COMPANY RESEARCH AND ANALYSIS REPORT

eGuarantee, Inc

8771

Tokyo Stock Exchange First Section

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Summary

The outlook is for the profit growth to continue against the backdrop of the strong demand for sales credit guarantee services

The core business of eGuarantee, Inc. <8771> is to provide credit risk guarantee services targeting sales credits issued by companies to their customers. The Company hedges the credit risk it assumes by transferring the guarantees to financial institutions via reassurance contracts. It follows a recurring revenue business model in which net sales equates to the product of the balance of outstanding guarantee times the guarantee fee ratio. As the number of client companies has increased, the Company's balance of credit guarantees outstanding has risen. As a result, eGuarantee has delivered sustained growth.

1. FY3/18 results

In the FY3/18 consolidated results, both sales and profits increased for the 12th consecutive year since the Company was listed, with net sales increasing 11.5% year-on-year (YoY) to ¥5,105mn and recurring profit rising 7.0% to ¥2,302mn. Against the backdrop of its advanced screening capabilities, the Company steadily developed new customers through setting detailed guarantee fee ratios and providing services that respond to customer needs, and the balance of guarantees outstanding rose 15.6% on the end of the previous fiscal year to ¥345.3bn, which was a factor behind the higher sales. The operating margin declined 1.7 percentage points compared to the previous fiscal year, but this was due to the worsening of the cost ratio from expanding the targets of the credits it underwrites from the previous low risk zone to some middle risks. Compared to the initial Company forecasts (net sales of ¥5,200mn and operating profit of ¥2,270mn), net sales were slightly below their forecast as the underwriting of middle risk was less than planned, but underwriting in the low-risk zone was more than expected, so on a profits basis, the results were slightly above forecast.

2. FY3/19 outlook

The outlook for the FY3/19 consolidated results is once again for new record highs, with net sales increasing 11.6% YoY to ¥5,700mn and recurring profit rising 10.7% to ¥2,550mn. The main reason for these forecasts is that there are many inquiries from companies that want to increase their sales while also hedging against the risk of uncollectable sales credits by using the Company's services, so the number of customer referrals from regional banks, which are its alliance partners, are increasing. In this fiscal period also, its policy will be to develop a diverse range of product and services that meet customer needs and to grow results while aiming to accumulate the balance of guarantees outstanding.

3. Growth strategy

The Company's management target for the near future is consolidated recurring profit of ¥5bn, and to achieve this level, it will need to increase the balance of credit guarantees outstanding to around ¥700bn to ¥800bn, which is approximately double the level at the end of the previous fiscal period. If growth continues at around the current pace of 15%, then the prospect is that it will be able to achieve this target in FY3/23. It is thought that this growth of the balance of guarantees outstanding of about 15% a year is possible through the Company working to strengthen the sales structure and improve productivity by increasing operational efficiency, and also by expanding the scope of credits it targets (up to middle risk). Moreover, in conjunction with the expansion in the scale of guarantees, for the building of a securitization structure also, it is strengthening its ability to tolerate risk by progressing the formation of new funds.

As the Company plans to achieving recurring profit from expanding the regular guarantee business, in addition to that, it has positioned as one growth area undertaking the guarantee of risk such as when developing the provision of financial services, of companies that utilize the Internet and provide matching services that connect companies and people and outsourcing services. Also, as a company's strength, that it has guarantee requests from in excess of 20,000 companies a month, and after the guarantee-request process and actually providing the guarantee, it has a business model that can ascertain the actual settlement conditions and the detailed information, for example what kind of transactions are carried out among them. Alongside the business expansion, it is considered to be creating an enormous information database on corporate transactions and to be actively utilizing it in future business development.

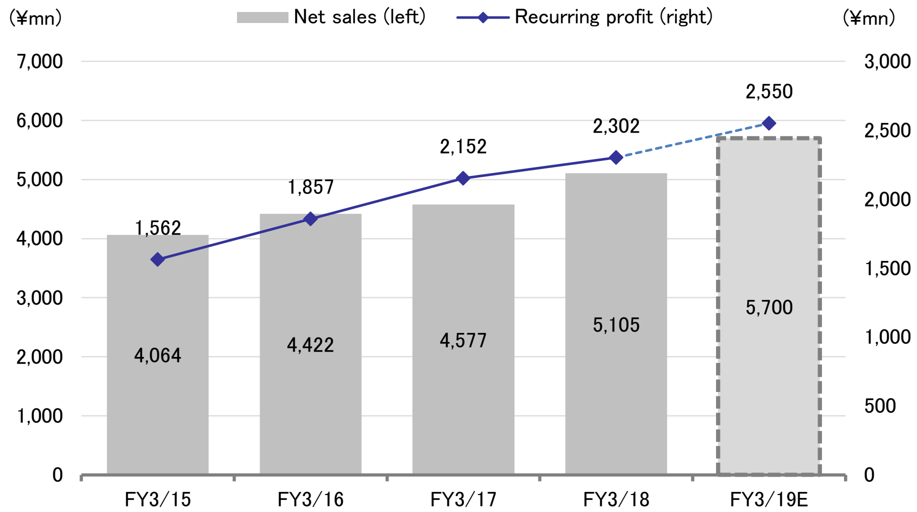
4. Shareholder return policy

Looking at the shareholder return policy, eGuarantee's basic policy is to pay dividends in line with earnings while retaining the internal reserves needed to aggressively expand business and ensure a strong financial position, targeting a payout ratio of around 30%. In FY3/19, eGuarantee plans to issue an annual dividend of ¥22.5 per share, representing a dividend payout ratio of 29.3%. If the Company achieves its target, it is likely to continue increasing its dividend. As for the Company's shareholder gift program, eGuarantee awards a QUO card worth ¥1,500 to each shareholder at the end of March every year.

