[Kibe-log]

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Reasons for the acquisition of Japan Wind Development

Dear Stakeholders, I am Kazunari Kibe, President and CEO of INFRONEER Holdings Inc.
Thank you so much for reading the "Kibe-log" again.

Last December, INFRONEER announced the acquisition of Japan Wind Development Co., Ltd. The acquisition price was 203.1 billion yen. The INFRONEER group's market capitalization is approximately 425 billion yen based on the closing price on January 31, so nearly half of that amount was allocated for the acquisition.

On January 31, we successfully completed the acquisition of all shares of Japan Wind Development to make it our subsidiary. In this issue of Kibe-log, I would like to share with you the purpose of the acquisition of Japan Wind Development in my own words.

Since announcing our acquisition of Japan Wind Development, we have received a wide range of responses from market participants. These comments can be broadly categorized into the following four groups.

① The acquisition price may be too high.
② Might the credit rating be downgraded due to the huge acquisition resulting in a higher cost of capital?
③ When will the acquisition start to contribute to earnings?
④ Is it safe to acquire a company with compliance problems?

I think all above comments are quite fair. However, I am very confident that this acquisition will contribute to the enhancement of the corporate value of the INFRONEER Group.

An “Express Ticket” to enhance the infrastructure business

First, let me address the first comment of four, the amount of the acquisition.

As I mentioned earlier, the amount of this acquisition is huge, approximately half of our market capitalization, and the latest index of its business value divided by EBITDA is approximately 98 times, which may seem quite expensive if you only look at the numbers. However, in my experience working with Japan Wind Development on the projects, I can honestly say that we were able to acquire that company not only at a premium, but at a much lower price.

Before the company's credibility was damaged by allegations of bribery to Diet members, the value of Japan Wind Development was said to be well over 300 billion yen. Because of the scandals, we were able to acquire the company for 200 billion yen.

When I talked to foreign investors after the acquisition, most of their comments were, “You got a good deal.”

What we appreciated most about Japan Wind Development was the “projects” under development by the company.

INFRONEER has been trying to shift its business model to generate profits by investing in and operating infrastructure, especially recycling capital through to EXIT in the renewable energy business. However, investing in infrastructure takes a tremendous amount of time and manpower to formulate a project.

In this respect, Japan Wind Development has ongoing projects with a total power generation capacity of 3,800 megawatts (MW), and has the resources to develop, operate, and maintain them. It is no exaggeration to say that the acquisition of Japan Wind Development is a short cut or an “express ticket” for INFRONEER to strengthen its infrastructure business.

So, the question is whether 203.1 billion yen is a fair price for 3,800 MW projects. We evaluated the project quite conservatively. We may have been too firm in our assessment.

Not a few wind power generation projects are withdrawn due to opposition from local communities and municipalities. Our group has been in the same painful situation many times. However, Japan Wind Development boasts an extremely high success rate of 95% for projects that reach the stage of the feasibility evaluation.

The company's employees continue to be closely involved in local community activities, such as company-wide participation in the famous Nebuta Festival in Aomori Prefecture. I think that such efforts of down-to-earth relationship building with local communities are reflected in the success rate of the projects.

Only 35% of the 3,800 MW projects was used to calculate the valuation

Japan Wind Development's projects to date are nearly complete. However, in calculating the valuation for the acquisition, only 1,350 MW, or 35% of the 3,800 MW projects, was included in the calculation.

In our evaluation, we only included projects that the company either already operates or projects that are currently under development. Large-scale offshore wind power generation and other projects that are still in the planning process have been daringly left out. This means that we did not include projects in our evaluation unless our development team was 100% sure of the project's success.

The valuation includes an estimated O&M (operation and maintenance) business value of 55-60 billion yen, but that is not even 30% of the total value. The remaining 140-145 billion yen of acquisition price is a valuation of only 35% of the power generation projects that Japan Wind Development owns.

As I mentioned "their success rate is 95%," it is unlikely that only 35% of the total number of projects will be successful. For the rest, we see a high possibility of upside.

In addition, to add to the details, Japan Wind Development has already sold completed power generation business to funds and other investors. Many of these are contracted to return to Japan Wind Development free of charge for demolition after the FIT*1 and FIP*2 periods have expired.

*1: FIT…A Feed-In Tariff system for renewable energy.
*2: FIP…A system under which an additional certain premium, calculated monthly, is added to the electricity sales price. The government is trying to shift from FIT to FIP.

However, although the Feed-In Tariff period has ended, wind power plants continue to generate electricity.

Japan Wind Development also has a maintenance team, so with proper maintenance, the power generation capacity could be maintained for another 30 or 40 years. There may be a case for replacing the equipment with more up-to-date equipment to further increase power generation capacity if we can expect a sufficient return on investment.

Since many landowners who lease their land to the power plants are also likely to want ongoing rental income from the land rather than demolition of plants, we can also expect to receive income from the sale of electricity generated by the power plants that have been already fully depreciated.

Considering all these factors, we determined that the acquisition price was quite reasonable.

