INFRONEER Holdings Inc.

Main Contents of Q&A from the FY2024 2Q Financial Presentation

Date : November 13, 2024 (Wednesday) 12:30-13:30
Speakers: President and CEO Kazunari Kibe
Executive Officers: Yuji Hatakama, Takao Nakanishi, Toshiaki Tomiyasu, Yasuo Kato, Masashi Shimojo

---

Q. We anticipate that the gross profit margin for building construction segment in the second half of the fiscal year will be around 13%, which is considered a high level. Could you please provide additional explanation for this? Furthermore, is there a possibility that the gross profit from building construction will decrease in the next fiscal year due to a reactionary decline from this term?

A. Regarding the concern that the projected gross profit margin for the current fiscal year may be difficult to achieve, our past full-year performance shows an increase of 2-3% in the second half. We are also expecting an increase of about 3% in the second half of this term. As we have large-scale construction projects scheduled for completion in the second half, we believe we can fully achieve our targets.

As for the reactionary decrease in the next fiscal year, we currently have orders worth 330 billion yen projected for the current fiscal year, and our backlog of construction projects is at an all-time high. Therefore, we believe that the likelihood of achieving 300 billion yen in sales for the next term is increasing. We are confident that we can achieve both sales revenue and gross profit margin at this level in the next fiscal year as well.

Q. Regarding the revenue from infrastructure management, we are planning to sell Ozu biomass the current fiscal year. How do we plan to proceed with the sale? Additionally, if we realize a gain from the sale this term, there may be concerns about a reactionary decrease in the next term. How should we think about this?

A. Currently, we are working with a third-party consultant to develop a sale strategy for Ozu biomass, and we have approximately 20 prospective buyers. Going forward, we will decide on the best scheme for the sale, whether to sell all at once or, for example, to spread the sale over three fiscal years, in consultation with the prospective buyers. By the time of the 3Q financial presentation, we expect to be able to indicate our sales policy. As for whether to sell this term, we will make a decision while considering the growth in profits of other segments.

As you pointed out, there may be a reactionary decrease in the profit of the infrastructure management segment alone in the next term, as there are no large sale projects. However, the profit contribution from civil engineering, construction, and paving for infrastructure management projects such as arenas is expected to increase significantly. Therefore, we believe that the overall profit contribution to the group from the infrastructure management segment will not decrease.

Q. Could you please explain the outlook for business profit for the next fiscal year? Your company has been discussing the achievement of the target of 59 billion yen in the final year of the medium-term management plan this term. With concerns about the reactionary decrease following the sale of Ozu biomass, is it possible for your company to further increase profits beyond the 59-billion-yen target for the next term? If so, what factors could contribute to this increase in profit?
Even if the sale of Ozu biomass is completed within this term and there are no sales in the following term, is your company still expecting to see over 50 billion yen in business profit? While the details of the Ozu biomass sale will be explained in your company's 3Q financial presentation, if there is a possibility that part of the sale will be carried over to the next term, can it be assumed that, including other potential upsides, your company is expecting an upside?

A. While I cannot provide exact figures, a significant portion of this term's business profit of 59 billion yen includes a significant gain from the sale of Ozu biomass. Excluding the profit from the sale, we are forecasting a figure that is comparable to last year's performance. Therefore, this term, if civil engineering segment, building construction segment, road civil engineering segment, machinery segment, and Japan Wind Development can achieve the same figures as last year, excluding Ozu biomass, we will reach our target. For the next term, upon reviewing our current backlog of projects, we can expect an upside in each segment compared to last year and this year, so you can be assured that there will not be a significant reactionary decrease. We are currently considering the next medium-term vision, and we will disclose the final targets to all stakeholders in due course. Towards that end, we are exploring various initiatives to further increase profits from this term. We believe that realizing these initiatives will be our answer to the market's expectations.