Key Points

- It guarantees companies' risk of irrecoverable sales credits and other credits and provides a service that contributes to their business expansion
- The outlook is for the higher sales and profits to continue in FY3/19 also from the extremely strong demand for sales credit guarantees
- Aiming to achieve consolidated recurring profit of ¥5bn as its medium-term target

Results trends



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

Company overview

It guarantees companies' risk of irrecoverable sales credits and other credits and provides a service that contributes to their business expansion

1. Company history

eGuarantee can trace its origins to its establishment as a subsidiary of ITOCHU Corporation <8001> by Mr. Masanori Eto, the current president and CEO of eGuarantee, during his third year as an ITOCHU employee in September 2000. Initially, eGuarantee set out to provide a service to hedge the risk of uncollectible sales credits, such as trade notes and accounts receivable, for B2B transactions over the Internet. However, demand for these services was lower than initially anticipated. Therefore, eGuarantee evolved into a provider of credit risk guarantee services for sales credits in real B2B business transactions that do not involve the Internet.

In March 2007, the Company was listed on the JASDAQ Securities Exchange (listing changed to the Tokyo Stock Exchange 1st Section in December 2012), and using the funds it raised from the listing, in 2008 it formed its first fund investing in corporate credit risk and started operations through a subsidiary. Previously, it had packaged its guarantees according to the degree of risk and sold these packages to all financial institutions for them to hedge risks. But by forming new funds, it is aiming to diversify its opportunities for profits and to expand the risk that it underwrites, thereby accelerating growth (as of March 2018, the fund association consisted of four consolidated subsidiaries and one equity-method affiliate).

In January 2012, eGuarantee acquired the factoring business of Coface Japan Finance Co Ltd., the Japanese arm of Coface Group, which is a leading French credit guarantee group. The purpose of the acquisition was to upgrade and expand the Company's business foundations and bolster its product development capabilities by obtaining expertise related to export credit guarantees. By leveraging the expertise obtained through this acquisition, eGuarantee entered into business alliances with local financial institutions in South Korea in December 2013 and China in June 2014, and has commenced export credit guarantee service business in those countries.

Alongside the expansion of its business scope, in 2013 the Company established eGuarantee Solution Inc., as a subsidiary to carry out sales-related administrative work (contract-related work and data registration services) and in 2014, it established RG Guarantee, Inc., as a subsidiary to be a specialized provider of small-ticket credit guarantee services. Then 2017, it separated the sales-related administrative work from eGuarantee Solution, Inc. and newly established eGuarantee Shared Services, Inc.

Company history

Month/year	Main events
September 2000	Established in Minato-ku, Tokyo as a subsidiary of ITOCHU Corp.'s financial, real estate, insurance and distribution company to guarantee financial credit held by factoring companies mainly as a result of the settlement of electronic commercial transactions
November 2001	Started offering a comprehensive guarantee service to non-financial companies through which it guaranteed the sales credit accumulated by companies in their normal course of business
February 2004	Started offering an individual guarantee service through which it guaranteed the sales credit accumulated by a single company
August 2004	Started a full-scale guarantee service for financial companies other than factoring companies
March 2007	Listed shares on the JASDAQ Securities Exchange
August 2008	Arranged Credit Creation 1, the company's first fund for investment in corporate credit risk
November 2009	Arranged Credit Investment 1
December 2011	Listed shares on the Second Section of the Tokyo Stock Exchange
January 2012	Purchased part of the business of Coface Japan Finance Co., Ltd., a member of a leading French credit guarantee group
April 2012	Established Denshi Saiken Acceptance Ltd., a joint venture with NEC Capital Solutions This joint venture purchases electronically registered credits at a discount and engages in factoring and securitization (it was dissolved in 2015)
December 2012	Listed shares on the First Section of the Tokyo Stock Exchange
November 2013	Established eGuarantee Solution, Inc. as a subsidiary to conduct contract-related administration work, data registration services and other related activities
December 2013	Entered into a business alliance with a leading local financial institution in South Korea and launched export credit guarantee services in the South Korean market
March 2014	Established RJG Guarantee Co., Ltd. as a subsidiary to provide small-ticket credit guarantee services
June 2014	Entered into a business alliance with the Tokyo Branch of China-based Bank of Communications and commenced export credit guarantee services in China
September 2014	Arranged the Credit Guarantee 1 fund
April 2015	Arranged the Credit Guarantee 1 fund
December 2017	Established the subsidiary eGuarantee Shared Services to carry out various administrative work
March 2018	Arranged Credit Guarantee 3

Source: Prepared by FISCO from the Company's materials

Consolidated subsidiaries (investment stakes, business content)

