

# Financial Review



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## FY2022 Review and Outlook for FY2023 Business Environment

In March 2022, the Obayashi Group formulated Medium-Term Business Plan 2022. The plan declared the Group's intention to secure stable earnings, and set securing a minimum of ¥100 billion in consolidated operating income as one of the performance targets for the five years from FY2022 to FY2026. In FY2022, the first year of the plan, consolidated operating income fell short of that target at ¥93.8 billion. However, we did achieve our targets for earnings per share (EPS), equity ratio, and return on invested capital (ROIC), which was newly adopted as a management indicator for Medium-Term Business Plan 2022.

The environment facing the Japanese economy has changed dramatically since the current medium-term plan was drawn up. In fact, we have seen raw materials and energy prices soar due to the Russia-Ukraine situation and other factors, as well as disruption in global supply chains, and rising import prices caused by the rapid depreciation of the Japanese yen. We are also witnessing unprecedented price increases on a wide range of materials in the construction market. The projects for the Obayashi Group that have been most affected by these developments are those in the domestic construction business for which we obtained priority negotiation rights in bids conducted up to FY2021, and this is one of the reasons why the Group's FY2022 performance came in lower than originally anticipated. Results of the domestic construction business are expected to be even more severely impacted in FY2023 than in FY2022 for several reasons. The prices of raw materials for construction are expected to remain high. Significant progress is being made on the construction of several large-scale properties for which we recorded provisions for loss on construction contracts, but those projects are not contributing to profits. Finally, labor costs for skilled workers are expected to increase and, at this point in time, there is little prospect of an improvement in profits from civil engineering construction projects in hand either. We are, however, currently taking steps in the domestic construction business such as reviewing contract terms to address material price rises, so we expect earnings will improve

toward the latter half of the current medium-term plan.

Domestic construction demand is holding steady and we expect construction demand to increase in multiple manufacturing fields, including semiconductors, storage batteries, machine tools, general machinery, and electrical machinery, as production bases are brought back to Japan and the government designates more commodities as specific critical products. We also expect capital expenditure for electric vehicle (EV)-related facilities and for data centers to rise as decarbonization and digitalization efforts pick up speed. In non-manufacturing sectors, we expect to see continued demand for large-scale urban redevelopment projects and the building of distribution facilities. In the civil engineering field, we foresee continued long-term demand for expressways and other infrastructure development, including repairs and renewal, and we expect construction demand to increase as the government strives to build national resilience and promote renewable energy policies.

In our overseas business, construction investment has been recovering in Asia as economies start to recover from the COVID-19 pandemic, while uncertainty surrounding construction investment in the office market and other non-manufacturing sectors persists in North America due in part to monetary policies and the performance slowdown of GAFAM,\* and other factors.

\* The acronym for Google, Amazon, Facebook (currently Meta), Apple, and Microsoft, which are major technology companies in the U.S.A.

### Medium-Term Business Plan 2022: Performance Indicators and Targets

|   | FY2022 Results   | Medium-Term Business Plan 2022 |
|---|------------------|--------------------------------|
| <b>Performance Indicators</b>                           |                  |                                |
| Consolidated net sales                                  | ¥1,983.8 billion | Around ¥2 trillion             |
| Consolidated operating income                           | ¥93.8 billion    | ¥100 billion or more           |
| Profit attributable to owners of parent per share (EPS) | ¥108.34          | ¥100 or more                   |
| <b>Stability Indicators</b>                             |                  |                                |
| Equity ratio  | 38.2%            | Around 40%                     |
| <b>Efficiency Indicators</b>                            |                  |                                |
| Return on invested capital (ROIC)                       | 4.9%             | 5% or more in the medium term  |
| Reference: Return on equity (ROE)                       | 8.0%             | 8% or more in the medium term  |

