COMPANY RESEARCH AND ANALYSIS REPORT

Japan Securities Finance Co., Ltd.

8511

Tokyo Stock Exchange First Section

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Summary

Aiming to contribute to the development of securities markets and further improvement of enterprise value

Japan Securities Finance Co., Ltd. <8511> (hereafter, also “the Company”), which is listed on the First Section of the Tokyo Stock Exchange (TSE), is a highly public financial institution that plays a role in lending transactions carried out on each of the securities exchanges. It has upwardly revised its FY3/18 full year results estimates to reflect the strong results in 1H. Based on the Mid-term Management Plan (FY2017 to FY2019), the Company and its group companies (“Group”) is aiming to continue to contribute to the development of securities markets and further improvement of enterprise value.

1. Major increases in revenues and income in the FY3/18 1H results

With its FY3/18 1H results reflecting a favorable market environment, including the rise in the Nikkei Stock Average and the increase in the balance of standardized margin transactions on the Tokyo Stock Exchange, the Company achieved major increases in revenues and income in its consolidated results, including operating revenues of ¥12,909mn (up 20.8% year on year (YoY)), operating income of ¥2,420mn (up 36.2%), recurring income of ¥2,723mn (up 32.8%), and net income attributable to owners of parent of ¥2,227mn (up 27.4%).

2. Upwardly revised the FY3/18 full year results estimates

Results for the Group’s Securities Finance Business, which is its main business, are greatly affected by various trends, such as in market conditions and interest rates. Therefore, instead of results forecasts, it discloses results estimates calculated from the assumptions for the balance of loans for margin transactions and other items at that point in time. Based on 1H results, for the average balance of loans for margin transactions for the full fiscal year, the Company raised results estimates to margin loans of ¥310bn (up ¥10bn compared to the previous estimate) and stock loans of ¥370bn (up ¥70bn), so it upwardly revised the estimates to consolidated operating income of ¥3,400mn (up ¥800mn), recurring income of ¥4,100mn (up ¥800mn), and net income attributable to owners of parent of ¥3,300mn (up ¥700mn).

Alongside the upward revisions to the results estimates, the Company also raised the dividend forecast from the previous annual ¥16 (interim ¥8, year end ¥8) to ¥18 (interim ¥9, year-end ¥9). As a result, the dividend payout ratio forecast became 52.2%.

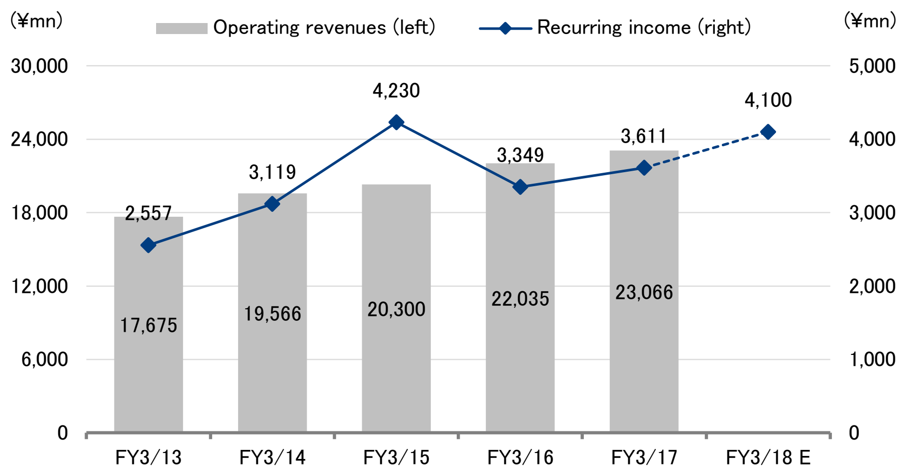
3. In the Mid-term Management Plan, it is strengthening existing businesses and also meeting new transaction needs domestically and overseas

Based on the Mid-term Management Plan for FY2017 to FY2019, the Company is utilizing its management capabilities in financing- and securities-related businesses, the high level of creditworthiness it has cultivated up to the present time, and its neutrality in the markets as it works to strengthen its margin loans business and other existing businesses and also actively strives to meet new transaction needs domestically and overseas. In this way, it is considered that it is aiming to make its existing foundation even stronger and to respond to the confidence that the markets and investors place in it. Specifically, it has set seven targets in the plan, including enhancing the margin loans business as part of the securities market infrastructure, flexibly addressing the needs of domestic and foreign financial instruments companies, and developing new businesses, and it is aiming to further improve enterprise value.

Key Points

- Major increases in revenues and income in FY3/18 1H results, reflecting favorable stock market conditions
- Based on the strong 1H results, the Company upwardly revised FY3/18 full year results estimates to consolidated recurring income of ¥4,100mn and net income attributable to owners of parent of ¥3,300mn and raised the dividend forecast to an annual ¥18
- Set seven targets in the Mid-term Management Plan (FY2017 to FY2019) with the aims of strengthening its existing businesses and meeting new transaction needs domestically and overseas

Results trends



Source: Prepared by FISCO from the Company's financial results

Company profile

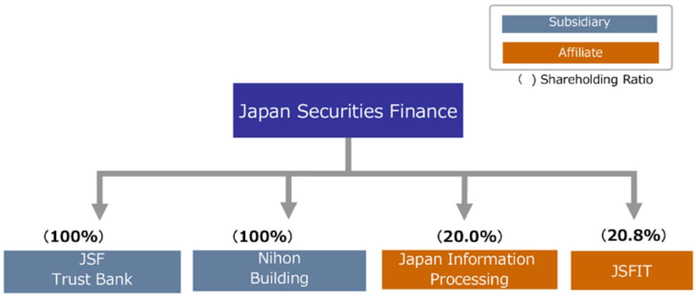
A highly public and neutral financial institution that plays a role in margin transactions

1. Company profile

The Company is a highly public and neutral financial institution that has received designations from various stock exchanges and plays a role in providing loans for margin transaction on those exchanges. The margin loans business, which is its main business, can only be conducted by securities finance companies that have been licensed to do so based on the Financial Instruments and Exchange Law, and they lend to securities companies the funds and the stocks needed to settle the standardized margin transactions. For individuals also, the Company is developing a securities-secured loan business that utilizes the Internet.