Company name	Investment stake (%)	Investment stake (%)
eGuarantee Solution, Inc.	100.0	Systems development
RG Guarantee, Inc.	80.1	Small-ticket sales credit guarantee service
eGuarantee Shared Services	100.0	Various administrative duties
Credit Link Fund 1	50.0	Credit risk investment and operation
Credit Investment 1	65.3	Credit risk investment and operation
Credit Guarantee 1	51.0	Credit risk investment and operation
Credit Guarantee 2	55.0	Credit risk investment and operation

Source: Prepared by FISCO from the Company's materials

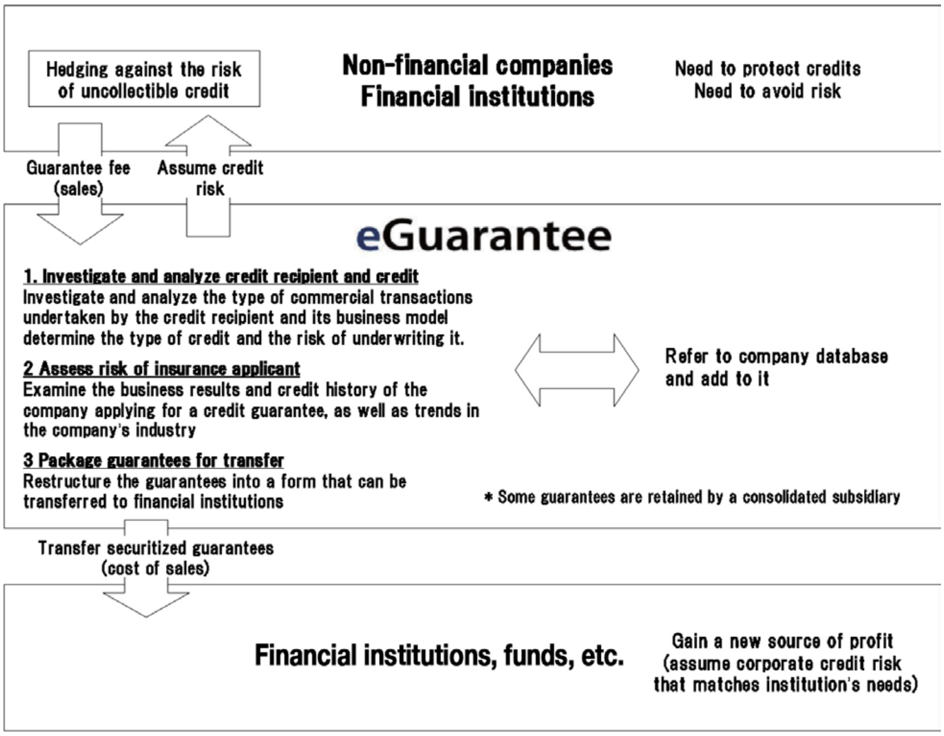
A stock-type business model that accumulates net sales from the "balance of guarantees outstanding x the guarantee fee ratio"

2. Business overview

(1) Description of businesses

eGuarantee's main business is insuring against the sales credit risk arising through transactions among companies. This business is illustrated graphically below.

Business flow



Source: Prepared by FISCO from the Company's securities report

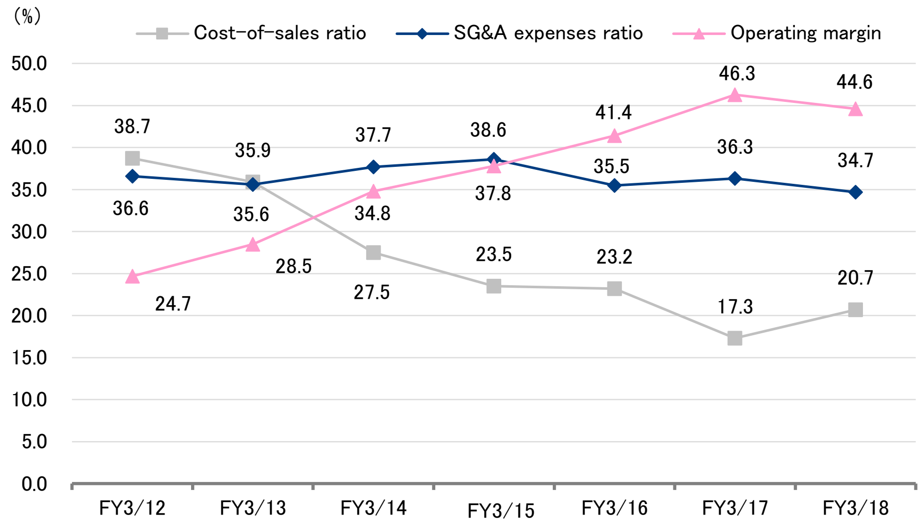
First, eGuarantee and its client company sign a contract by which eGuarantee promises to pay to the client a fixed amount to compensate for a sales credit from transactions with other companies if it should become irrecoverable by paying a guarantee fee to eGuarantee, the client company minimizes its risk of loss from an irrecoverable sales credit. In other words, the client company is able to pay a certain guarantee fee in exchange for minimizing its risk of loss from an irrecoverable sales credit. Most contracts are effective for one year, and the client company pays the entire guarantee fee on the business day before the guarantee start date in principle. eGuarantee divides the sales proceeds into 12 equal monthly installments and records the sales every month, so month-to-month sales fluctuations are relatively small and this functions as a recurring revenue business model.