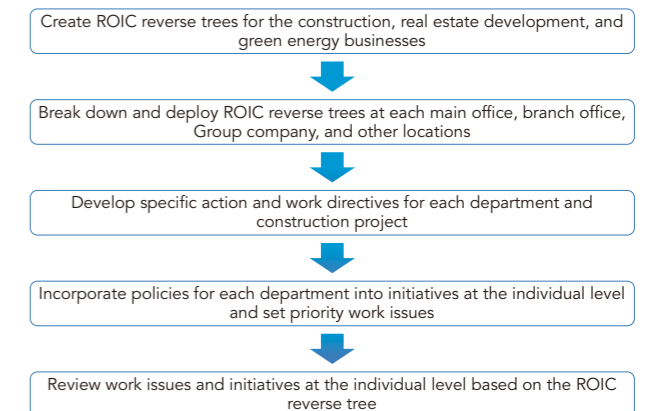
## Pursuing ROIC Management

We need to address performance in various parameters in order to ensure sustainable development for the Group. Naturally, we must seek to improve the value we offer customers and to improve profitability while maintaining a firm commitment to safety and quality. However, we also need to improve capital efficiency by enhancing our management resources and conducting optimal investment in order to secure a level of earnings that exceeds the cost of capital. With that in mind, we adopted return on invested capital (ROIC) as one of performance indicators in Medium-Term Business Plan 2022, and set a minimum ROIC target of 5% or more over the medium term based on the cost of capital for the Group. In the previous plan (Medium-Term Business Plan 2017), we used return on equity (ROE) as a performance indicator. However, we decided to review the performance indicators because we wanted to evaluate the efficiency not only of equity but also of overall invested capital. We also wanted to further optimize working capital and improve the effectiveness of our investments, and at the same time ensure solid investment in intangible assets, such as human resources, digital systems, and technology, which we believe will strengthen our competitiveness in the future.

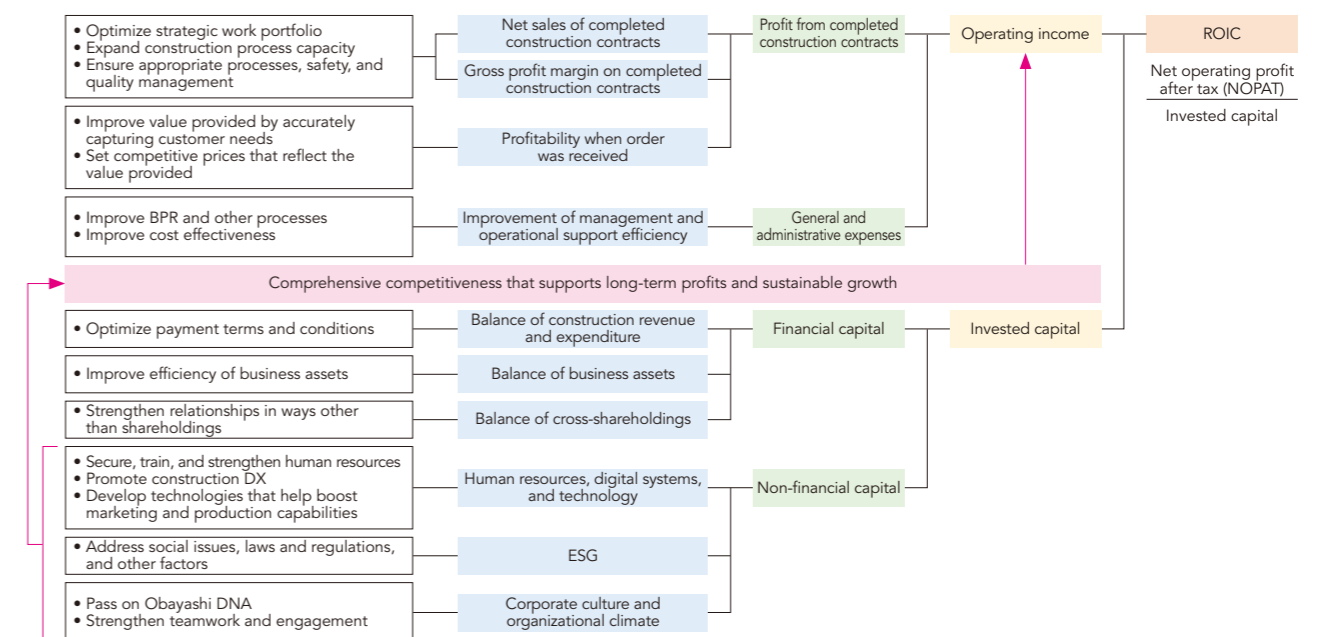
To improve ROIC for the entire Group, we must maximize and efficiently utilize management resources and improve individual ROIC in each of the Group's businesses from domestic construction, our core business, to the overseas construction business in North America and Asia, real estate development business, and green energy business. Given the different risks for each business and varying expected yields in each market, we intend to make clear the weighted average cost of capital (WACC) level for, and evaluate the significance of, each business. The Obayashi Group will strive to increase its corporate value by strengthening its business portfolio based on the WACC and the target ROIC level for each core business.

