INFRONEER Holdings Inc.

Main Contents of Q&A from the FY2023 Financial Presentation

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Q. Regarding your company's profit margin of orders received in the building construction segment, the plan for the past three years is 7%, but the plan for this fiscal year is 7.5%, up 0.5 percentage points. I would like to know what the intent is for this and how competitive the competition is when it comes to recent orders in the building construction segment.

A. I would like to answer why we have increased the planned profit margin of orders received by 0.5 percentage points. Until the previous fiscal year, we had begun construction with the goal of improving profits by about 4% from the start of construction to completion. However, in recent years, due to factors such as rising prices and tight labor, we have not been able to improve our profit margin to our target after receiving orders. We have determined that the only way to improve this situation is to increase the profit margin of orders received, and we are raising our target for the current fiscal year.

Regarding competition for orders in the building construction segment, we have been able to win a steady stream of orders over the past three to four years, in line with our goal of securing a steady stream of large construction projects every year for 10 years. We expect more than 10 projects of 10 billion or more in the current fiscal year. Since there are no spot orders or thin margin orders due to insufficient order backlogs, and the order backlogs is comparatively well developed upstream, we believe that 7.5% profit on orders received is attainable at a high rate.

Q. I would like to ask about the infrastructure management segment. You mentioned that Maeda Corp. is bidding on several projects. Please be more specific as to the status.

A. Maeda Corp. is currently participating in the bidding process for two arena concession projects, both of which will announce their results this month. One of these projects is being bid on by only one consortium, so we believe that if we do not get disqualified, we can win it. In addition, there is one concession arena project in the Hokuriku region, which is considered a strong project for acquisition.

Although no public announcement has been made for this fiscal year, we have heard that a large water supply project that will contribute to Water PPP 4.0 is also expected. In the next fiscal year, we expect to see several large projects such as reconstruction + concession projects and BT + concession to accommodate the entry into the new top league "B Premier" by B-League club teams in various parts of Japan.

Q. I understand that your company plans to sell Ozu Biomass this fiscal year. Please confirm whether it is assumed that the company will be sold in a lump sum during the current term and whether the sale is highly probable. This project will probably be the last project that your company will be able to sell. Please provide an overview of the company's prospects for sale in the next fiscal year and beyond.

A. Regarding the potential sale of Ozu Biomass, we are currently in the process of selling the company and conducting due diligence. The timing of the sale of Ozu Biomass is contingent upon the valuation of the business, which is anticipated to increase with the commencement of operations and the results of electricity sales, leading to a higher sales price. To achieve the important target of 59 billion yen in business profit for this fiscal year, we will make a comprehensive judgment, considering the profitability of other segments as well.

With the sale of the Ozu Biomass project, there will be no more saleable projects developed by Maeda Corp. on hand for the next fiscal year and beyond. However, our policy of recycling capital for Japan Wind Development's development projects and other new projects, particularly renewable energy projects, remains unchanged. (*We are currently examining the impact on INFRONEER's consolidated PL of the sale of SPC projects under IFRS, both in lump sum and in installments.)

Q. Your company has announced that Japan Wind Development Co., Ltd. reported an operating income of 100 million yen for the current fiscal year. However, in the document, Japan Wind Development Group's operating income for FY24 is listed at 1.5 billion yen. I would like to know the difference between these amounts.

I remember that when your company announced the M&A, it indicated that it expected to be able to generate profits of around 10 billion yen consistently, including from divestments. In the current announcement, the profit has been changed to 1.5 to 2.0 billion yen annually. I would like to know what kind of strategy was used to achieve this.

A. In this fiscal year, Japan Wind Development Group non-consolidated operating income of 1.5 billion yen was recorded after the sale of some of the projects. However, after the acquisition, we had a close examination with the auditing firm, and they assessed goodwill of 139 billion yen and PPA assets of 96 billion yen, which are FIT and FIP rights, against our acquisition price. Applying IFRS standards, we do not need to amortize goodwill annually, but when we consolidate the gain on sale, we will prorate the goodwill as cost at the time of sale. Japan Wind Development will generate 1.5 billion yen in operating income on a non-consolidated basis this fiscal year but consolidated operating income will decrease to 0.1 billion yen due to the deduction of 1.4-billion-yen worth of goodwill on a prorated basis when consolidated.