As eGuarantee's net sales are the product of its balance of guarantees outstanding times its guarantee fee ratio, the key to driving growth in net sales lies in increasing the balance of credit guarantees. eGuarantee refers to various data, including economic indicators published daily, trends in the number of corporate bankruptcies and the probability of credit default based on past experience, and revises guarantee fees every month based on this data. When the number of corporate bankruptcies is decreasing, the credit risk is lower. This means that the guarantee fee ratio will also be set lower. The actual guarantee fee ratio is set for individual contracts and based on the result of eGuarantee's investigations of risk associated with the companies subject to the guarantee. eGuarantee is not bound by industry practice in setting its guarantee fee, but sets a fee that justifies the cost of hedging the risk for the client.

In regard to the credit risk assumed by the Company, eGuarantee packages its guarantees into a portfolio of financial risk products according to risk. It then transfers the guarantees to financial institutions, investment funds and other entities (securitization). Upon the transfer of credit risk, eGuarantee pays guarantee fees and commissions to the entities that accept its guarantee packages. These guarantee fees and commissions constitute the bulk of eGuarantee's cost of sales.

Therefore, eGuarantee's gross margin depends mainly on the spread between the guarantee fee ratio agreed upon by the Company and its clients and the reinsurance fee ratio that applies to fees and commissions paid by the Company to the entities that accept the transfer of credit risk. eGuarantee has been reducing the cost-of-sales ratio by diversifying and upgrading its methods of transferring credit risk to lower the reinsurance fee ratios and by arranging investment funds at a subsidiary that shrinks the amount of guarantee fees paid to third parties. It has also benefited from a lower deflation ratio than anticipated. Although the cost of sales ratio has been on a declining trend in recent years, in the fiscal year ended March 31, 2018 the cost of sales ratio has increased due to the start of middle-risk credit guarantee services.

Ratio to net sales



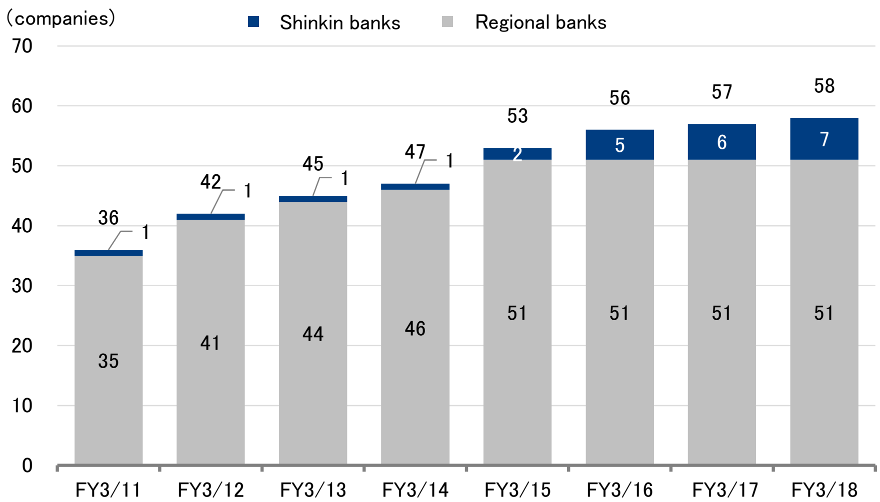
Source: Prepared by FISCO from the Company's financial results

(2) Operational structure

In addition to its head office in Tokyo, eGuarantee has opened branches in Osaka, Fukuoka, Aichi, and Hokkaido in the course of expanding its network across Japan. The Company plans to maintain its current operational structure in terms of its business locations for the time being. Meanwhile eGuarantee has efficiently developed customers by forming business alliances with financial companies, primarily regional banks, trading companies, leasing firms and other partners. In particular, eGuarantee had entered into business alliances with 51 regional banks as of the end of March 2018, establishing an alliance network spanning nearly all of Japan. Looking at the breakdown of the number of customer referrals, referrals from regional banks now account for around 80% of the total, followed by referrals via trading companies and those from other channels. Additionally, eGuarantee has been ramping up business alliances with shinkin banks, which have many local small and medium-sized companies among their customers, since FY3/16 and had alliances with seven shinkin banks at the end of March 2018.

eGuarantee had more than 2,000 client companies, ranging from small and medium-sized enterprises to major corporations. Furthermore, the Company screens the credit of over 20,000 companies every month. eGuarantee's customers are spread out evenly across a multitude of industries, including the wholesaling, retailing, and manufacturing sectors, and this means that its business performance is not susceptible to business volatility in any particular sector.