Q. Can the civil engineering segment sustain its high-profit margin? The civil engineering segment has maintained an exceptionally high-profit margin of 20% in the first half, but is this level expected to continue into the second half and the next fiscal year? Furthermore, is there potential for an upward adjustment?

A. FY23 saw a significant upward trend due to special factors, but this term, we have achieved a gross profit margin of over 20% in Q2, and we are projecting a full-year gross profit margin of just under 19%. Regarding the civil engineering market for the next term and beyond, it is very active due to national policies such as strengthening infrastructure. The same is true for the energy situation, so we believe the market will continue to be active.
In this context, we are developing medium to long-term plans to expand our civil engineering business towards FY27 and FY30. Over the past five years, the gross profit margin has been around 18-19%. For public works projects, the pricing structure allows us to adequately reflect the increased labor costs resulting from contractor shortages, so

we believe we must at least maintain this level. We also expect the profit level for the next term and beyond to continue at the same level.

Q. What is the concession pipeline like for the second half and the next term?

A. As for the concession pipeline for the second half and the next term, we are currently participating in the bidding process for a major water infrastructure project. In addition, there are various development plans for arenas and stadiums. Although it is unlikely that any projects will emerge within this term, we expect several large-scale projects for stadiums and arenas to materialize in the next term.

Q. I understand that the allocation of proceeds from the sale of cross-shareholdings will be detailed in the medium-term management plan. As Japan Wind Development embarks on large-scale projects, will the proceeds from the sale of cross-shareholdings be directed towards these investments, or will the approach primarily involve borrowing?

I would like to comprehensively understand the future use of funds, including investments in Japan Wind Development, the sale of cross-shareholdings, and shareholder returns. Additionally, regarding financial discipline, am I correct in understanding that there will be no change to the D/E ratio from the figures stated in the medium-term management plan, or given the acquisition of Japan Wind Development, is there a possibility that the new medium-term management plan will consider a revision based on a policy that allows for slightly more leverage?

A. Regarding the use of funds from the sale of cross-shareholdings, we are exploring various options for the use of these funds, including share buybacks and debt reduction. For investments in Japan Wind Development, we aim to maximize leverage and are considering funding through non-recourse project finance.

While the proceeds from the sale of cross-shareholdings could potentially be allocated to investments in Japan Wind Development, our goal is to improve capital efficiency by leveraging, while still maintaining financial discipline. As projects near commencement, non-recourse project finance will come into play. Until then, the capital requirements are not significant, so we plan to cover these costs with corporate low-interest financing and will also need to consider capital recycling strategies in the medium to long term.

We intend to retain projects with future upside potential as much as possible. However, for projects receiving high fixed-price purchase system (FIT) prices, there may be opportunities to sell early at favorable prices, so we are considering early sales and fund recovery as part of our capital recycling efforts.

While we have a rough guideline, we are currently evaluating the appropriate D/E ratio and level of leverage, considering a range of factors. We plan to provide more detailed explanations in the next medium-term management plan.

Q. Regarding the profit margin at the time of order receipt in building construction segment, we have maintained a high profit margin of 9.4% in the second quarter, consistent with the first quarter. Is there any difference in profitability when broken down by usage type? Generally, it may be becoming more challenging for developers to secure profitability on office projects, which could suggest that it is becoming tougher for general contractors from a profitability standpoint.

A. Our company strictly manages order discipline in the building construction segment, aiming for a profit margin of orders received of at least 7.5%. In that sense, there isn't much difference in profitability by usage type. However, if anything, logistics facilities typically do not exceed the 7.5% margin by a significant amount. Profitability for office projects is quite challenging, and to be honest, we are somewhat hesitant to take on such orders. The projects we are currently receiving orders for include our headquarters building and our own buildings, and we have received a large-scale construction order of about 30 billion yen for the next term. Believing in the necessity of targeting steel construction as well, we have been challenging ourselves to secure such projects and have successfully received orders for them.