Based on this goodwill calculation, we decided that we should sell Japan Wind Development's projects at a time when we can sell them at the highest possible price.

This time, we are valuing one-third of Japan Wind Development's holdings. By developing projects outside of the valuation range and increasing the overall value of the portfolio, the impact of goodwill on the gain on sale will diminish. Through these efforts, we aim to contribute profits to the consolidated PL.

Considering the current speed of development and fluctuations in the price of electricity sold due to changes in environmental values, we believe that the value of the projects will increase if they are sold a little later.

As of the last announcement, the company still has the potential to generate about 5-10 billion yen in operating income per year. Japan Wind Development plans to maintain its performance to the extent that it does not incur a consolidated loss due to the sale until FY27, and from FY28, the profit from the sale of electricity will also increase, so the company plans to maximize its profit in FY30.

Q. Please provide your insights on the company's achievement of 59 billion yen in business profit for this fiscal year. Given the possibility that the impact of cost increases may still be felt, there is concern that targets may be missed in, for example, the building construction and road civil engineering segments. If that is the case, I would like to know if selling Ozu Biomass in bulk would be sufficient to reach 59 billion yen. Furthermore, I would like to know if the figures for this fiscal year are expected to be based on a lump-sum sale or if there is some buffer.

A. This fiscal year, we are aware that we need to achieve a business profit of 59 billion yen. While it is true that this is not a number that any segment can achieve on its own, we believe, together with our operating companies, that it is a number that can be achieved if the entire Group works hard. Regarding the downside forecast, it is notable that the majority of the 300 billion yen in sales this fiscal year was generated with high profit margins from orders received in the building construction business. Furthermore, we have contractual clauses in place to protect against fluctuations in pricing, which mitigates the risk of cost increases. We will continue to collaborate closely with customers, the field, and sales to achieve sales targets, which in turn will lead to profits. Regarding the sale of Ozu Biomass, we will make a comprehensive decision on the timing of the sale, considering the timing of the sale with other segments.The projected sale price of Ozu Biomass is consistent with the valuation that was established a few years ago, providing a margin of safety.

Q. At the previous briefing, it was explained that the company would raise funds that would not result in share dilution. However, we believe there is a discrepancy with the market's perception. We appreciate that the high conversion price makes dilution less likely, but we would like to understand the background that led to the issuance of 60 billion yen in CBs.

A. We have raised over 200 billion yen from financial institutions. However, due to high interest rates, we need to refinance the debt while lowering the cost of capital in the long term.

Furthermore, as you have rightly pointed out, depending on the financing instrument, share dilution may occur. After careful consideration, we have decided to issue Green Convertible Bonds (CBs) with maximum dilution control as the best solution to reduce the cost of capital while minimizing dilution.

We have been able to reach terms and conditions that will prevent dilution of the company's shares unless something happens to the best of our ability. We were also able to raise funds with a zero coupon, which we consider to be the best possible way to take into account the cost of capital and the dilution of the voting rights of our shareholders.

Q. If Ozu Biomass were to be sold this fiscal year or the next, when thinking about the profit from the sale of subsequent projects, we realized that according to the explanation given earlier, there would not be much profit from the sale of the projects included in the valuation of Japan Wind Development. Please tell us if we should expect volatility in the amount of profit in the infrastructure management segment from FY26 onwards.

A. The sale price of a project is affected by various conditions, such as development costs, the FIT or FIP electricity sale price, as well as the progress of the project, and also depends on the timing of the sale. When considering the sale of projects in the future, we will take into account the amortization of goodwill at the time of sale and consider whether it is better to retain the project or sell it in the future, while planning to avoid as much fluctuation in the amount of profit as possible from the sale of the project.

Furthermore, there are also a number of development projects that have not been valuated at this time and developing these will reduce the cost of selling goodwill, so we intend to focus on developing these projects.

Maeda Corp. is currently engaged in the development of a number of large-scale projects, including renewable energy projects following the completion of the Ozu Biomass project. We are also engaged in joint projects with Japan Wind Development and exploring the possibility of large-scale concession projects. Considering this, our objective of generating 50 billion yen in business profit by fiscal 2030 from renewable energy and concessions remains unchanged, and we believe we are making steady progress toward this goal.