Number of business partners (regional banks, shinkin banks)



Source: Prepared by FISCO from the Company's materials

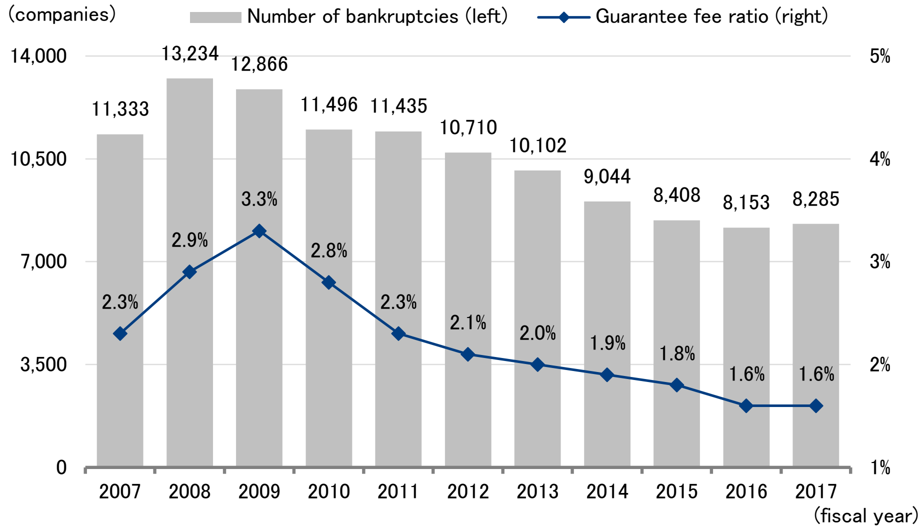
The size of the sales credit market exceeds ¥200tn with robust growth potential

3. Market size

The size of the market for trade receivables (trade notes and accounts receivable) targeted by the eGuarantee's mainstay service is estimated to be more than ¥200tn. While not all of these trade receivables will require credit risk guarantee services, trade receivables guarantee services are used extensively in the US and Europe and have robust growth potential.

In addition, the number of corporate bankruptcies, which has an impact on the guarantee fee ratio, has continued to decline since peaking out in fiscal 2008. In fiscal 2017, the number of corporate bankruptcies shifted to an increase of 1.6% YoY to 8,285, an increase for the first time in nine years. In addition to the ongoing recovery of the Japanese economy, accommodative loans terms from banks under an ultra-low interest rate policy, and other positive factors form the backdrop to the declining number of corporate bankruptcies. The fewer number of corporate bankruptcies has been accompanied by a decline in the guarantee fee ratio, and the guarantee fee ratio currently stands at just under 2%. A decline in the guarantee fee ratio is a negative factor that pushes down net sales. Meanwhile, considering that a lower guarantee fee ratio also reduces the fees paid to acceptors of securitized guarantees, a decrease in the guarantee fee ratio is a neutral factor that has no impact on the gross margin. During an economic recovery, companies tend to see an increase in the number of their new transaction counterparties in step with sales growth, and tend to generate surplus cash that can be used to hedge the credit risk of sales credits. For these reasons, the balance of credit guarantees outstanding tends to increase in recovery times.

Number of corporate bankruptcies in Japan



Note: Guarantee fee ratio = net sales ÷ (period-start/period-end average balance of guarantees outstanding)
Number of bankruptcies examined by Teikoku Databank
Source: Prepared by FISCO from the Company's materials

4. Risks

We examine the risks that should be taken into consideration when looking at eGuarantee's business performance. The following are the three primary risks that could affect the Company's business results. However, we believe that these risks do not present major concerns at this time.

(1) Profit-structure risk

The Company's profit structure is that it records as net sales the guarantee fees it receives from customers, and it records as costs of sales the payments to financial institutions and others that transfer risk to it, with the difference between these two amounts being the Company's profits. The payments to the customers that transfer risk to it are determined by the track record in executing guarantees over several years, so even if it temporarily incurs large costs from the execution of guarantees, this will not become a factor causing costs to rise in the short term. However, during a period in which the execution of guarantees continues to occur frequently, such as during an economic recession, the risk-transference cost rises. If the Company cannot transfer this rise in the risk-transference cost to the prices of guarantee fees, it becomes a factor causing profitability to deteriorate. Also, on the one hand it is possible that demand for the Company's services will increase during an economic recession due to the rise in the risk of bankruptcy, but on the other hand, it also considered possible that the balance of guarantees outstanding will decrease due to a decline in the number of contracts from a rise in the guarantee fee ratio and a fall in the contract-renewal rate. In FY3/09, which was the time of the last economic downturn, the balance of guarantees outstanding declined 2% on the end of the previous fiscal year, but net sales increased by double-digits due to the rise in the guarantee fee ratio. There is also the risk that the Company will be unable to execute guarantees during an unprecedented economic recession in the event of the management collapse of the financial institutions and others that transfer risk to it.

(2) Competition risk

There are hardly any other companies like the Company that specialize in providing sales credit guarantee services, but there are factoring companies affiliated to major financial institutions that provide guarantee factoring as a similar service, and also property insurance companies that provide transaction credit insurance and other such services. However, in terms of the scope of the companies that are targets of the guarantees, the guarantee-limit amount, and the credits targeted, the Company's strengths include that it is able to respond flexibly to diverse customer needs, so at the present time it is considered to have almost no competition risk. However, if in the future, financial institutions or other companies develop the same services as the Company and launch businesses, thereby causing competition to intensify, its profitability may decline. The Company does face some competition from a small-scale provider of a small-ticket sales credit guarantee service, of Trust & Growth Co., Ltd., which is a subsidiary of Raccoon Co., Ltd. <3031>. But small-ticket sales credit guarantees constitute only a small percentage of the Company's total business and the penetration rate of this service is also low, so this competition has hardly any effect on it.

