OBAYASHI

Disclaimer:
This document has been translated from the Japanese original for reference purpose only. If there is any discrepancy between the Japanese original and this English translation, the former 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

Summary of the Financial Results Briefing Conference
for FY2024 2nd Quarter
(April 1, 2024 to September 30, 2024)

Date:	Tuesday, November 12, 2024, from 10:30 to 11:50
Respondents:	Kenji Hasuwa, President and CEO
	Atsushi Sasagawa, Executive Vice President
	Toshimi Sato, Executive Vice President
	Yoshihito Sasaki, Senior Managing Executive Officer
	Yasuo Morita, Senior Managing Executive Officer
	Yoshiaki Takata, General Manager of Accounting Department
Attendees:	95 securities analysts, institutional investors and others

---

1. Presentation on Financial Results for FY2024 2nd Quarter, Forecasts for FY2024 and Addendum to Medium-Term Business Plan 2022 Implementation Status

An explanation was provided by the President and CEO, based on the Presentation on Financial Results FY2024 2nd Quarter (April 1, 2024 to September 30, 2024).

2. Main Questions and Answers

(1) Domestic Building Construction Business

Q: It appears that an additional provision for loss on construction contracts of about 3.0 billion yen was recorded in the second quarter. Will the risk of profit deterioration due to inflation remain in the future, or is it within the range that can be absorbed by the profit to be generated by improved profitability? Can you evaluate the profit margin in the second quarter, and how will the additional provision for loss affect the profit margin in the future?

A: While the profit margin for the second quarter improved due to projects that significantly increased profits, it fell short of the initial plan mainly due to the provision for loss for some projects. Although the profit margin for the second quarter is slightly below the full-year forecast, we will improve it toward the end of the fiscal year to achieve the plan.

Q: I would like to know about the projects you have recorded the provision for loss on construction contracts. What were the reasons for the provision for loss and are there any risks of additional recording in the future?

A: We refrain from talking about individual project. The provision for loss was mainly on large projects after a close examination based on the progress of negotiations with clients and suppliers and subcontractors for additional construction work due to rising prices. Although we do not see a significant risk of an additional provision for loss in the future, there might be a downward swing to the plan due to the fact that we are receiving additional claim from mechanical and electrical (M&A) subcontractors with manpower and M&E equipment shortage. In total, we do not believe that there will be a significant impact on the performance, as all provision for loss have been recorded to a reasonable extent at this stage.

Q: Are the projects for which the provision for loss on construction contracts was recorded under construction?
A: All the projects which we have recorded provision for loss this fiscal year are under construction and not including new contracts.

Q: Progress on orders received in the first half of the fiscal year are already halfway to the plan. Is this in line with your plan, although you will receive orders for large projects in the second half?
A: Orders received totaled 648.8 billion yen against the plan of 1.3 trillion yen due to large orders received in the first half of the fiscal year. Unlike net sales recorded on a percentage-of-completion basis each month, orders received are recorded at the time of receiving orders. The timing of the recording greatly affects the amount of order received for each fiscal year, especially with many projects over 100.0 billion yen. Therefore, there is a possibility that orders received will exceed the full-year plan. We are striving to receive orders strategically, keeping in mind the equalization of construction volume and the capacity of construction work, rather than the increase or decrease from period to period. Another reason for the recent increase in orders received is the rise in contract price. Although a certain degree of inflation is anticipated when making the plan, construction costs have risen by more than 20% over the past three years. Particularly, we are negotiating with our clients to have M&E work contracted separately or in cost-plus fee basis because of shortage of M&E subcontractors. When M&E work are contracted in cost-plus fee basis, amount of orders received will increase. In the past, M&E work ratio to building construction was about 25% but recently it has exceeded 30%, and it is 50-60% for semiconductor and data center projects.