The Group consists of two wholly owned consolidated subsidiaries of the Company: JSF Trust and Banking Co., Ltd. (hereafter, "JSF Trust Bank"), which carries out a trust business, including trusts for the separate management of customers' money and securities and securities trusts, and a banking business, including deposits and loans; and Nihon Building Co., Ltd., which leases and manages the real estate owned by the Group. The Company also holds stake of approximately 20% in two equity-method affiliates, Japan Information Processing Service Co., Ltd. and JSF Information Technology Co., Ltd. (JSFIT), which provides information processing and other services.

Group companies



Shareholding Ratio	Name	Capital (mill yen)	Business overview
100%	JSF Trust and Banking Co., Ltd.	14,000	Trust service, Banking service
100%	Nihon Building Co., Ltd.	100	Real estate ownership and leasing Real estate trading and brokerage
20.0%	Japan Information Processing Service Co., Ltd	2,460	Information processing services Software development and sales
20.8%	JSF Information Technology Co., Ltd	100	Information processing services Software development and sales

Source: The Company's results briefing materials

2. History

During the reopening of the stock markets after the Second World War, in order to introduce anticipated demand and supply that would expand trading, the margin transactions and margin loans system was created, and securities finance companies were established at each stock exchange. However, because there was little trading volume on the regional stock exchanges and management conditions were severe for regional securities finance companies, they were consolidated into the Company and (at that time) Osaka Securities Finance Company, Ltd. Together with Chubu Securities Financing Co., Ltd. of Nagoya, these three securities finance companies coexisted for a long time. But upon the management integration of the TSE and the Osaka Stock Exchange in 2013, the Company merged with Osaka Securities Finance with the objectives of improving convenience for stock market participants and investors and raising market efficiency. Moreover, in 2017, Chubu Securities Financing, which had been conducting a margin loans business on the Nagoya Stock Exchange, decided to voluntarily close its business, so these three securities finance companies consolidated into one company, Japan Securities Finance. Currently, the Company is conducting its margin loans business on all four of Japan's stock exchanges in Tokyo, Nagoya, Sapporo, and Fukuoka.

The Company was newly established in 1950 and listed on the TSE. Following the creation of the margin transaction system in 1951, it started the margin loans business, which is its main business. Subsequently, in 1977, it launched the general stock loans business for the lending of stock certificates to securities companies separate from margin loans. In 1985, it launched a secured collateral loans business, in which loans were collateralized by the securities held by customers with securities companies, and then in 1989, it started a brokerage business for bond lending transactions, with securities companies and financial institutions as the other parties to the transactions. It established JSF Trust and Banking Co., Ltd. (JSF Trust Bank) in 1998, started the margin loans business for the JASDAQ market in 2004, and began loans for negotiable margin transactions, to lend to securities companies the funds necessary to settle negotiable margin transactions in 2005. In this way, the Company has expanded the scope of its business. In 2013, it merged with Osaka Securities Finance, and moreover in 2017, it inherited the margin loans business of the dissolved Chubu Securities Financing, and the Company is continuing to grow and develop as the only currently surviving securities finance company in Japan.

History

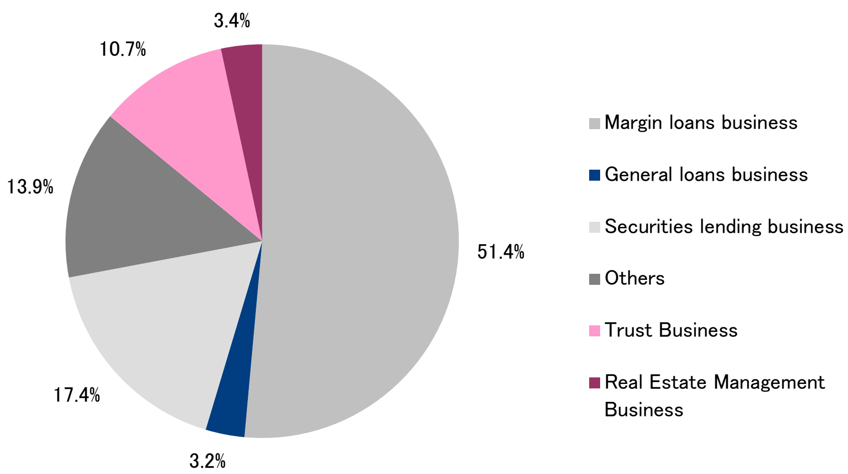
Year	Major events
1927	Established as Tokabu Daiko Co., Ltd.
1943	Name changed to Tokyo Securities Co., Ltd.
1949	Name changed to Japan Securities Finance Co., Ltd.
1950	Launched operations as a specialized securities finance institution Began current account transactions with the Bank of Japan (BOJ) and listed on the Tokyo Stock Exchange Launched lending business as a transitional measure prior to the introduction of a margin transaction system
1951	Launched loans for margin transactions with the establishment of a margin transaction system
1955	Established branch offices by acquiring the complete operations of securities finance companies in Hokkaido, Niigata, and Fukuoka
1956	Granted license according to the Securities and Exchange Law
1960	Launched business in loans secured by bonds
1967	Launched revolving credit line lending of short-term working funds to securities companies
1968	Launched bond financing business with the aim of facilitating bond underwriting and circulation
1977	Launched general stock lending business to lend stock certificates to securities companies separate from the margin transaction business Launched BOJ agency business after designation by the BOJ as a government bond principal and interest payment agent
1979	Launched agency services for a portion of BOJ operations following the establishment of the substitute certificate system for registered bond system for bond financing
1985	Launched secured loans on securities using a revolving credit line format that accepts securities deposited by customers at a securities company as collateral
1987	Launched trading via the JSF Online System after developing a network among securities companies
1989	Launched bond borrowing and lending transactions with securities companies and financial institutions as customers
1996	Launched cash-collateral bond borrowing and lending transactions
1998	Established JSF Trust and Banking Co., Ltd.
2000	Launched securities business limited to Gensaki for treasury bills, etc
2002	Launched e Stock Lending, a stock borrowing and lending transaction system Began handling “new” Gensaki
2003	Increased capital in JSF Trust and Banking Co., Ltd
2004	Launched margin loans business for the JASDAQ market Renewed the JSF Online System and launched trading via JSFNET
2005	Launched the loans for negotiable margin transaction business
2013	Merged with Osaka Securities Finance Company, Ltd.
2017	Launched margin loans business for the Nagoya Stock Exchange