(3) Legal-regulations risk

Credit risk guarantee services are not subject to legal regulations, such as the Insurance Business Act and the Financial Instruments and Exchange Act. However, if in the future legal regulations relating to these services are newly enacted, this may affect the Company's results, such as changing its business model or changing the competitive environment.

Financial results

For the 11th consecutive fiscal period since its listing, set new record highs for profits from the growth of the balance of guarantees outstanding

1. Summary of FY3/18 results

In the FY3/18 consolidated results, net sales increased 11.5% YoY to ¥5,105mn, operating profit rose 7.4% to ¥2,276mn, recurring profit grew 7.0% to ¥2,302mn, and net profit attributed to owners of parent increased 9.9% to ¥1,468mn. In the context of the steady performance of the Japanese economy, the Company is aiming to expand the base of its credit risk undertaking business, and as a new channel, it has entered-into business alliances with the Bank of The Ryukyus, Limited. <8399> and three other companies. In addition, by strengthening consulting sales, include by setting detailed guarantee fee ratios against the backdrop of its advanced screening capabilities, re-approaching customers that it came into contact with in the past, and providing services according to customer needs, at the end of the fiscal period the balance of credit guarantees outstanding had risen steadily, up 15.6% on the on the end of the previous fiscal year to ¥345.3bn.

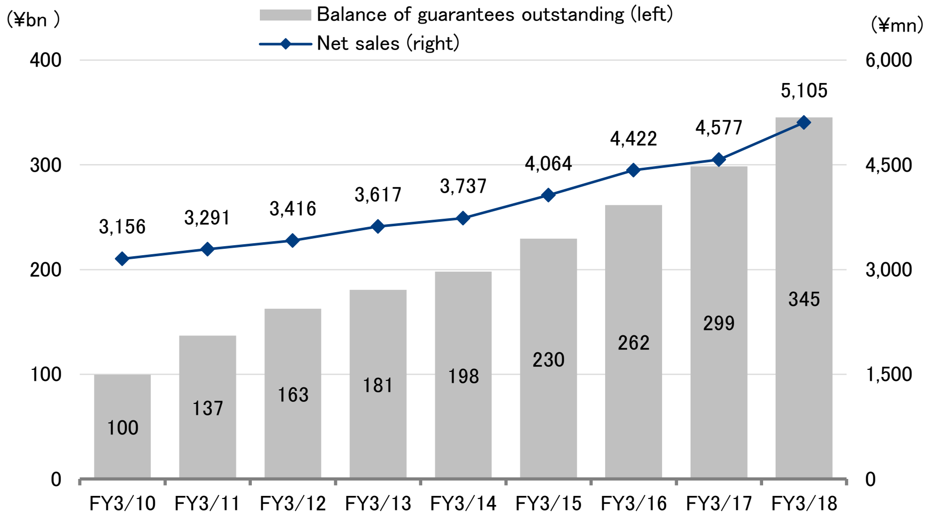
Consolidated financial results for FY3/18

(¥mn)

	FY3/17		FY3/18				
	Results	Ratio to net sales	Forecasts	Results	Ratio to net sales	YoY change	vs. forecast
Net sales	4,577	-	5,200	5,105	-	11.5%	-1.8%
Cost of sales	794	17.3%	-	1,056	20.7%	33.0%	-
SG&A expenses	1,663	36.3%	-	1,772	34.7%	6.6%	-
Operating profit	2,119	46.3%	2,270	2,276	44.6%	7.4%	0.3%
Recurring profit	2,152	47.0%	2,300	2,302	45.1%	7.0%	0.1%
Net profit attributed to owners of parent	1,335	29.2%	1,450	1,468	28.8%	9.9%	1.3%

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

Balance of credit guarantees outstanding and net sales



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

The cost-of-sales ratio rose 3.4 percentage points compared to the previous fiscal year to 20.7%. But this was because the re-guarantee fee increased due to the Company not restricting its credit guarantee targets to the low-risk zone and expanding them to as far as the middle risk zone. From the analysis of customer and other data that it has accumulated up to the present time, it improved the accuracy of bankruptcy probabilities and judged that generating profits from the middle zone was possible even when providing guarantees for it, and started developing operations for it in FY3/18. For example, in the past the Company targeted the sales credits of companies with a bankruptcy probability of 1% or less, but it has expanded the scope of this to 1.5%. Initially, this will be a factor causing the cost-of-sales ratio rise, but it seems likely that it be able to set highly precise guarantee fee ratios by accumulating a track record of results.

Also, compared to the initial Company forecasts, net sales were 1.8% below forecast. But this was because the middle risk credit guarantees with high guarantee fee ratios were less than forecast, and the balance of guarantees outstanding achieved its forecast. Conversely, on a profits basis, the low-risk zone credit guarantees were above forecast, and also the costs ratio improved more than expected, so profits were slightly higher than forecast.