Roadmap to 100-billion-yen operating profit

Next, I would like to address the second comment on the possibility of downgrading the INFRONEER's credit rating.

Over the past few years, we have been making investments to transform ourselves into an infrastructure services company, including making MAEDA ROAD CONSTRUCTION Co.,Ltd a wholly owned subsidiary and investing in infrastructure projects. Since this acquisition comes during these efforts, I understand concerns about the rating downgrade due to the deterioration of INFRONEER's finances.

As we announced on February 9 of this year, we are considering issuing bond-type class shares.

The bond-type class shares have more restricted rights than common share. While they do not have voting rights or the right to convert into shares, they have priority over common share in terms of dividends, with receiving fixed dividends for about five years after issuance and variable dividends thereafter.

We plan to apply to list these class shares on the TSE Prime Market, and once listed, they will be able to be traded like ordinary shares.

The equity nature of bond-type class shares, i.e., how much of the funds raised can be incorporated into equity, is also designed so that 100% of the amount raised can be incorporated into equity for accounting purposes, and 50% can be incorporated into equity for rating purposes.

Whether to issue bond-type class shares, and if so, when, and how much funds will be raised, will be determined in the future. Using this approach, the increased debt for the acquisition of Japan Wind Development will be replaced by raising equity capital to hedge the risk of a downgrade in the rating.

On March 21, we also announced the issuance of a 5-year Green CB (Convertible Bond) of 60 billion yen. This was also designed as a conversion suppression type.

Specifically, during the first four years after the issuance, CBs cannot be converted into shares until the company's share price exceeds 2,845 yen for a certain period, which is 150% of 1,897 yen based on the closing price of 1,649.5 yen on March 21 plus a premium of 15%. Furthermore, during the final year (excluding the three-month period immediately prior to redemption), they cannot be converted until the price exceeds 2,466 yen, which is 130% of 1,897 yen for a certain period.

In general, CBs have almost zero cost of capital, but there is a concern about dilution. In this case, however, I believe that the possibility of dilution is minimal.

Regarding the third comment, I have talked on this point “When will it start contributing to earnings?” in various occasions. I believe that Japan Wind Development on a stand-alone basis can generate operating income of more than 30 billion yen in FY2030.

This figure assumes that all wind power plants developed by the company are continued to be owned. If Japan Wind Development were to sell the power plants in operation and those under development to funds and other entities, the company's estimated operating income would be at least 5 billion yen per year after FY2024, and 35-40 billion yen can be achieved in FY2030.

INFRONEER has a goal of earning more than 100 billion yen in operating income in FY2030.
It is assumed that half of this amount, 50 billion yen, will be earned from the infrastructure business. A half of it, 25 billion yen, will be earned from Japan Wind Development and the remaining 25 billion yen will be earned from infrastructure concessions. This is a fully feasible assumption.

Moreover, there are the wind power plants back from the funds, as I mentioned earlier, and they would contribute to our earnings as well.

After the FIT and FIP periods are over, the price of electricity sold is expected to fall. However, on the other hand, I believe that more and more companies will promote “RE100,” which means that 100% of the electricity used in their businesses will come from renewable energy sources.

If more companies believe that they will be better evaluated by investors if they achieve RE100, they will find environmental value in wind-generated electricity and will be willing to purchase it at a higher price.

These future environmental values are not included in the target of operating income of 100 billion yen. Therefore, I think there could be an upward potential in this area as I mentioned.

Synergies to be obtained by joining the INFRONEER Group

Lastly, let me talk about the final comment on compliance.

The former president of Japan Wind Development has been indicted on allegations of bribery to a member of the Diet. In the past, the company has also been punished for false statements in financial reports and other documents. Thus, it is a deniable fact that the company had compliance problems.

Our focus when acquiring the company was to determine whether the problems including bribery, were caused by the former president personally or by the entire company. To this end, we brought in more than 20 lawyers to conduct a thorough due diligence. As a result, we concluded that it was not a company-wide problem and decided to proceed with the acquisition proposal. I have absolutely no concerns about this business decision.

Contrary to Japan Wind Development, INFRONEER is a company with a nominating committee and is working to strengthen its governance with a majority of independent directors on its board of directors. We would like to further improve governance of Japan Wind Development by bringing it into the group.

There are other synergies by the acquisition.

Since the earlier bribery scandal has reduced Japan Wind Development's creditworthiness, its financing interest rate is much higher than that of INFRONEER. We have a group-wide CMS (Cash Management System) in place, which will greatly lower their funding costs. If the interest rate differs by 2%, the interest payment burden will differ by 100 million yen when borrowing 5 billion yen. That is a big difference.

With all of this in mind, I think this was a good acquisition deal for both parties.

Under the banner of “De-construction”, INFRONEER is trying to evolve from a traditional construction company to a comprehensive infrastructure service company. We are proud that this acquisition has helped to solidify the foundation for INFRONEER’s evolution.

No matter how much we talk about our story, they will not be convinced if we don't show the results. I believe that the only way to completely dispel the concerns of everyone involved in the market is to show the right results. I hope you will look forward to our future endeavors.