Source: Prepared by FISCO from Company materials

3. Business activities

The Group's businesses are divided into three segments: the Securities Finance Business conducted by the Company and the Trust Business and Real Estate Management Business conducted by the two subsidiaries. The Securities Finance Business is further divided into the margin loans business, general loans business, securities lending business, and others. Looking at the percentages of total operating revenues provided by each business in FY3/18 1H, the margin loans business provided 51.4%, general loans business 3.2%, securities lending business 17.4%, and others 13.9%, meaning that the Securities Finance Business contributed 85.9% of the Group's total revenues. The Trust Business contributed 10.7% and Real Estate Management Business 3.4%.

Percentage of operating revenues by business (FY3/18 1H: ¥12,909mn)



Source: Prepared by FISCO from the Company's results briefing materials

Business overview

Main business is the Securities Finance Business, centered on the margin loans business

Below is an overview of the contents of each business.

1. Securities Finance Business

The Securities Finance Business, which is conducted by the Company itself, contributed 85.9% of FY3/18 1H consolidated operating revenues. The Securities Finance Business is divided into the margin loans business, general loans business, securities lending business, and others.

(1) Margin Loans Business

This is the Group's core business and it contributed 51.4% of consolidated operating revenues. It involves the lending to securities companies of the funds and stock certificates necessary to settle standardized margin transactions.

In a margin transaction, investors buy and sell stocks by depositing a certain amount of collateral (margin money) to a securities company and borrowing from the securities company the funds to buy the stock they wish to hold or sell. This system enables investors to buy stocks of an amount greater than their cash on hand or sell stocks that they do not own, which adds to the expanse of trading and contributes to the smooth circulation of stocks and formation of appropriate prices.

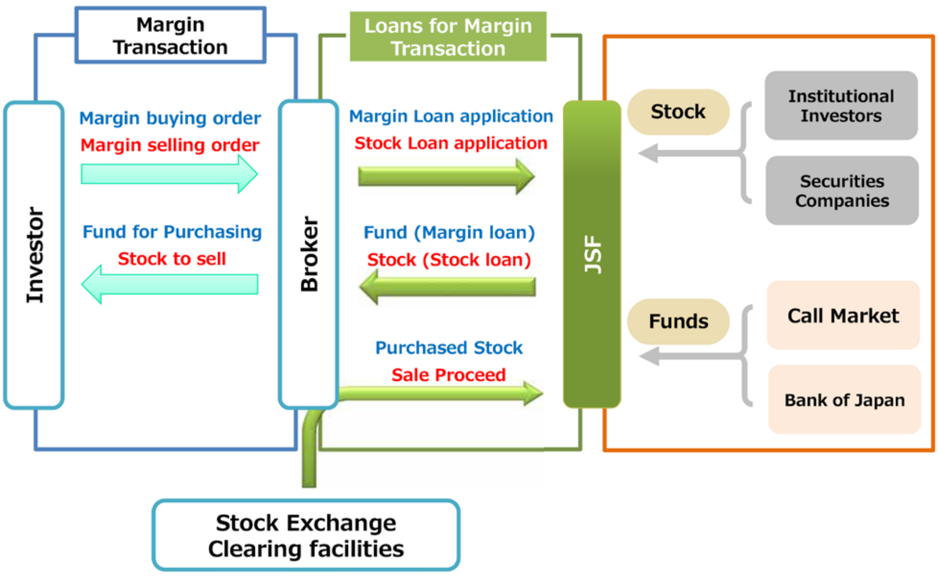
There are two types of margin transactions: standardized margin transactions and negotiable margin transactions. In a standardized margin transaction, aspects such as premium charges and a term of repayment are stipulated by the stock exchange, and securities companies can borrow from the Company the stock certificates to be sold or the funds for the purchase that they need to settle the transaction (the margin loan). On the other hand, in a negotiable margin transaction, the customer and the securities company can freely set the transaction conditions between them, but securities companies cannot use a margin loans to settle a negotiable margin transaction.

In this way, margin loans are a transaction in which the Company receives a certain amount of collateral for the loan from the securities companies, which trade on the stock exchanges, and in return it loans to them the funds or stocks needed for a standardized margin transaction. These transactions are carried out through the stock exchange's clearing corporation.

The Company receives an application for a loan for each issue from the securities companies on the trading date of the standardized margin transaction. For the execution of the loan, instead of the securities company, the Company transfers the funds for the purchase of the stock to be held or sold to clearing facilities of stock exchanges. In return, it receives the purchased stock certificate (collateral stock certificates for loans) or the sale fee (collateral money for stock loans), which it allocates to the collateral for each respective loan, and the transaction is completed.

In the event that the Company cannot cover applications for margin loans and stock loans from securities companies using its collateral stock or money of internal holdings, it responds through methods such as raising funds from the call market or elsewhere or borrowing the stock in question from institutional or other investors.