Is financially sound and building a business model that is highly profitable and stable

2. Financial conditions and indicators

Looking at the financial position at the end of FY3/18, total assets were up ¥2,635mn the end of the previous fiscal year to ¥14,368mn. The main change factors were that in current assets, cash and deposits increased ¥1,825mn due to the sales of shares (¥1,281mn) held in the ESOP (Employee Stock Ownership Plan) Trust and also from the higher earnings, and that in non-current assets, tangible non-current assets rose ¥502mn on the acquisition of an employee dormitory.

Total liabilities were up ¥1,470mn on the end of the previous fiscal year to ¥4,928mn. The main change factors were that deposits increased ¥1,107mn following the sales of shares held in the ESOP Trust, and also that alongside the growth of the balance of credit guarantees outstanding, advances received and income taxes payable increased by ¥160mn and ¥105mn, respectively. Net assets were up ¥1,164mn on the end of the previous fiscal year to ¥9,440mn. Retained earnings increased ¥1,047mn, while treasury shares decreased ¥166mn (an increase factor) following the sales of shares in the ESOP Trust.

Looking at the financial indicators, the equity ratio, which is an indicator of financial stability, declined 2.4 percentage points on the end of the previous fiscal year to 58.0%, but this was due to the increase in deposits following the sale of shares held in the ESOP Trust. Moreover, the Company has an abundance of cash and hand and no outstanding interesting-bearing debt, so it is judged to be highly financially sound. Looking at the indicators of profitability also, the operating margin fell slightly compared to the previous fiscal year to 44.6%, including due to the start of the strategic underwriting of middle risk, but even so a high level of profitability is being maintained. Further, both ROA and ROE declined slightly compared to the previous fiscal year, to 17.6% and 19.0% respectively. But if we look at the last few years, we see that they are being maintained at high levels, and that highly stable profit is one of the features of the Company.

Consolidated balance sheet and indicators

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	Change
Current assets	6,801	7,443	8,809	10,918	2,109
(Cash and deposits)	4,561	5,403	6,627	8,453	1,825
Fixed assets	2,801	3,202	2,924	3,450	525
Total assets	9,602	10,645	11,733	14,368	2,635
Current liabilities	3,218	3,389	3,342	4,812	1,470
Fixed liabilities	210	146	115	115	-
(Interest-bearing debt)	126	70	5	-	-5
Total liabilities	3,429	3,536	3,457	4,928	1,470
Net assets	6,173	7,109	8,275	9,440	1,164
(Stability)					
Equity ratio	53.8%	56.7%	60.4%	58.0%	-2.4pt
Interest-bearing debt ratio	2.4%	1.2%	0.1%	-	-0.1pt
(Profitability)					
ROA	17.3%	18.3%	19.2%	17.6%	-1.6pt
ROE	18.8%	19.9%	20.4%	19.0%	-1.4pt
Operating margin	37.8%	41.4%	46.3%	44.6%	-1.7pt

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

Business outlook

The outlook is for the higher sales and profits to continue in FY3/19 also, from the extremely strong demand for sales credit guarantees

1. FY3/19 outlook

The outlook for the FY3/19 consolidated results is for double-digit increases in sales and profits, with net sales increasing 11.6% YoY to ¥5,700mn, recurring profit rising 10.7% to ¥2,550mn, and net profit attributed to owners of parent growing 10.3% to ¥1,620mn. The Company's policy will be to continue to actively underwrite risk, including undertaking middle risk, while paying attention to the economic climate and bankruptcy trends. On the other hand, it is also preparing for changes to the risk environment in the future and undertaking risk based on careful risk assessments. In addition, it is working to develop products and services that meet customers' needs in new forms, while also aiming to accumulate the balance of guarantees outstanding through expanding its sales resources.

Demand at the present time continues to be plentiful, and if looking only at the number of inquiring companies, it has doubled compared to a year and a half ago. Inquiries are increasing from companies that want to develop new customers and to grow sales while hedging against the risk of sales credit bad debt. For major companies also, in an increasing number of cases they are deciding that using the Company's services is more efficient than using their own in-house human resources to manage sales credits of below a certain level. Furthermore, it seems that synergies are being created, of companies entering-into contracts for the Company's low risk guarantee services in conjunction with its provision of middle risk credit guarantees. The middle risk balance of guarantees outstanding is currently only a few percent of the total balance, but the policy going forward is to gradually increase it.

Other than the above, the progress being made in the revitalization of regional banks with low service utilization rates (with few referrals) is leading to an increase in the number of customers. Depending on the bank that is the alliance partner, there are banks with low service utilization rates even among the alliance banks. The effects of the measures for these banks, such as appealing to the merits of the banks' customer companies using the Company's services, started to appear in FY3/18, and this momentum is being maintained in FY3/19 also.

Consolidated results outlook for FY3/19

(¥mn)

	FY3/18		FY3/19		
	Results	Ratio to net sales	Results	Ratio to net sales	YoY change
Net sales	5,105	-	5,700	-	11.6%
Operating profit	2,276	44.6%	2,510	44.0%	10.3%
Recurring profit	2,302	45.1%	2,550	44.7%	10.7%
Net profit attributed to owners of parent	1,468	28.8%	1,620	28.4%	10.3%

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

2. Key policies

The Company has set two key policies for FY3/19; expanding the scale of guarantees by increasing sales resources, and strengthening the ability to undertake risk in preparation for the expansion of the scale of guarantees.

