Message from the President

To Our Shareholders:

I am pleased to report an overview of Penta-Ocean Construction Group's business performance in fiscal 2006 (57th business term), which covers the period from April 1, 2006 to March 31, 2007.

Management Conditions

During the term under review, the Japanese economy continued to stage a modest recovery, supported by capital investment growth. This recovery can be attributed to robust exports and a solid corporate performance, as well as the growing impact of improved employment and income conditions.

Construction investment in the private sector increased for the third consecutive year, on active private-sector and real estate investment. However, investment in the public sector continued to fall. Moreover, frequent low-price bidding and other challenges arose in a construction industry that is undergoing reforms to procurement procedures, from pure price competition to Technical Integrated Bid Evaluation System. The revision and strengthening of the Antimonopoly Law added to the difficult operating environment.

The emergency measures for ensuring the quality of public works announced in December 2006 proved effective, and was successful to an extent in stopping low-price bids. Nonetheless, it remained difficult to receive orders in both the public and private sectors throughout the fiscal year. In overseas construction markets, construction investment in Southeast Asia and the Middle East, areas that account for the majority of the Group's overseas operations, maintained their impressive performance from the previous term.

Business Results for the Term under Review

Responding to the intensifying competition for winning orders, the Penta-Ocean Group made concerted efforts to bolster the earnings capacity of its core operations and to improve its financial strength through gradual operational expansion, while adhering to a basic principle of emphasizing earnings. However, in addition to the intense competition for orders, factors such as the decline in winning bid ratio for public works, rising material and labor costs, less profitable projects carried over from the previous term, and bidding suspension and other penalties produced adverse effects, with the consequence that results for the term under review were substantially below projected figures. In particular, the bidding suspension and other administrative penalties imposed on us by the central government and local governments in March 2006 in connection with a bid-rigging case involving construction work for the Defense Facilities Administration Agency had a tremendous impact. Substantial decreases in the amount of completed civil engineering work in Japan and gross income on such completed work also had severe repercussions for our results. Compliance forms the core of corporate social responsibility (CSR). We solemnly accept these penalties, and have instituted a Group-wide commitment to preventing any recurrence of this situation, and to develop an organization for legal observance. At the same time, we are working to build an effective internal control system.

Consolidated business results fell substantially in the term under review. Consolidated net sales totaled ¥323,265 million (an 8.9% decrease year-on-year), consolidated operating income reached ¥4,644 million (a 67.2% decrease year-on-year), and consolidated ordinary income came to ¥2,078 million (an 81.7% decrease year-on-year). We also registered a consolidated extraordinary loss of ¥19,855 million, which included a ¥7,956 million loss on the evaluation of real estate on hand, a reflection of the early application of the so-called lower-of-cost-or-market method to inventory assets, an ¥8,679 million loss on development projects, and a ¥1,774 million impairment loss. In spite of ¥5,423 million reported as consolidated gains on sale of marketable securities, we produced a consolidated net loss of ¥5,858 million (compared with consolidated net income of ¥3,876 million in the previous term).

Challenges and Prospects for the Next Term

We have entered a new era in which genuine technical capabilities are required in both public and private sectors in Japan and internationally, as demonstrated by the introduction of Technical Integrated Bid Evaluation System. In view of this and other factors with implications with earnings, including rising labor and material costs, as well as the increased costs of technical proposals submitted to win orders, we expect that the operating environment will remain difficult for some time.

Under these circumstances, the Penta-Ocean Construction Group established a medium-term management plan called

"Evolution 21" (covering the period from fiscal 2005 to fiscal 2007). Under this plan, we are working to bolster the earnings capacity of our core operations and to strengthen our financial standing. In the next term (fiscal 2007), the final year for Evolution 21, we anticipate a solid recovery in performance, with consolidated net income rising to ¥2,000 million. However, with sincere regret, we must acknowledge here that achieving our initial targets has become difficult given the adverse effects of the rapid and adverse changes that have taken place in the operating environment surrounding construction companies.

The Penta-Ocean Construction Group is aiming to gradually expand its business and to increase the size of operating income in all segments, including domestic civil engineering, domestic building construction and overseas operations, while adhering strictly to the basic principles of not accepting loss-making construction projects and not allowing accepted construction projects to slip into the red. To achieve these goals, the Group is stepping up its activities in port zones, which enable it to make effective use of its 110 years of experience and technologies in areas ranging from marine civil engineering to building construction, including land civil engineering and distribution warehouses. As the leader in port zones, the Group is resolved to bolster its technical and price competitiveness based on our on-site construction technologies, and is committed to winning orders for profitable projects.

In the domestic civil engineering segment, we will step up activities for public works bidding under Technical Integrated Bid Evaluation System, and strengthen civil engineering sales activities in the private sector. To maintain a technologically edge in both the public and private sectors, we intend to improve our ability to make technical proposals that suit market conditions and customer needs, and to enhance our cost competitiveness using our on-site construction technologies as a support.

In the domestic construction segment, we will bolster our sales activities based on business and technical proposals, and push forward with our strategy of rising about the competitive environment by differentiating ourselves from other companies. In particular, we will strengthen our sales activities for logistics facilities in port zones and their inland districts where we can take full advantage of the Group's strengths. Through these initiatives, we aspire to establish Penta-Ocean Construction as a brand.

In the overseas operations segment, we will implement comprehensive risk management at the time of bidding and at the time of construction. At the same time, we will maintain a firm policy of accepting orders with the emphasis on earnings, and will strive to secure profitable orders in close consultation and cooperation with our domestic divisions. We can also display our strength in port zones overseas. We will strive to win orders for plant construction in reclaimed sites, the development of port zones and building construction in such areas, in addition to land reclamation and dredging operations.

As described above, operating conditions for construction companies have undergone great changes. The environment for orders remains difficult. The Penta-Ocean Construction Group will respond appropriately and swiftly to the changing times, and will transform itself into a corporate group capable of generating stable earnings as the leader in port zones, excelling in technologies and management. Please let me take this opportunity to offer to our shareholders my profound apologies for our decision not to pay dividends in the 57th business term, the fifth consecutive period without such payment since the 53rd term. All directors and employees are resolved to increase corporate value and to resume dividend payments at an early stage.

We ask our shareholders for their continued understanding and support.

June 28, 2007

Y. Murashige

Yoshio Murashige
President