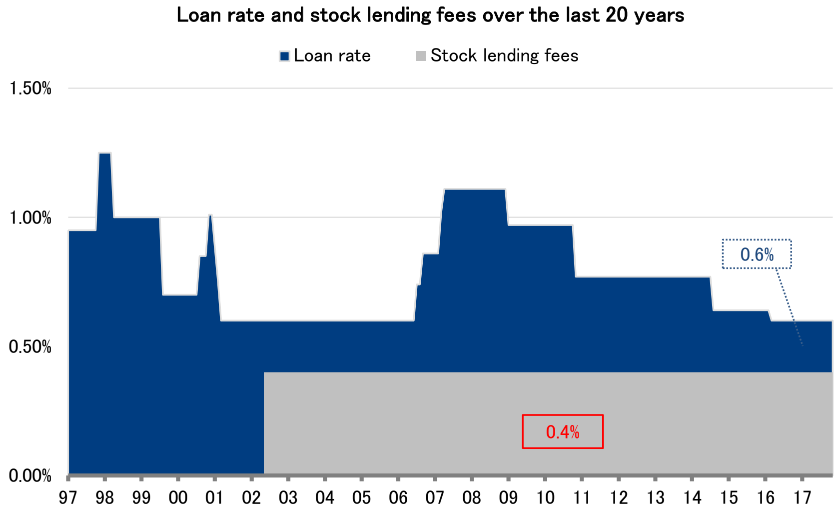
Structure of margin transactions and loans for margin transactions



Source: The Company's results briefing materials

For the Company, its main revenues are interest on loans (loan rate, currently 0.60%) and fees on lending securities (stock lending fees, 0.40%). But affected by the long term ultra-monetary easing policy, the loan rate is at a historically low level.

Loan rate of loans for margin transactions



Source: Company materials

(2) General Loans Business

This business involves lending to securities companies, such as for working capital, and also to individuals and general business corporations via the Internet, using securities as the collateral. It contributes 3.3% of consolidated operating revenues.

(3) Securities Lending Business

This business involves brokerage operations on the government bonds lending and borrowing markets and lending of stocks necessary to settle trades. It contributes 17.4% of consolidated operating revenues. The lenders are mainly securities companies and the borrowers are institutional investors, such as life and non-life insurance companies.

(4) Others

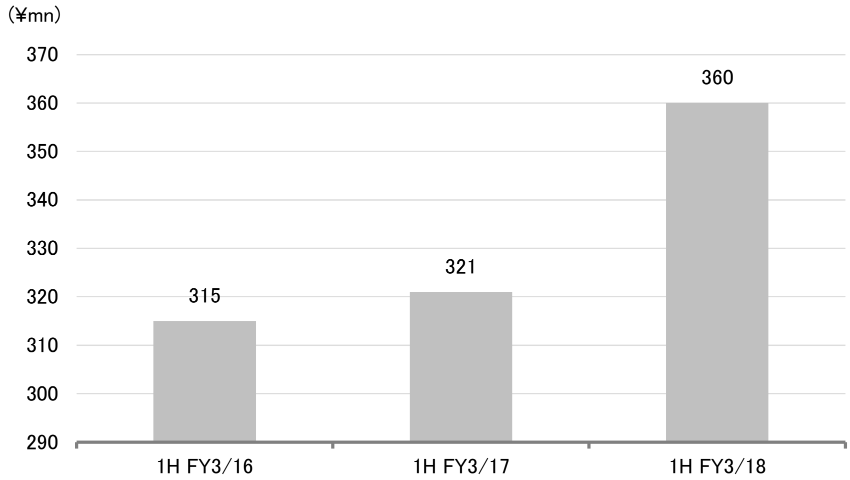
Others includes the management of government bonds and other securities, and it contributes 13.9% of consolidated operating revenues.

2. Trust Business

Since its establishment in 1998, JSF Trust Bank, which is the Company's wholly owned subsidiary, has been focusing on trusts to protect customer assets for individual investors and others, in order to protect the money and other assets they have deposited with securities companies, FX traders, commodity futures traders, and others. Also, in recent years, it has been accumulating a track record for the acceptance of ABL (asset backed loan) trusts based on introductions by securities companies. In addition, it has recently begun engaging in cloud funding and protection trusts for lump-sum payments on entering a residence. In such ways, alongside the development of the financial markets, JSF Trust Bank is provided highly precise services that meet the needs of customers.

The Trust Business contributes 10.7% of the Group's consolidated operating revenues, and the main sources of revenues in it are trust charges, interest on loans, interest and dividends from securities, and gains on the sale of government bonds and other bonds. Stable revenues in the Trust Business are provided by trust charges, which have continuously increased in recent years and achieved record highs, but even so, the Company Group is working to develop new trust products toward further improving revenues. Also, looking at the lenders, we see that more than 90% of the total lending amount is to the government (including government guarantees), so it can be said that the loans are highly stable.

JSF Trust Bank: Trend in trust charges



Source: Prepared by FISCO from the Company's results briefing materials

3. Real Estate Management Business

This business, which is conducted by the wholly owned subsidiary Nihon Building, involves leasing real estate owned by the Group companies. It is small scale and contributes only 3.4% of the Group's consolidated operating revenues.

Results trends

Major increases in revenues and income, reflecting favorable stock market conditions

1. Summary of 1H FY3/18 results

In the stock markets in FY3/18 1H, the Nikkei Stock Average, which at the beginning of the period was ¥18,983, fell to its lowest level in the period during April due to the increased risk relating to North Korea. But in early June, the markets reacted favorably to the results of the French presidential elections and it recovered to the ¥20,000 level for the first time in around a year and a half. However, concerns about North Korea reignited and it fell again at the start of September. But then, against the backdrop of developments such as the reports of the dissolution of the House of Representatives and expectations for an additional interest rate hike in the United States, it began rising again based on the strong dollar and the weak yen. In September, it recorded a record high for the first time in two years, and at the end of September, it ended trading at ¥20,356.