Q. According to reports, regarding concessions for arenas and stadiums, there is a slight shift towards renovation rather than reconstruction for some projects considering rebuilding, depending on their building structure. As your company primarily focuses on reconstruction as the main approach to lead into building concessions, is it correct to understand that such trends do not significantly affect your strategy?

A. It's not so much about shifting from reconstruction to renovation, but for gymnasiums that, with appropriate modifications, can meet the standards of the B League or V League Premier, we propose that unnecessary reconstruction is not needed.

The first renovation concession arena in Japan was awarded to MAEDA CORP. in Toyama Prefecture in May. We believe this will become a model for regional arenas.

As we have always stated, our ultimate goal is not just construction; we aim to optimize operations by being involved in design and construction and to spread a business model where we can profit well from operations, a first for a Japanese construction company.

Moving forward, in addition to new BT+ concessions, we intend to pursue renovation concession sales for existing gymnasiums that do not meet the standards of the B League or V League Premier. Our company is considering taking on renovation projects as part of our business.

Q. Regarding the building construction segment for the next fiscal year, based on the previous explanation, it appears that a "sales volume of 300 billion yen is expected, indicating that the gross profit margin is expected to remain at this level for the next term, similar to this fiscal year's performance. However, the presentation material on page 3 states that the next fiscal year is expected to exceed this term. Does this mean your company is anticipating an increase for the next term, or are you expecting to maintain the same level? Given that this term achieved a record high of over 32 billion

yen and the plan indicates a further increase in profit for the next term, is it safe to assume that we can expect an increase in profits for the next term as well?

A. With numerous large-scale projects and thorough planning from the early stages, it is fair to anticipate an increase in profits.

Q. Regarding the infrastructure management segment, what is the reason for this time's increase in profits of about 300 million yen in the Aichi Road Concession?

A. The increase in profits for the Aichi Road Concession is largely attributed to the significant increase in traffic volume beyond expectations.

Q. Regarding the infrastructure management segment, Japan Wind Development has posted a business loss of 1.5 billion yen in the second quarter, yet the full-year plan is set at a profit of 100 million yen. Is this in line with the plan?

A. Regarding Japan Wind Development, our plan for this fiscal year includes planning to sell several small-scale wind power plants in the fourth quarter. Similar to the Ozu biomass, we have already initiated the sale process and are receiving offers from interested parties.

However, we are currently assessing whether it is better to sell this term or wait a bit longer for the value to increase further, and we aim to reach a conclusion by the third quarter.

One of the projects, which has started operations with a high Feed-in Tariff (FIT) price of 22 yen, is being considered for sale. For projects that are still under development, we are proceeding with discussions to sell them, but depending on the sale policy, there may be some fluctuations in the annual plan.

Q. As construction costs continue to rise, project delays and other impacts are becoming more apparent in the industry. Despite this, there doesn't seem to be much talk about the spread of cost-plus fee contracts and open book pricing contracts as a means of appropriate risk sharing. What is the actual situation regarding the adoption of these practices, or if they are not progressing, what barriers exist?

A. We have been promoting open book pricing contracts, cost-plus fee contracts, and cost disclosure methods to various clients, but it seems that these practices have not yet spread widely beyond our company. We have an increasing number of large and medium-sized projects that are likely to be contracted under the cost-plus fee, open book pricing, and cost disclosure methods, although we cannot yet disclose them to everyone.

Recently, one of Japan's leading developers has offered to create a project team and working group with us to explore the open book pricing and cost disclosure methods that we are implementing, and we are currently in the process of forming this working team.

We have been advocating for contracts in Japan that ensure cost transparency, and include proper incentives and penalties, not only when costs rise but also when they return savings to the client when costs fall, for the past 20 years. It is our understanding that developers are finally starting to grasp this concept from this fiscal year.

While it is uncertain to what extent other construction companies will follow suit, I personally believe that these practices are optimal for the Japanese market and are necessary not just for our company but for the Japanese construction market as a whole.

Q. In the CEO presentation material on pages 7, 8, and 9, there was a discussion about stadium and arena development. Are there differences in the level of development and implementation depending on the region or project?