Q. Regarding the infrastructure management segment, I would be grateful if you could provide an overview of the current market environment. We submitted a bid for the Osaka pipeline project, but it was awarded to another general contractor. I would like to gain a better understanding of the current market situation, how other general contractors are entering the market, and whether the market environment is conducive to securing sufficient orders.

A. Regarding PFI obtained by other general contractors, we believe that it is distinct from our objective of infrastructure operation projects. We believe that conventional PFI is limited to municipal financing and is not intended to operate infrastructure to generate revenue or change the rules of the world.

We are proud to be the only general contractor taking on the challenge of changing the current rules and changing the operation itself by also awarding performance contracts for water, sewer, and arena.

Q. I understand from the explanations and materials presented here that care has been taken to limit dilution as much as possible when issuing Green CB. Conversely, it seems that you are considering long-term debt as an alternative to rolling short-term debt. The background to the issue of the Green CB is that it was probably issued after considering foreign exchange levels and other factors, as it was intended for overseas markets.

Should the yen continue to weaken in the future, I would be grateful if you could let me know whether you are considering issuing green CBs again, or whether other types of bond-type class shares would be a candidate.

A. While not yet at an obvious stage, bond-type class shares can also be issued if the shareholders' meeting approves an amendment to the articles of association. In light of the specific circumstances at hand, it may be beneficial to consider bond-type class shares or other capital-raising instruments, provided they are more suitable for the situation.

Currently, there are no plans to issue green CBs again if the yen weakens. Please note that the Green CBs will not be affected by foreign exchange rates this time.

Q. I would like to request information regarding the gross profit margin for building construction. The original plan for the previous fiscal year was set at 10.9%, but after two revisions it dropped to 9.2% and then to 8.8%, with the final figure landing at 8.2%. Despite our initial expectations, the gross profit margin did experience a notable decline, exceeding the two-point threshold initially anticipated. Could you please explain the discrepancy between the expected and actual results?

Furthermore, the target for this fiscal year was set at 10.7%. I would like to inquire as to the achievability of this target.

A. The primary reason for the decline in gross profit margin in the previous fiscal year was the inability to place orders with subcontractors at the anticipated prices. Furthermore, we had four loss-making construction projects, a situation not experienced in recent years, which reduced the gross profit margin by approximately 2%. One contributing factor to the losses was the inability to secure additional construction work and price increases.

In the current fiscal year, the head office will continue to provide support, and all branches and construction sites will be managed monthly. In the event of price increases, additional construction work, or other problems, we will work with the head office and branches to find a solution, rather than leaving them to the field.

Furthermore, with the completion of construction work expected to reach approximately 270 billion yen this fiscal year, the potential for reaching 300 billion yen is clear. We are confident that we will be able to achieve a profit of 27 billion yen with the current amount on hand. Given that we received orders of 300 billion yen in the previous fiscal year, we believe we can achieve 32 billion yen in the current fiscal year with a high degree of certainty.

Q. In the infrastructure management segment, the gross profit forecast for this fiscal year is 15.5 billion yen on a consolidated basis, compared with 3.4 billion yen in the previous fiscal year and 10.2 billion yen in the previous fiscal year, which was highly volatile. Based on the information presented thus far, it is evident that if the contracting business, including road construction under infrastructure management, is performing well, we will maintain control of the infrastructure management business. Conversely, should any issues arise in the contracting business, we will ensure that the infrastructure management business remains stable and profitable, thereby demonstrating our commitment to portfolio management.

However, I recognize that the gross profit of 15.5 billion yen is an extremely high level. For the next term and the following terms, maintaining the Japan Wind Development projects as previously explained and selling all of them this term will result in a decrease in the next term's profit. Should we sell only a portion of the assets, we would still be able to generate a profit in the following term. Please confirm whether this approach to controlling total revenue from infrastructure management is correct.

A. At this juncture, your understanding is accurate. In addition to renewable energy, the Aichi Toll Road represents the largest profit contributor to the concession portion. Its operating profit fluctuates around 1 billion yen, depending on whether or not there are major repairs. Until we see an increase in the number of projects like the Aichi Toll Road in the future, as you mentioned, we believe that the sale will play a role in adjusting the overall profit.