Q: Regarding future order trends and prices, if suppliers and subcontractors continue to request additional claims, will you continue to factor cost increases in your order activities or is it difficult to raise prices any further? What is your approach to pricing?
A: As stated in the addendum to Medium-Term Business Plan 2022, we are working on the premise to focus on profitability in receiving orders. We are negotiating with clients on the basis of appropriate profit margins on actual costs, however M&E subcontractors are short of manpower and M&E equipment until FY2028 and are refusing to give us quotations. The price of M&E work is said to be rising at a rate of 3% per month, and contracts are often priced at market value making us difficult to foresee the future price. Therefore, we negotiate with our clients to have the M&E work contracted separately and bid on the premise of arranging M&E subcontractors.

Q: You mentioned that the additional provision for loss on construction contracts you recorded is for projects in hand. Is there any change in your plan for a 10% profit margin on completed construction contracts by the end of FY2026? Also, is there any risk of recording more provision for loss? Other companies seem to have a resolute attitude of not receiving orders for unprofitable projects. Do you have any concerns for large projects?

A: There is no change in our plan to achieve a 10% profit margin on completed construction contracts in FY2026. Although there are cases where large redevelopment projects in the Tokyo metropolitan area planned or under construction have been cancelled due to significant cost increases, we first target construction projects and then negotiate with developers and redevelopment associations. In addition, from the viewpoint of work style reform, it is important to obtain appropriate construction periods. We are negotiating on the premise of securing profitability and appropriate construction periods. For large-scale projects to come, start of the construction is not yet decided due to increasing construction costs, and we are still in the process of making proposals. The project will be between 100 billion and 300 billion yen, so the impact on the company's performance will be huge, and we will make a careful decision.

(2) Domestic Civil Engineering Business

Q: You mentioned that the profit margin for domestic civil engineering in the second quarter was boosted by additional claim approvals. Can I expect to see more in the second half of the year, when there are relatively more projects to be completed?

A: The results for the first half of the fiscal year were the result of additional claim approvals for several large projects that were about to be completed, which exceeded our expectations, as well as steady efforts to strengthen our earning power. Although we cannot assure an upward swing in full-year profit margin plan at this time, we have no major concerns. We will continue to put our efforts to achieve results that exceed our plan.

(3) Real Estate Development Business

Q: Regarding the asset size of 700.0 billion yen for real estate development business in FY2026 and more than 100.0-billion-yen investment amount remaining during the Medium-Term Business Plan 2022, are you planning to adjust to the targeted asset size through replacing the assets, etc.? I would like to know your image of the asset size, taking into consideration the performance indicator targets of ROE of 10% or more.

A: As of the end of FY2024, the target for our real estate assets is 700.0 billion yen, but this does not mean 700.0 billion yen is an upper limit. While monitoring real estate market conditions, including interest rates, we will improve capital efficiency by off-balancing assets through private funds or selling properties that have already generated cash flow and by using leveraged financing.

(4) Outlook for FY2024

Q: Is the provision for loss on construction contracts recorded in the second quarter within the plan? Is the reason for keeping the forecast plan for operating income unchanged an upward swing in civil engineering absorbing the loss from building construction? Or, does the extraordinary gains from progress in sale of cross-shareholdings contribute to the upward swing? What is the probability of achieving the plan? Is there a possibility of upward swing, and what is the outlook for operating income?

A: The provision for loss was not recorded by incorporating the current level of operating income, but rather to minimize future concerns by checking the overall situation once again. Regarding consolidated operating income, we will work to achieve the planned annual figure of 93.0 billion yen as a matter of necessity. As explained, there are some uncertainties that require close monitoring, but at this stage we believe we can fully achieve the goal. Regarding profit attributable to owners of parent, the sale of cross-shareholdings is progressing, and we will sell them as ahead of schedule as possible, with the understanding of the companies that hold them. We intend to work to increase annual plan of our profit attributable to owners of parent, 87.0 billion yen, as much as possible.

Q: Regarding extraordinary income, the result of the first half of the fiscal year was 31.8 billion yen against the full-year plan of 35.0 billion yen. Is it because more cross-shareholdings were sold than expected? Is there a possibility of an upward swing for the full year?