(1) Expanding the scale of guarantees by increasing sales resources

In order to respond to the plentiful demand, the Company is aiming to strengthen its sales force and education system. It is also working to improve operational efficiency through a fully-fledged review of sales administrative work, and to increase the number of contracts and to expand the scale of guarantees.

In terms of the personnel system, the Company had 149 employees at the end of FY3/18 (consolidated basis). Of these, around 100 were members of the sales department, and it plans to increase the number of employees in this department by around 20% a year. Also, in the review of sales administrative work, it will clearly distinguish the staff who are directly involved in sales from the middle office staff who are involved in preparing proposals and other such work, toward establishing a structure that makes it easier for the sales force to concentrate exclusively on sales activities with customers, thereby improving the productivity of sales.

The Company is also aiming to streamline back office operations by transferring them to a subsidiary, eGuarantee Shared Services, which it newly established in 2017. In addition, the subsidiary eGuarantee Solution is strengthening systems development in order to improve operational efficiency, and the intention is to improve productivity in all of the companies through pursuing the systemization of various operations. The Company also has in sight utilizing AI technologies in the future. It recruits around 20 new graduates a year, and going forward it intends to recruit more personnel, including mid-career hires, alongside the growth in results.

(2) Strengthening the ability to undertake risk in preparation for the expansion of the scale of guarantees

In order to build a securitization structure in preparation for the expansion of scale of guarantees, the Company is establishing a system to stably undertake risk over the long term and strengthening its ability to undertake risk through forming funds in which the main sponsor is an organization other than the Company itself. Already in March 2018, it announced that it will invest as a silent partner in the Credit Guarantee No. 3 joint venture company (investment stake 49%, investment amount, ¥96mn).

As the situation of long-term, low interest rates continues, the yield from fund management by financial institutions and others is declining, so needs for new investment destinations are strengthening. Therefore, the Company's policy going forward is to expand the scale of guarantees by also utilizing fund composition through minority investments. For the fund's management period as well, funds are being formed not only of one year, but also of three years, which is a comparatively long period. So for the credit guarantee period, the Company can provide a long-term guarantee service of a three-year guarantee, and as the guarantee fee ratio is higher for long-term guarantees, this will become a factor increasing sales. Also, by expanding the scope of guarantees from low risk to middle risk, the scope of the financial institutions that are the securitization destinations and the funds are also widened, which could ultimately lead to an expansion of the scale of guarantees.

Aiming for consolidated recurring profit of ¥5bn as the medium-term target

3. The medium-term target

As its medium-term management target, the Company is aiming for consolidated recurring profit of ¥5bn. In terms of the standard to achieve this target of ¥5bn, the balance of guarantees outstanding must approximately double on the end of the previous fiscal period, to approximately ¥700bn to ¥800bn. If growth continues at around the current pace of 15%, then the prospect is that it will be able to achieve this target in FY3/23.

In order to grow the balance of guarantees outstanding, it is thought that growth of about 15% a year is possible through, as previously mentioned, the Company working to strengthen the sales structure and improve productivity by increasing operational efficiency, and also by expanding the scope of credits it targets (up to middle risk and to various credits other than sales credits*). Also, currently around 80% of its new customers are referrals from regional banks and it has built a network that covers almost all of the country. But it is working to further enhance its sales network by expanding its alliance partners to other business categories.

* Small-ticket credits, purchase credits, special credits, loan credits, long-term bonds, etc.

In particular, recently, against the backdrop of the expansion of the EC market, needs have been growing from companies that are developing the B2B marketplace on the Internet that want to utilize the Company's sales credit guarantee service as one type of financial service. So it is expected that alliances with these companies will increase in the future.

Shareholder return policy

Aiming to continue to increase the dividend alongside the growth in profits

The Company's basic dividend policy is to pay dividends in line with earnings while also considering supplementing the internal reserves it needs to strengthen its financial structure and to actively develop its business. The standard for the dividend payout ratio is around 30%. Looking at the trend up to the present time, since the Company starting paying dividends in FY3/09, it continuously and consecutively increased it up to FY3/18, and it has expressed its intention to continue to increase the dividend in the future also, if the profit growth is maintained. In FY3/19, it plans to pay a dividend of ¥22.5 (dividend payout ratio, 29.3%), which is unchanged YoY. But at FISCO, we think that it is highly possible it will increase it, if the results achieve their forecasts.

In addition, the Company has a shareholder gift program. Specifically, eGuarantee uniformly awards a QUO card worth ¥1,500 to each shareholder who holds 100 or more shares at the end of March every year. Based on the share price (¥2,123) as of June 20, 2018, the total return on investment for each shareholder holding one unit of shares was 1.8%.

Information security

As the Company handles information on its customer companies and others through its guarantee service business, it is aware that information security measures are an important management issue. Therefore, it is taking various steps to ensure information security, including updating to the latest security software, restricting access to the information management system according to the person in change and the managerial position, and providing education and training on information management.

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FISCO Ltd.