However, our objective for infrastructure management by 2030 is to become an infrastructure operator that is not an adjuster. Therefore, it is essential to acquire a substantial number of large-scale projects, particularly those with high profitability.

Q. I would like to know the status of buyers of Japan Wind Development's assets and the market environment for renewable energy power sources, not limited to Japan Wind Development.

In the public opinion, there are still doubts about the ability of sellers to sell renewable energy power sources at the prices they are thinking of, due to the operation of nuclear power plants and the calming down of electricity demand.

On the other hand, previous announcements indicated that in addition to the increased demand for electricity from businesses, including data centers, there will be an increase in demand for electricity from companies outside of Japan as well, as they work to reduce CO2 emissions.

For our part, we believe that there are both ways of thinking and are in a state of quiet contemplation. We believe that the willingness of buyers of renewable energy electricity is not yet in full swing and has not surfaced in the press. We assume that you have seen the actual situation on the ground, so please tell us what is going on behind the scenes. The buyers of electric power are biased toward certain industries, and in most of these cases, the power purchased by trading companies is sold to electric power companies, gas companies, and steel companies. Please tell us about the underwater market trends, demand trends, and your company's sales structure, including how your company plans to develop buyers of electric power.

A. Although we cannot give individual prices, renewable electricity is currently bought and sold on average for 11-13 yen, but in some areas, it is over 30 yen. Some manufacturers and municipalities are buying it for nearly 40 yen in some cases. The price differs depending on the region, such as where a lot of nuclear power is in operation or not at all. As you know, the demand for electricity is increasing even in Japan, where the birthrate is declining. We believe that nuclear power generation will not be restarted, and coal-fired power generation will face a demanding situation. Although it is not necessary to use renewable energy to meet the increased demand, we believe that the market demand for renewable energy is extremely high because nuclear power generation cannot provide the electricity and coal-fired power generation tends to be difficult to buy.

Electricity prices are rising, especially as large capacity buyers are preparing for medium-term targets such as GHG Protocol Scope 1 and GHG Protocol Scope 2. I personally believe that it will rise more. Under these circumstances, even before we acquired Japan Wind Development, we have been researching the prices at which renewable energy power is being sold and purchased in different regions. We are building up our department to look for buyers directly, without trading companies, and we believe it is especially important to focus our efforts on this area. We are currently discussing with Japan Wind Development the organization, personnel, sales methods, etc.

Q. I would like to inquire about the current state of cost disclosure methods. With construction costs rising, and the difficulty of coming to terms with customers, how widespread is the cost disclosure method and what is the level of interest in it? Alternatively, in terms of the nature of risk sharing in construction, we believe there will be an increase in ordering methods such as equipment separation, etc. I would like to know if you have any views on the form of contracting in the face of fluctuating construction costs.

A. The cost disclosure method is being actively pursued within our group, and Maeda Corp. and Japan Wind Development have agreed to basically use the cost disclosure method for their construction projects. In countries like the United States, where the partnership between the client and the contractor is excellent in terms of fairness, most large projects are constructed on a cost-plus-open-book basis. Only in Japan, there is a lack of awareness of the cost disclosure method on the part of both the client and the contractor.

On the other hand, I frequently visit the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), where I have learned that the MLIT's bidding contract law already allows for the adoption of the cost disclosure method. In line with this, the MLIT was also revising the terms and conditions of the private sector's old four-group alliance. The cost disclosure method was scheduled to be included until it was removed due to strong opposition from some groups.

Currently, Japan is the only country where profit loss is not shared with the client. In Japan, we are the only company that conducts the cost disclosure method, and we believe that we should spread the method. The MLIT also believes that it should be expanded, but it has not spread well in Japan. In this context, there are a number of clients who understand us, and we intend to pursue the ideal form, independently of the world's trends.

In discussing how to share the risk of price increases, we have started a study session with a major developer regarding the cost disclosure method. The developers are also requesting that we deal with them on a fair basis, as they cannot bear the risk of price increases. We are currently studying the possibility of investing half of the construction cost as project funds. We believe that there has been a change in awareness among developers to adopt the cost disclosure method.