We use the ROIC reverse tree to help people within the Company understand and pursue ROIC management and work to improve productivity through operational reforms. Instilling ROIC management in the construction business, for example, doesn't just involve the pursuit of measures to improve profits on completed construction projects and reduce general and administrative expenses in order to generate higher operating income, but also involves considering the need to optimize financial capital and invest in non-financial capital. In FY2022, we launched ROIC reverse trees for the construction, real estate development, and green energy businesses that are tailored to the specific business characteristics of each main office, branch office, and domestic and overseas Group companies. We then took into account specific actions in each department and construction project as well as any issues and initiatives at the individual level and reviewed the status of implementation at the end of the fiscal year. We will continue to promote investment in important management resources such as human resources and technology, which support the sustainable growth of the Group. We will also continue to use the ROIC reverse tree to promote operational reforms that will help improve ROIC.

### Deployment of ROIC Reverse Tree Method



### Example ROIC Reverse Tree for the Construction Business



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### Investment Progress under Medium-Term Business Plan 2022

Regarding cash allocations in Medium-Term Business Plan 2022, we use cash inflows from business income based on performance targets, the sale of cross-shareholdings, and other items as our source of funds.

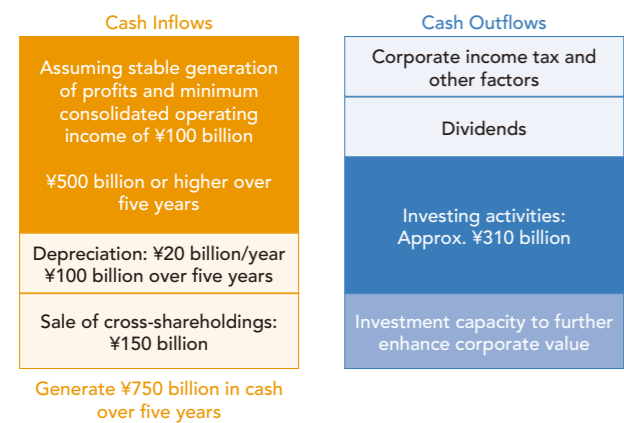
We plan our cash outflows after thoroughly considering the balance between the following three elements:

1. The scale of equity capital required to ensure corporate stability in an uncertain era
2. The amount of growth investment required to maintain a company's competitive advantage and further enhance its corporate value
3. Stable shareholder returns over the medium to long term

We plan to invest a total of ¥600 billion to improve corporate value over the five years of Medium-Term Business Plan 2022, and we invested ¥166.7 billion toward that end in FY2022, the first year of the plan. With regard to human resource-related investment, we formulated the Obayashi Group Human Resource Management Policy in December 2022, and we

are now working to expand our training systems, develop personnel systems that facilitate diverse work styles, secure and train human resources, and improve employee engagement. Regarding investment in digital systems, technology, construction machinery and business facilities, and other relevant areas, we are implementing investments designed to improve productivity in anticipation of the application of regulations to cap overtime work in the revised Labor Standards Act of Japan from FY2024. In the real estate development business, we are looking to diversify asset types by expanding the scope of our business from offices to distribution and other facilities, and to globalize our business portfolio by developing and acquiring properties in London and developing properties in Thailand. We are also using the private fund established by the Group to refresh our asset portfolio and improve the efficiency and profitability of our investments. On the M&A front, we formed a capital alliance with timber manufacturer and distributor Cypress Sunadaya Co., Ltd. This alliance is designed to help strengthen supply chains in the construction market for non-residential wooden structures and timber interiors, an issue that the Group needs to address in promoting the Circular Timber Construction® recycling-oriented business model.