In 1H on the TSE, the margin transactions buying balance decreased from ¥2.35 trillion at the start of the period to around ¥1.80tn in early May. But after that, supported by buying from individual investors during a phase of falling share prices, it recovered and reached its peak for the 1H in late August, at ¥2.15tn, and at the end of September, it was ¥2.30tn. Conversely, the margin transactions selling balance, which was ¥580bn at the start of the period, decreased and bottomed-out in the middle of April at ¥570bn. But new selling could be seen during the phase of rising share prices in early June, and it increased to as high as ¥770bn. Subsequently, it temporarily decreased in late August during a phase of falling share prices from repurchases by investors looking to lock-in profits, but it recovered again in late September, and had reached ¥730bn by the end of this month.

Based on these stock market trends, in FY3/18 1H, the Group's outstanding loan balance (average for the period) increased ¥84.3bn YoY to ¥536.7bn. Due to the increase in fees on lending securities in the margin loans business, consolidated operating revenues rose greatly to ¥12,909mn (up 20.8%). Also, operating expenses were ¥6,518mn (up 32.8%), because of factors including an increase in fees on the borrowing securities in the margin loans business and bond borrowings, but general and administrative expenses were basically unchanged YoY at ¥3,970mn (down 0.7%). As a result of these factors, income increased greatly, with operating income of ¥2,420mn (up 36.2%), recurring income of ¥2,723mn (up 32.8%), and net income attributable to owners of parent of ¥2,227mn (up 27.4%). As the market environment was better than expected, the Company had achieved approximately 85% of its full year estimate for net income attributable to owners of parent by the end of July.

1H FY3/18 consolidated results

(¥mn)

	1H 3/17		1H 3/18		YoY	
	Amount	% of operating revenues	Amount	% of operating revenues	Change	Change (%)
Operating revenues	10,683	100.0%	12,909	100.0%	2,226	20.8%
Operating profit	5,774	54.0%	6,391	49.5%	617	10.7%
General and administrative expenses	3,996	37.4%	3,970	30.8%	-26	-0.7%
Operating income	1,777	16.6%	2,420	18.8%	643	36.2%
Recurring income	2,049	19.2%	2,723	21.1%	673	32.8%
Net income attributable to owners of parent	1,747	16.4%	2,227	17.3%	479	27.4%

Source: Prepared by FISCO from the Company's financial results and results briefing materials

The operations of each segment in 1H are outlined below.

(1) Securities Finance Business

In the margin loans business, the average margin loan balance for the period increased ¥50.2bn YoY to ¥313.8bn, so interest on loans rose. Also the balance of stock loans during the period climbed by ¥146.5bn to ¥373.8bn, so stock lending fees also rose. In addition, premium charges relating to over-lent issues increased, and in conjunction with this, fees on lending securities grew. As a result, operating revenues in this business were ¥6,640mn (up 51.1%).

In the general loans business, lending to individuals, general business corporations, and securities companies each trended at low levels, and the average lending balance during the period in this business declined ¥11.3bn YoY to ¥36.1bn. Conversely, alongside the recovery of the stock market cash-secured stock lending transaction increased. As a result of the above, operating revenues in this business were ¥414mn (down 9.4%).

In the securities lending business, the general stock lending secured higher revenues, while in the bond lending also, revenues greatly increased due to the rise in the lending balance. As a result, operating revenues were ¥2,242mn (up 14.5%).

In others, operating revenues were ¥1,794mn (up 2.4%), mainly because while interest income from government bond holdings declined, revenues from dividend income from holdings of investment trusts and other securities increased.

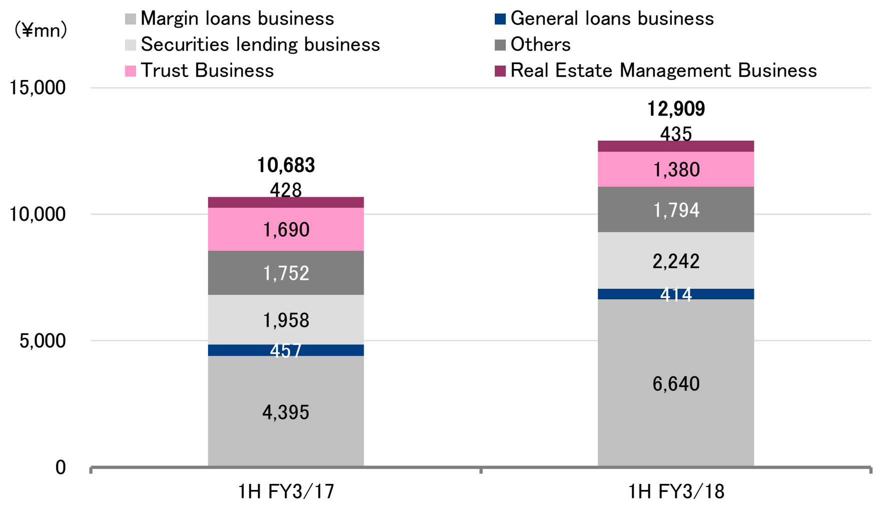
(2) Trust Business

Trust charges continued to increase from the strengthening of custodian-type services, but gains on the sales of holdings of government bonds and other bonds declined. Revenues from interest on loans also fell due to the lower interest rate, and as a result, operating revenues were ¥1,380mn (down 18.3%).

(3) Real Estate Management Business

Operating revenues were ¥435mn (up 1.7%).

Trends in operating revenues by business



Source: Prepared by FISCO from the Company's results briefing materials

In assets, both current assets and non-current assets increased

2. Financial position and management indicators

At the end of FY3/18 1H, total assets were up ¥190.8bn on the end of the previous fiscal period to ¥4.8358 trillion. This was because while items including short term investments and collateral money for securities borrowed decreased, items such as cash and operating loans increased. The majority of cash are temporary deposits arising from borrowed money and cash flow in the trust account of JSF Trust Bank.

The equity ratio fell 0.1 of a percentage point on the end of the previous fiscal period to 2.9%. Also, annualized ROA (return on assets) was unchanged YoY at 0.1%, but ROE (return on equity) rose to 3.2%. As the amount of the assets held for business purposes in the Company Group is large, its equity ratio and ROA tend to be low compared to other industries.

