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OBAYASHI CORPORATION
4th Quarter: Summary of the Financial Results Briefing for the Fiscal Year Ended March 31, 2022 (Online Conference) and Main Questions and Answers

- Date/Time: Friday, May 13, 2022, 10:30 a.m. to 11:30 a.m.

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1. Results for FY2022.3 (the fiscal year ended March 31, 2022)

An explanation was provided based on the Presentation on Financial Results (April 1, 2021 to March 31, 2022) and 4th Quarter Financial Results (April 1, 2021 to March 31, 2022).

2. Full-year forecasts for FY2023.3 /Promoting ESG Management, etc.

An explanation was provided based on the Presentation on Financial Results (April 1, 2021 to March 31, 2022).

3. Main Questions and Answers

(1) The Group’s Business Environment

Q What was the trend in FY2022.3 regarding the profitability at the time of receiving orders in the domestic building construction business? And what is the profitability forecast?

A For FY2022.3, our profitability at the time of receiving orders dropped because we accepted orders for large-scale projects with low profitability. Learning from this experience, we are putting in place a more stringent screening process to secure profitability when accepting orders to avoid loss. The more objective and stringent process will involve identifying cost-saving opportunities and risk factors, such as rising prices. We are already seeing the fruit of our efforts in controlling orders with low profitability, and profitability at the time of receiving orders in FY2022.3 improved from the previous fiscal year.

(2) The Group’s Forecasts

Q You have explained that the forecasts for FY2023.3 regarding orders received in the domestic building construction business is around 1 trillion yen, given the abundant construction projects in hand and an emphasis on profitability when receiving orders. However, this is below the level of orders received in FY2021.3. Which of these factors will be the leading cause of this? Is it because Obayashi has reached its maximum construction capacity, or is there only 1 trillion yen worth of profitable projects available? Please explain.

A We set the forecasts for orders received in the domestic building construction business in

FY2023.3, considering our construction capacity. The level of orders received remained high between FY2020.3 and FY2022.3, and our share among the five major construction contractors was at around 25%. Given this situation, the balance carried over as of the end of March, 2022 was also high compared to the other major construction contractors. Many of the orders received in FY2023.3 are highly probable orders, with about half already confirmed. Of course, we also emphasize profit in our order planning, but we have set our target based more on our construction capacity with the revised Labor Standards Act coming into effect in FY2025.3.

Q The gross profit margin on completed construction contracts indicated in the domestic building construction business forecasts for FY2023.3 is 8.8%. This is close to the 9.0% indicated in the initial forecasts for FY2022.3 announced a year ago but given the progress of the large-scale projects that recorded provisions for loss on construction contracts in FY2022.3 will push down the overall profit level while the soaring cost of materials will put pressure on the profit, this seems quite challenging to achieve. The initial forecasts for FY2022.3, assumed a near-zero profit from large-scale projects. Is this also the case for FY2023.3 or can we expect small and medium-sized projects to be minimally affected by the rising materials cost and profitability to improve as a result?

A The value of completed construction and gross profit on completed construction contracts in FY2023.3 comprise about 70% of confirmed orders received. The mega projects with low profitability among this 70% will push down the overall profit. However, despite the differences between projects and regions, small and medium-sized projects are stable in both volume of orders received and profitability. Therefore, we believe we can achieve the 8.8% gross profit margin on completed construction contracts.

Q You mentioned abundant construction projects in hand when explaining the domestic building construction business forecasts for FY2023.3. Still, the value of completed construction has only increased by around 3% since FY2022.3. Is it correct to say that since the large-scale projects that recorded provisions for loss on construction contracts in FY2022.3 will not progress much this fiscal year, it will not significantly push down the profit and, therefore, the gross profit margin on completed construction contracts will be at a high level of 8.8%?

A The value of completed construction has not increased much from FY2022.3 and it is unlikely to change significantly from the current level throughout the term of the Medium-Term Business Plan 2022. As for gross profit margin on completed construction contracts, in addition to the progress of large-scale projects with provisions recorded pushing down the profit level, there are concerns about soaring materials costs putting pressure on the profit but 8.8% is still our target.

Q The gross profit margin on completed construction contracts in the domestic civil engineering business forecasts for FY2023.3 is lower than FY2021.3 and is at the same level as FY2022.3, which saw gross profit margin drop due to a drop in profitability of some projects. Please give your reasons for this forecast.

A Over these past few years up to FY2021.3, gross profit margin on completed construction contracts in the domestic civil engineering business has been relatively high due to profitable projects. However, the number of profitable projects has been decreasing since FY2022.3, and this trend is expected to continue. Taking this into consideration, gross profit margin on completed construction contracts for FY2023.3 is expected to be at the same level as FY2022.3.

(3) Soaring Materials Cost

Q Please provide details on the negotiations with your clients on the soaring materials costs in the domestic building construction business.

A The soaring construction materials costs and supply shortage are in crisis that we have never experienced in the last 30 years. The supply chain was already in disorder due to shortages in items such as semiconductors, and now with the Russian invasion of Ukraine, prices are expected to increase further, and the uncertainty of the future poses a considerable risk.

How we handle the increasing materials costs varies before and after signing the contract with the client. Before signing the contract, we indicate the latest market price in our cost estimate at the time of the tender. Then at the time of signing, we negotiate to include a clause that would allow us to discuss an increase in the contract amount in anticipation of a price increase. Once the contract has been signed, we quickly conclude a procurement contract to minimize the risk of a price increase. Previously, there were instances where clients refused to discuss increasing the contract amount, even though we had a prior agreement to do so when prices increased, but clients are becoming more understanding, and we can say the situation is changing.

We will be persistent in our negotiations with our clients, utilizing information from the Japan Federation of Construction Contractors on issues such as soaring materials costs. We do not leave the project offices to handle the negotiations on their own. Our head office monitors the talks and provides support as needed.

Q Are there any risks that the high materials costs will impact the forecasts forFY2023.3?

A The cost estimate submitted to clients reflects the market value. Still, the forecasts may be impacted depending on the outcome of the negotiation with our clients regarding the soaring prices.

(4) Other Questions

Q Please explain if and how factors such as the post-pandemic recovery and the US interest rate hike will have an impact on the overseas building construction business forecasts for FY2023.3.

A Although each country is still experiencing the novel coronavirus outbreak, it is affecting the country’s economic activities less and less, and we have been able to continue with our onsite construction projects in all the countries. As for construction investments, one think tank forecasts a strong demand coming from North America and Asia. Our forecast for FY2023.3 on orders received by our overseas building construction subsidiaries is expected to increase by about 100 billion yen from the previous fiscal year. The value of completed construction is expected to increase by about 70 billion yen. Currently, we do not foresee any impact from the US interest rate hike on our results but it is something we will continue to keep our eyes on, including its potential impact on our clients’ capital expenditure plans.

Q Please explain how the reduction in shares that we own in our customers' businesses has been incorporated into the forecasts for FY2023.3. The planned extraordinary gain of 6 billion yen seems somewhat conservative. Does this mean you are not expecting much reduction in FY2023.3?

A We have set a target to sell off 150-billion-yen worth of shares to bring our consolidated net assets to within 20% as early as possible, before the March 2027 deadline. Selling has already started, and we have already sold 17-billion-yen worth in FY2022.3 and recorded 10.2 billion yen in extraordinary gain. The 6-billion-yen extraordinary gain in the forecast for FY2023.3 is calculated based only on the shares available for sale as of now. There is a possibility that more shares will become available for sale depending on the negotiations with the holder.