#### The Medium-Term Business Plan 2022 Cash Allocation



\* The above cash allocation plan dates from the formulation of Medium-Term Business Plan 2022. The current estimates for cash inflows have decreased following subsequent changes in the business environment (sharp rise in construction prices and other factors).

#### Breakdown of Cash Flows from Investing Activities

| Item   | Investment plan (Billions of yen) |
|--|-----------------------------------|
| Human resource-related investment  | 25                                |
| Digital-related investment   | 70                                |
| Technology-related investment  | 80                                |
| Construction machinery and business facilities                           | 50                                |
| Real estate development business   | 300                               |
| Green energy business  | 50                                |
| M&A and other areas  | 25                                |
| <b>Investment plan</b>   | <b>600</b>                        |
| Deduction of amount not included in cash flows from investing activities | (150)                             |
| Recovery from the sale of assets in real estate development business     | (140)                             |
| <b>Investing activities</b>  | <b>310</b>                        |

#### Investment Plan for Medium-Term Business Plan 2022 (FY2022 to FY2026)

|  | FY2022     |              | Medium-Term Plan 2022 (FY2022-FY2026) |
|--|------------|--------------|---------------------------------------|
|  | Plan       | Actual       |                                       |
| <b>Intangible asset investment for platform development</b>  |            |              |                                       |
| Human resource-related investment  | 5          | 5.1          | 25                                    |
| Digital-related investment   | 14         | 16.0         | 70                                    |
| Technology-related investment  | 16         | 16.1         | 80                                    |
| <b>Ongoing tangible asset investment with a focus on strengthening the foundation of the construction business</b> |            |              |                                       |
| Construction machinery and business facilities   | 10         | 14.8         | 50                                    |
| <b>Growth investment toward expanding business portfolio</b>   |            |              |                                       |
| Real estate development business <sup>1</sup>  | 100        | 101.1        | 300                                   |
| Green energy business  | 10         | 3.2          | 50                                    |
| M&A and other areas <sup>2</sup>   | 5          | 10.3         | 25                                    |
| <b>Total investment</b>  | <b>160</b> | <b>166.7</b> | <b>600</b>                            |

1. Excluding ¥140 billion recovered as a result of sales of assets (net ¥160 billion when combined with recovered amount)  
2. Including open innovation investment

#### Breakdown of ¥600 Billion Investment from ESG Perspective

| Breakdown from ESG perspective (Billions of yen) |                  |                 |              |  | Other business investments |
|--|------------------|-----------------|--------------|--|----------------------------|
| E: Environment                                   | S: Human capital | S: Productivity | S: New areas |  |                            |
|  | 25               |                 |              |  |                            |
|  |                  | 70              |              |  |                            |
| 20   |                  | 50              | 10           |  |                            |
|  | 5                | 45              |              |  |                            |
| 100  |                  |                 |              |  | 200                        |
| 50   |                  |                 |              |  |                            |
| 170  | 30               | 165             | 35           |  | 200                        |

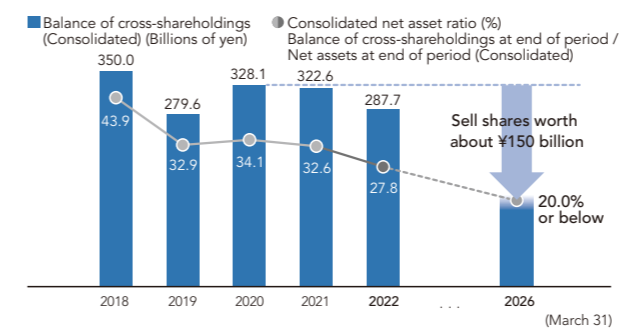
### Reducing Cross-Shareholdings

Obayashi Corporation holds shares in customers' businesses (hereinafter, "cross-shareholdings") for the purpose of maintaining and strengthening business relationships. We consistently verify the medium- to long-term economic rationale of these cross-shareholdings and sell holdings whose significance has diminished from a business perspective based on a comprehensive consideration of capital costs, business returns, and valuation risks. We use the cash generated from the sale of cross-shareholdings to increase corporate value by effectively investing in vehicles that offer stable income and in areas that contribute to sustainable growth.