Consolidated balance sheet

(¥mn)

	March 31, 2017	September 30, 2017	Change
Current assets	3,942,440	4,003,878	61,437
Cash	1,076,761	1,339,661	262,899
Short-term investments	238,498	218,001	-20,496
Operating loans	587,752	634,457	46,705
Collateral money for securities borrowed	1,930,722	1,666,706	-264,016
Non-current assets	702,610	831,974	129,363
Investments in securities	690,208	819,957	129,749
Total assets	4,645,051	4,835,853	190,801
Current liabilities	4,477,440	4,668,760	191,319
Call money	626,898	963,206	336,307
Short-term borrowings	13,010	14,010	1,000
Commercial paper	185,000	263,000	78,000
Collateral money for securities lent	2,492,578	2,244,111	-248,466
Borrowed money from trust account	1,095,054	1,108,001	12,946
Non-current liabilities	27,898	24,572	-3,325
Total liabilities	4,505,339	4,693,333	187,994
Net assets	139,712	142,519	2,807

Source: Prepared by FISCO from the Company's financial results and results briefing materials

Management indicators

	FY3/17	1H FY3/18
[Stability]		
Current ratio	88.1%	85.8%
Equity ratio	3.0%	2.9%
[Profitability]		
Operating income ratio	12.1%	18.8%
ROA (return on assets)	0.1%	-
ROE (return on equity)	2.2%	-

Source: Prepared by FISCO from the Company's financial results

Business outlook

Based on the favorable 1H results, the full year results estimates were upwardly revised

The results of the Securities Financing Business, which is the Group's main business, are greatly affected by trends in market conditions, interest rates, and other factors, so it does not disclose results forecasts. However, it does announce results estimates with the aim of appropriately disclosing the Group's business conditions. It reviews these estimates every quarter and announces them when it announces its results.

In a situation in which the Nikkei Stock Average reached its highest level in 20 years in the 1H, the loans average balances were ¥313.8bn for margin loans (up 19.0% YoY) and ¥373.8bn for stock loans (up 64.5%), exceeding the previous assumptions (as of July, ¥300bn for margin loans and ¥300bn for stock loans). Therefore, the newly calculated assumptions were upwardly revised to ¥310bn for margin loans and ¥370bn for stock loans. Conversely, as it is difficult to anticipate any changes during FY3/18 to the trend in monetary policy, which affects both the level of the lending interest rate and the demand for financing from securities companies, the Company assumed that the current situation would continue when estimating the results.

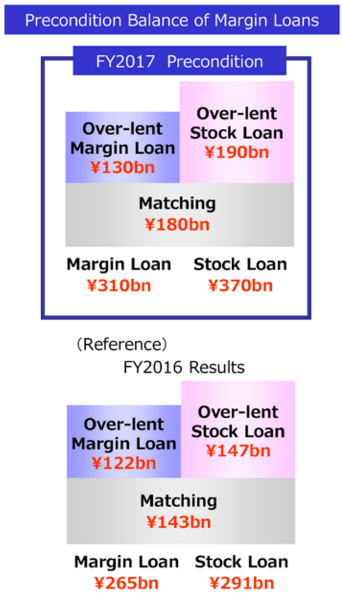
Based on the above, for the Company on a non-consolidated basis, the FY3/18 results estimates were upwardly revised from the previous estimates to operating income of ¥2,500mn (up ¥631mn YoY), recurring income of ¥3,200mn (up ¥563mn), and net income of ¥2,700mn (up ¥367mn).

Furthermore, JSF Trust Bank upwardly revised its previous estimates, as its trust business performed steadily, but it is forecasting a decline in income YoY from the effects of the increase of borrowed money from the trust account. In Nihon Building also, the real estate management properties are fully occupied and it is anticipated that the revenue level will exceed the previous estimate. But net income is still expected to decline YoY due to the fall in the gain on sale of investment securities that was previously recorded as extraordinary income.

As a result, the Group's consolidated results estimates are for revenues and income to increase significantly, for operating income of ¥3,400mn (up ¥597mn YoY), recurring income of ¥4,100mn (up ¥488mn), and net income attributable to owners of parent of ¥3,300mn (up ¥221mn).

On entering the 2H also, the Nikkei Stock Average in early November temporarily exceeded ¥23,000, and during October, the Company's average margin loans balance was ¥328.4bn and the average stock loans balance was ¥423.2bn, both trending above the assumptions for the results estimates. While it will be dependent on the market environment in the future, if the results continue to trend around the current level, the FY3/18 full year results may even exceed the Company's new estimates.

Estimated figures for FY3/18



(¥ mil)		FY2017 Estimated Figures	YoY.⊿	⊿ from prev. EF
Consolidated				
	Operating Income	3,400	597	800
	Recurring Income	4,100	488	800
	Net Income	3,300	221	700
JSF	Operating Income	2,500	631	700
	Recurring Income	3,200	563	700
	Net Income	2,700	367	600
JSF Trust and Banking	Recurring Income	340	▲86	90
	Net Income	280	▲71	60
Nihon Building	Operating Income	545	+39	5
	Recurring Income	625	+35	5
	Net Income	415	▲16	5

Preconditions of Loans for Margin Transactions
●Loan Rate : 0.60%, ●Interest on Collateral Money : 0%, ●Lending Fee : 0.40%

Source: The Company's results briefing materials

Medium- to long-term growth strategy

Working to strengthen the revenue base by developing businesses other than the margin loans business

