

Disclaimer:

This document is the English version of the Japanese document released on August 10, 2023. It was translated into English and presented solely for the convenience of users who are not familiar with Japanese. If there is any discrepancy between the Japanese document and the English document, the Japanese document will prevail. This document includes forward-looking statements based on the information available at the time the Japanese and English documents were released. Actual results may vary from the forward-looking statements contained herein due to various factors. Obayashi Corporation (non-consolidated) is called the "Company" in this document.

OBUYASHI CORPORATION
Summary of the Financial Results Briefing Conference
for FY2023 1st Quarter
(April 1, 2023 to June 30, 2023)

Online conference held on Monday, August 7, 2023, from 14:00 to 14:50

1. Financial Results for First Quarter and Full-Year Forecast for FY2023

An explanation was provided, based on the "FY2023 1st Quarter Financial Results (April 1, 2023 to June 30, 2023) .

2. Main Questions and Answers

(1) Financial Results for First Quarter

Q: The Profit on completed construction contracts in the domestic building construction business is worsening due to the increase in completed construction contracts with low profitability. Given that the profit for the first quarter is lower than the full-year plan and the impact of large-scale projects with low profitability will continue into the second quarter and onwards, how do you plan to recover to achieve the full-year plan? Further, profit on completed construction contracts was about 9% from the second quarter onwards in the previous fiscal year even though you had large-scale projects with low profitability. Please explain how the profit has declined so much in the first quarter. My impression is that the first quarter performance has been lower than expected. Is it within the expected range?

A: There were fewer completed projects in the first half, and with projects with high profitability not making progress, the percentage of low profitability projects in completed projects became high and this resulted in low profit, but this is within expectations. We once again verified the full-year outlook after seeing the first quarter results, and we anticipate the profit to rise as there are many projects that will be completed in the second half. The reason for the decline in the profit in the first quarter compared with the second half of FY2022 is that the profits grew due to completed projects in the second half of FY2022.

Q: You have explained that profits of projects in hand worsened due to the impact of rising material and labor costs. Were there any factors other than those incorporated in the beginning of the fiscal year?

A: We had incorporated the impact of rising material and labor costs, but there were a few projects whose cost of sales were affected by material costs in particular in the first quarter. In addition to the fewer completed projects, this was a factor behind worsened profits in the first quarter.

Q: Provision for loss on construction contracts has declined compared to the end of the previous fiscal year. Are there any projects that newly became subject to the provision? How has the rise in material and labor costs affected the margin of building construction business?

A: As for addition to provision for loss on construction contracts, it is not zero yen, but there is no major impact. Reversal of provision following progress in construction of projects for which provisions were already made accounts for the majority, and losses are not necessarily expanding because of the rise in material and labor costs.

Q: What is behind the increase in profits at the domestic construction group subsidiary?

A: In the previous fiscal year, Obayashi Road Corporation faced a tough situation in terms of profitability of asphalt mixtures due to rise in crude oil prices. That situation has improved in this fiscal year. In addition to that, the order environment is also improving.

Q: Progress rate of selling, general and administrative expenses has been high. Is it as planned for the full year? Is the depreciation of SEP vessels also a factor in the increase in selling, general and administrative expenses?

A: The progress rate of selling, general and administrative expenses is a little over 25% and is as planned. Regarding labor cost, we have incorporated wage increase of 6%, and though expenses have been concentrated in the first quarter, the increase is within expectation. We do not anticipate any large change for the full year. SEP vessels are still under construction in progress in accounting treatment, and depreciation has not started. We are planning to reflect that in the civil engineering costs, but it is safe to assume that there is no significant impact.

Q: We understood that the increase in selling, general and administrative expenses is in line with the plan, but is there a possibility of it ballooning more than expected due to the yen's depreciation? Is there a chance of overseas selling, general and administrative expenses increasing more than the plan due to the impact of depreciation of yen?

A: Selling, general and administrative expenses of overseas group subsidiaries are increasing more than planned on a consolidated basis due to the impact of the exchange rate, but profits are also increasing at the same time.

Q: We understand that orders received for domestic building construction business are growing. Which types of works are you seeing the growth in orders in the first quarter? Also, what is the status of profitability at the time of receiving orders?

A: We had orders for offices and plants in large projects. The order environment is steady, and profitability at the time of receiving orders is gradually rising.

(2) Full-year Outlook

Q: We would like to know about the outlook for material and labor costs. Have you incorporated the increase in construction cost in the plan to a certain extent?

A: Material and labor costs have peaked after rising significantly in the previous year and the year before that, and we do not see any major changes at the moment. At the current level, there is no change in the full-year outlook as they have been incorporated in the income of each work. As for labor costs, in our view, there are risks of labor shortage occurring especially in finishing works through the next fiscal year.

Q: How should we take the progress in profits to the full-year plan? There seems to be a more-than-expected impact of the soaring material and labor costs in the first quarter. Is my understanding correct that you expect to recover it in the second half? The movement of share price following the first-quarter disclosure seems to suggest that there would be downward revision to the full-year plan in the second quarter. So, I would like to confirm that.

A: The main reasons are the impact of the high material costs and a slight delay in the progress of highly profitable projects. As for achievement of the full-year plan, the decline in the profitability in the first quarter was temporary. We expect to achieve the results according to the plan, as profitability will recover along with the progress in highly profitable projects going forward and the number of completed projects will also increase through the second half.

(3) Business Environment

Q: We are paying attention to profitability at the time of receiving orders to estimate the trend of gross profit of building construction business for the next fiscal year. Has the profitability at the time of receiving orders been improving? Is profitability at the time of receiving orders different for large-scale construction projects and small- and medium-scale projects? Is there a risk of downward pressure on profit from delays in progress of work or increase in rush works caused by overtime regulations? What is your view on the future trend of gross profit of building construction business for the current fiscal year and the next?

A: Profitability at the time of receiving orders is showing an improving trend. The intense competition for large-scale projects has been easing and profitability at the time of receiving orders of small- and medium-sized projects also continues to be in a relatively favorable condition. The impact of soaring costs on construction projects in hand is limited to a small part and the price rise has been passed on to clients to a certain extent, and it is expected to make progress in line with the plan in the full year. Therefore, the impact of projects with low profitability remains till the next fiscal year, but profitability is expected to improve after that as profit at the time of receiving orders recovers.

Q: It seems like it is difficult to secure mechanical and electrical (M&E) contractors in Japan. What is the situation like? Is it affecting profitability or have you been able to pass it on to clients?

A: It is difficult to give a quantitative answer, but the impact is not small. We are focusing on taking early measures because securing the framework for construction has impact on profitability. We have been negotiating with clients to pass on the impact by using the cost-on method, but responses vary by client.

(4) Others

Q: What is your stance on the Osaka-Kansai Japan Expo-related projects?

A: There are several projects, orders received for which have been already announced. There will be no change in our stance of deciding the projects we take on by taking into consideration construction capacity, profitability, and delivery.

Q: When is the peak of implementation of construction contracts for which provision for loss on construction contracts was recorded? How have they been progressing?

A: The ratio of provisions for loss on construction contracts to completed construction contracts peaks in the first half. They will gradually decline thereafter, but they will still account for a certain percentage through FY2024, and they continue to be a factor that reduces overall profitability. It will be FY2025 when the impact of the provisions is resolved.