We instigated a further review of the significance and efficiency of cross-shareholding investments as part of Medium-Term Business Plan 2022. We committed to selling a total of around ¥150 billion in cross-shareholdings, starting in FY2021, to reduce cross-shareholdings to 20% or less of consolidated net assets as soon as possible before the end of March 2027. We sold a cumulative ¥41.5 billion in cross-shareholdings on a consolidated and market price basis over FY2021 and FY2022, which represents 27.7% of the targeted sales amount. As of the end of March 2023, the value of cross-shareholdings totaled ¥287.7 billion, or 27.8% of consolidated net assets. If we include cross-shareholdings that we have already agreed to sell, cumulative sales of cross-shareholdings would be ¥56.3 billion, or 37.5% of targeted sales.

Achieving the targeted cross-shareholding sales requires the understanding of the business partners that we hold shares in, so we will continue to participate in careful dialogue to carry out those sales.

#### Changes in Balance of Cross-Shareholdings and Consolidated Net Asset Ratio



#### Changes in Sale of Cross-Shareholdings

|                               | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 |
|-------------------------------|--------|--------|--------|--------|--------|
| Amount sold (Billions of yen) | 5.4    | 9.2    | 7.7    | 16.9   | 24.6   |

#### Cumulative Amount Sold from FY2021 (Progress Rate vis-à-vis the Target of ¥150 Billion)

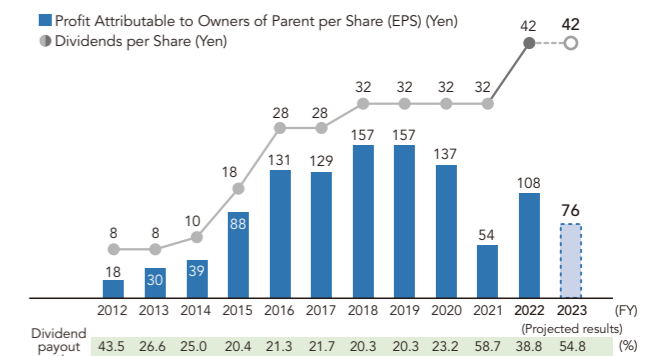
|   |                       |
|---|-----------------------|
| Cumulative amount sold                      | ¥41.5 billion (27.7%) |
| Cumulative amount sold + Agreed sale amount | ¥56.3 billion (37.5%) |

### Shareholder Returns

We stipulated a dividend policy in Medium-Term Business Plan 2022 that involved achieving a dividend on equity (DOE) ratio of approximately 3%. Maintaining stable long-term dividends is a top priority. With that priority in mind, we stipulated the policy to provide stable shareholder returns over the medium to long term by using profits accumulated primarily during Medium-Term Business Plan 2017 to enhance equity capital. That policy also considers the business plan and the growth investment strategy for increasing corporate value for the five-year term of Medium-Term Business Plan 2022. Based on that policy, we increased the annual dividend for FY2022 by ¥10 year on year to ¥42 per share. The Company is committed to strengthening its earnings base through growth investments and efforts to increase corporate value over the medium-to long-term, while also providing shareholders with stable dividends based on DOE to appropriately reflect equity levels.

However, given the significant changes in the business environment envisaged in the current medium-term plan, we believe it is necessary to restate the Group's growth strategy and planned steps for improving corporate value. As part of that effort, we will explore the best capital policy, which would include the consideration of various options, such as dividend increases and share buy-backs, taking into account market requests relating to the price-to-book ratio (PBR) of our shares.

#### Earnings Per Share (EPS) and Dividend Per Share



### Improving Corporate Value

Through Medium-Term Business Plan 2022, the Obayashi Group will contribute to creating a sustainable society according to its vision for 2050 and the Obayashi Philosophy. To that end, the Obayashi Group strives to strengthen its business foundation and accelerate Company-wide transformation based on three fundamental strategies: (1) strengthen and expand the foundation of the construction business, (2) innovate technologies and businesses, and (3) expand the business portfolio for sustainable growth. The entire Group is getting behind the effort to view the dramatic changes in our business environment as a growth opportunity, as we seek to respond flexibly and decisively to change, work tirelessly to strengthen our management foundation, and strive to increase corporate value through continuous growth.