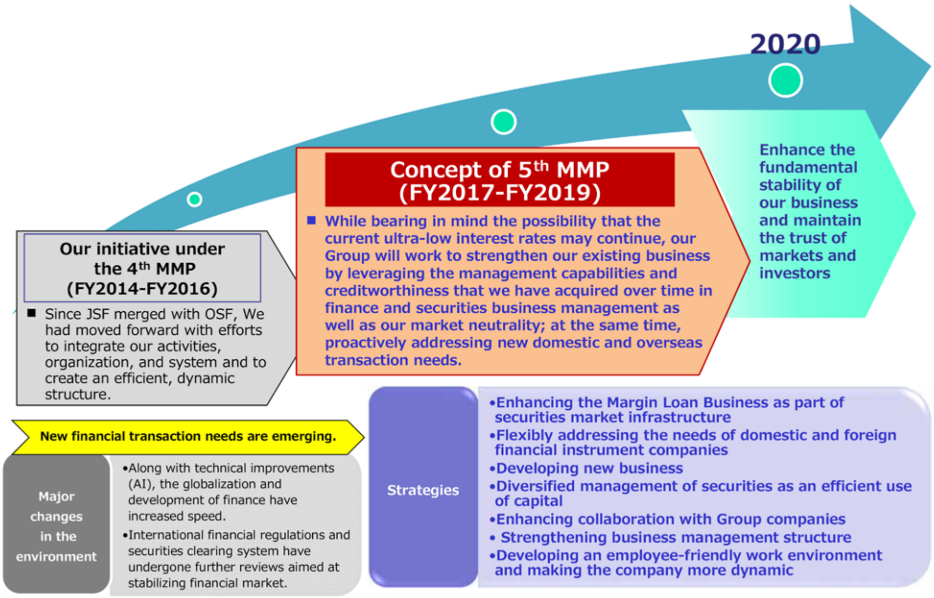
1. New medium-term management plan

More than four years have passed since the Company merged with Osaka Securities Finance, and during this time, based on the 4th Mid-term Management Plan (FY2014 to FY2016), the Group has worked to integrate its businesses, organizations, and systems, and it has progressed the construction of a structure that is efficient and fully of vitality. On the other hand, the business environment facing the Group is changing greatly. Specifically, the globalization and increased sophisticated of financing is accelerating in conjunction with the technological improvements that utilize artificial intelligence (AI) for products and services. Moreover, the reviews of the international financial regulations and the securities settlement system have been further advanced toward stabilizing the financing markets, and based on these developments, new needs for financing transactions are being created.

While keeping in mind the possibility that the current low interest rate will continue, the Group is utilizing the management capabilities in the financing- and securities-related businesses and high level of creditworthiness it has cultivated up to the present time, and its neutrality in the markets, as it works to strengthen its margin loans business and other existing business, and also actively strives to meet new transaction needs domestically and overseas. Through this, it is considered that the Company is aiming to make its existing foundation stronger and to respond to the confidence that the markets and investors have placed in it. In other words, its intention is to strengthen its revenue foundation by, on the one hand, working to enhance the margin loans business that is its main business, but on the other hand, also developing other businesses.

Based on this approach and in advance of the 70th anniversary of its establishment in 2020, the Company is currently progressing the 5th Mid-term Management Plan, with FY2017 as its first year. Through it, it intends to continue to contribute to the development of the securities markets.

Outline of the 5th Mid-term Management Plan (FY2017 to FY2019)



Source: Company's results briefing materials

2. The specific strategies

The seven basic strategies in the 5th Mid-term Management Plan are as follows.

(1) Enhancing the margin loans business as part of the securities market infrastructure

The Company is aiming to respond appropriately to the environmental changes in the stock markets and to conduct stable management and improve the convenience of the margin loans business. It is also working to accurately ascertain trends among market participants and promote the use of loans for margin transactions, to strengthen its dissemination of information relating to standardized margin transactions and loans for margin transactions, and to expand the fields of view of investors.

In terms of examples of specific measures, in addition to improving its ability to procure stock certificates, it is enhancing the provision of information relating to stock procurement, targeting major domestic and overseas securities companies, in order to promote the use of stock loans. It is also holding seminars and study meetings for securities companies on the margin transactions and loans for margin transactions to promote its more widespread use. Moreover, in order to expand the issues that it lends and borrows, the Company is improving its methods of approaching the issuing companies (including by aiming to promote understanding of the margin transactions and loans for margin transactions in the divisions responsible for IPO within securities companies).

(2) Flexibly addressing the needs of domestic and foreign financial instruments companies
The Company is aiming to expand direct transactions with non-residents of Japan, including overseas corporations that are its existing trading partners, and also to expand transactions through accepting foreign securities as collateral. In such ways, it intends to actively respond to a diverse range of transactions with domestic and overseas securities companies and others, and thereby to expand revenue opportunities. In addition, alongside the shortening of the settlement period for securities, it is actively working to meet new transaction needs in order to expand the securities lending business.

In terms of specific measures, the Company has been lending funds collateralized by foreign securities and also lending foreign securities. It has concluded stock lending and borrowing contracts with overseas financial institutions using standard international contracts. Moreover, it is responding in order to meet the new needs that are being created in conjunction with the shortening of the settlement periods for government bonds and stocks (government bonds: it is responding to the transition to repurchase agreement method from the former lending and borrowing method. Stocks: it will consider new schemes and improving its ability to procure stock certificates as a response to fail-cover needs).

(3) Developing new businesses
Against the backdrop of its business history as a securities finance company, the Company is utilizing its features to develop new businesses from a long term perspective in collaboration with related parties domestically and overseas, and with its Group companies.

A specific example of this is its activity to support (technological support) the establishment of securities finance company in Indonesia. In such ways, it is aiming to develop new businesses and enhance existing businesses, while collaborating with overseas finance- and securities markets-related parties, particularly in Asia.

(4) Diversified management of securities as an efficient use of capital
The Company will secure stable revenues by responding to changes in the external environment and flexibly reviewing its portfolio, based on appropriate risk controls. It will also establish methods of procuring foreign currencies in order to expand its management of foreign currency-denominated securities, such as foreign government bonds, and to support the development of its businesses using foreign currencies.

(5) Enhancing collaboration with Group companies
The Company will enhance collaboration with Group companies, particularly its subsidiaries, and actively respond to diversifying transaction needs. It will also work to further solidify the revenue foundation for the Group as a whole through measures that are integrated between it and the subsidiaries.