The discussion about the sports market on page 9 includes the expansion of market size with the inclusion of club operations. Does this mean that as the sports market expands, the rental fees for stadiums and arenas are likely to increase, thereby promoting further development?

Additionally, I assume there are differences between arenas and stadiums, but are there areas that are more likely to progress easily and others that seem to have higher hurdles?

A. The main point of today's presentation was to convey that it's not enough to simply build stadium and arena infrastructure; we must also consider how to manage operations, such as ticket sales and the development of secondary markets, to drive market expansion.

For example, next year the Dodgers will play their opening game at the Tokyo Dome. MLB manages the ticket sales, including the secondary market, and it's said that prices behind the back net have exceeded 10 million yen. If the Tokyo Dome were operating on its own, the price would probably be around 100 to 300 thousand yen at the current time.

In the sports business in the United States, such as MLB and NBA, as well as the English Premier League and Spain's La Liga, there is a well-established system where various stakeholders, including sports teams and arenas, receive a proper distribution of fees. This includes naming rights, and the industrialization of sports is well established.

To conduct such robust arena management, it's not feasible with the traditional model of municipalities owning gymnasiums. On the other hand, if it's left entirely to the private sector and treated like a real estate business, the sports business will not be revitalized. It's important to create a comprehensive business plan with operations in mind from the start, and to design and construct the building accordingly.

Construction companies tend to focus on just building, but it's crucial to design and construct with the end operation in mind. I wanted to ensure everyone understood this, which is why I explained it today.

Regarding differences by region or project, there's a common belief that sports businesses can only succeed in major metropolitan areas like Tokyo, Osaka, or Fukuoka.

However, that's an outdated business model.
An arena was built in Okinawa, and many initially said it was okay to operate at a loss because it was publicly funded. But now it's profitable. Those who have visited know it's not located in downtown Naha but quite far away. Yet, the Ryukyu Golden Kings basketball team is strong, and the local support has created a scheme that fills the arena every game.
When an arena for the B League was built in Saga, many from national municipalities said it couldn't possibly succeed, but it's likely profitable with full attendance at each game.
As I mentioned today, if it's just a rental business, it might not be profitable outside of big cities. However, if you can successfully manage broadcasting, ticket sales, and local excitement, sports can be industrialized and successful even in less populated areas. This is happening worldwide, and we want to spread it in Japan.
We became a sponsor of the B League this year. Our vision aligned with that of the B League's chairman, and we became a sponsor to use sports industrialization as a major tool for regional revitalization and creation. We are now taking on the challenge of industrializing sports.

Q. The prospect of President Trump being re-elected is increasing in the United States. How does your company view the potential impact, or what was the impact during his last presidency?

A. If the yen were to weaken, it would have a significant impact on the Japanese economy as a whole, which would have an indirect effect on the construction industry and our company. On the other hand, when Mr. Trump last took office, he promised to rebuild the U.S. infrastructure through PPP (public-private partnerships), so we expected him to promote PPPs and concessions. However, it was not as much as I had expected. However, although there were no large-scale projects, the increase in the number of concession projects in some states may be a good thing for our company. For example, the U.S. is also in great need of funds for maintenance and repair of toll roads and general roads. The reason for this is the shift to EVs. In both the U.S. and Japan, gasoline taxes are used to pay for road maintenance and repair, but with the shift to EVs, the amount of gasoline used has decreased significantly, resulting in a decrease in funding for maintenance and repair. Although it varies from state to state, the decrease in gasoline taxes in the U.S. has led to the conversion of public roads to toll roads, or concessionaires, using digital technology. We believe that this trend will probably occur not only in the U.S. but also in Europe and Japan. In light of this trend, we believe that concession of general roads will surely proceed in Japan as well. For this reason, we are currently working on various PPP in the road sector, including comprehensive outsourcing. We believe that this reality is quite likely to be approaching, and we expect that Mr. Trump will likely be the catalyst.