A: The sale of cross-shareholdings is progressing well. Some of the sales that planned for the second half were sold in the first half ahead of schedule. We will continue negotiations with the shareholding companies, and if it is possible to sell the shares agreed to with the company's shareholding ahead of schedule, we will do so.

(5) Capital Policy and Shareholder Returns

Q: What is your view of the "necessary equity of 1 trillion yen" as a performance indicator target in the Medium-Term Business Plan 2022? Will the amount of necessary equity increase due to the impact of the yen's depreciation and the recent entry into the data center business? Or is it within the scope of the investment in the Medium-Term Business Plan 2022?

A: The level of necessary equity and profit will vary depending on the business environment and operating conditions. It is difficult to provide a standard value for flexible shareholder returns since the characteristics of the construction industry make it necessary to consider not only the performance for a single fiscal year but also the outlook for a few years in the future. As indicated in the addendum to Medium-Term Plan Business Plan 2022, the level of equity required by the end of FY2026 is set at 1 trillion yen, and if profit attributable to owners of parent increases in the future due to improved profitability and gains from the sale of cross-shareholdings, we will consider shareholder returns flexibly, including investment decisions.

Q: Regarding the timing of implementing flexible shareholder returns, you mentioned that it would be at a time when the current fiscal year's results are in sight; is there any change in that? TAISEI has said that they will carry out share buyback in three years ahead schedule in lump sum using the proceeds from the sale of cross-shareholdings. Is there a possibility that Obayashi will implement share buyback in lump sum, given that the equity is accumulated?

A: We are aware of TAISEI's share buyback, but regardless of what other companies are doing, we are considering a flexible return based on our capital policy. The construction industry is affected by domestic and international policies, such as political unrest in Japan and the recent presidential election in the United States, so it is difficult to predict the future. We have not yet reached a conclusion, including whether it should be done on an annual or lump sum basis, however once we decide an implementation plan, we will promptly announce it.

(6) Data Center Business

Q: You are planning to invest 100.0 billion yen over the next 10 years. What is the amount of investment and return on investment for the first phase of the project scheduled to open in FY2028?

A: We refrain from disclosing detailed investment amounts and stand-alone profitability of the two sites. We plan to build a core data center and surrounding sub data centers, which will largely depend on the speed of land purchases and renovations. We expect to achieve a single-year operating surplus or a surplus trend cash-flow in year 2030-31.

Q: You mentioned that the real estate development and operation will be done by a newly established company. Will the new company be able to design, build, and operate the data centers on its own even if there is no alliance?

A: We plan to directly operate the first two data centers for the time being, and to a certain extent we will directly operate the sub data centers. However, we are also considering a joint venture with a telecommunications carrier or acting as a proxy for clients. Once the network is established to a certain degree and Obayashi Group establishes a competitive advantage in the urban data center business, we plan to further expand the network by utilizing our technologies and know-how to connect to the core data center on behalf of our customers.

Q: As a business, investment efficiency for data center is not high in the short term. What is the significance of the project and the background behind the investment decision? If the investment amount is profitable, could it be as high as 200.0-300.0 billion yen? How long is the investment period? Is the profitability around 7-10%?

A: As indicated in the addendum to Medium-Term Business Plan 2022, our group aims to achieve sustainable growth and increase corporate value through the establishment of a group business structure that will generate performance equal to or greater than that of our core domestic construction business. The data center business is positioned as a business area with a different profit structure from the real estate development and green energy businesses. As demand for data centers increases exponentially, partly due to advances in generative AI, we focus on urban data centers which are expected to grow at a high rate. We do not rule out the option of expanding our investment in the future, but our first challenge is to get the two properties off the ground, and then flexibly change our business scheme in the future. We would like to steadily grow our urban data center business.

We are aware of efficiency of the business, as the same as those of the real estate development and green energy businesses, but we also aim for sustainable corporate growth, primarily by diversifying our business portfolio beyond the construction business, which is vulnerable to the vagaries of the economy.