(6) Strengthening the business management structure
The Company has reconfirmed that it positions compliance as a prerequisite of management so that it may actively respond to the social demands required of it and to realize its corporate philosophy. In order to establish society's unwavering trust in it, it is striving to ensure the effectiveness of internal audits and to further enhance risk management to respond to the diversification and increasingly complexity of the risks associated with the financing business. To continue the margin loans business, which is its most important business, even in the event of a major disaster, it will establish a remote site backup system, while also paying attention to the trends in the finance and securities industries.

A specific example of this is its ongoing effort to strengthen cyber-security measures.

(7) Developing an employee-friendly work environment and making the Company more dynamic

The Company is working to improve productivity per employee and make the Company more dynamic by establishing an employee-friendly work environment that provides its employees with job satisfaction.

3. The necessity for calculated targets

As described above, the Company's Mid-term Management Plan has qualitative targets, but it does not present quantitative calculated targets, such as for revenues and income. Certainly, the margin loans business, which accounts for the majority of the Company's revenue, is greatly affected by stock-market conditions and the financing environment, so it understandable that it is difficult for it to present revenue target for three years in the future. However, at FISCO, we think that in order for investors to share the Company's image of itself in the future and to confirm the progress made in each fiscal period, it would be meaningful for it to present calculated targets of some sort, even if not numerical figures such as for revenues and income.

Shareholder return policy

Provides enhanced returns to shareholders

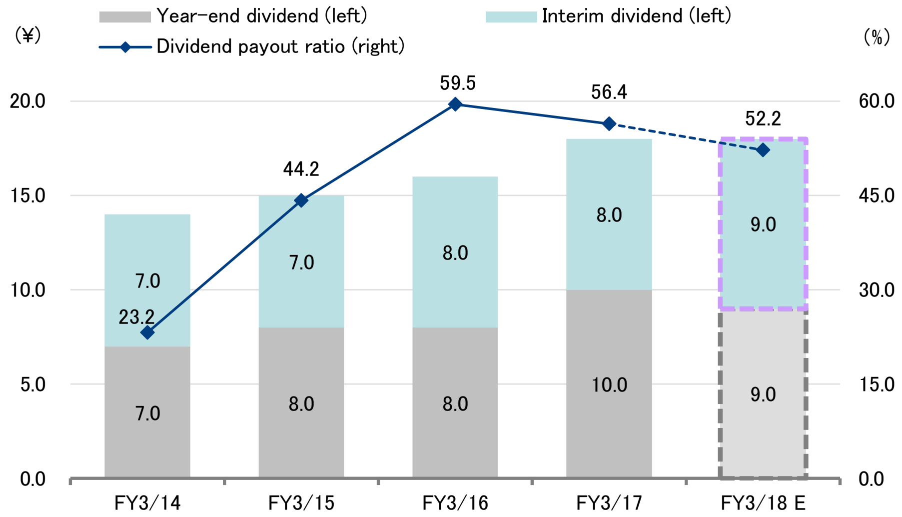
The Company maintains a firm level of capital in order to ensure the stability of management and the financial soundness that is required of it as part of the securities-markets infrastructure. But at the same time, its basic approach is to stably return profits to shareholders, while comprehensively considering aspects such as the earnings environment and the investment plan. As the standard that reflects results, its policy for returning profits to shareholders is for the consolidated dividend payout ratio to not fall below the 60% level, while also considering consolidated dividends on equity (DOE).

Based on this policy, in FY3/17, the Company paid an interim dividend of ¥8 and a year-end dividend of ¥10, for a total dividend of ¥18, which was an increase of ¥2 YoY for a dividend payout ratio 56.4%. Also, on considering the favorable FY3/18 1H results and the new results estimates, it has upwardly revised the previous dividend forecast, which was for an interim dividend of ¥8 and a year-end dividend of ¥8 for a total dividend of ¥16, to an interim dividend of ¥9 and a year-end dividend of ¥9, for a total dividend of ¥18. Consequentially, the dividend payout ratio will be 52.2%.

Further, since FY3/15, the Company has been buying back its own shares, which has led to improvements in earnings per share and the shareholders' equity ratio. In FY3/18 also, it has set a framework for acquiring 1.5 million shares for ¥1bn, and it is currently acquiring them. As a result, the total returns ratio ((dividend payment amount + share buyback amount) / net income attributable to owners of parent) is forecast to be 82.5% (compared to 66.3% in the previous fiscal year). From FY3/19 onwards as well, the Company will investigate buying back its own shares while considering factors such as the capital level and risk conditions.

Looking at the FY3/18 dividend payout ratio forecast, we see it is below the Company's standard. As its results are greatly affected by the market environment, the actual year-end dividend will depend on the 2H results. But up to the present time, the market environment and the results have trended above the Company's expectations. So in the event that the actual results exceed the estimates, it is possible that the actual dividend will be increased from its current forecast.

Trends in the dividend and the dividend payout ratio



Source: Prepared by FISCO from the Company's financial results and results briefing materials

Information security measures

As part of the securities market infrastructure, it is implementing measures to ensure that there are no impediments to its businesses

As part of its measures to establish and maintain a structure for business continuity, the Company is working to deal with cyber-attacks. Specifically, centered on the BCP Measures Headquarters that supervises business continuity during times of emergency, its efforts include ascertaining the damage situation, communicating with external organizations, and preparing reports.

The Company has been implementing a variety of measures up to the present time, such as constructing a contingency plan for an anticipated targeted attack email, surveying the effects on the management of each business in the event that the Internet connection was completely severed and improving the contingency plan based on the results of this survey, holding cyber-attack drills, participating in the joint exercises held by Financials ISAC Japan, and using external experts to conduct reception tests of targeted attack emails. Also, its technological measures include separating the Internet environment and the business environment and installing software to protect against targeted attack emails.

Going forward also, the policy is to improve the ability of the Company as a whole to respond to risks, including through drills based on various conditions and assumptions, and various types of training.

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