overcome difficult phases, such as business process reforms using open innovation and DX, to further increase profits from this amount.

Q Does the Medium-Term Business Plan 2022 factor in the rising materials prices? If not, please tell us their expected future impact.

A The Medium-Term Business Plan 2022 factors in the rising materials prices. However, we cannot fully foresee future steel prices, given the presence of factors such as the higher purchase prices of scrap metals due to China's demand recovery and the suspension of new contracts by Tokyo Steel Manufacturing Co., Ltd. following Russia's invasion of Ukraine. To deal with this uncertainty, it is important that we make best efforts to minimize materials price fluctuations by promptly concluding procurement contracts after signing contractor agreements. In addition, for the projects that are currently underway, we are explaining the situation in detail to gain an understanding of our clients even if their contract does not allow indexation.