COMPANY RESEARCH AND ANALYSIS REPORT

eGuarantee, Inc

8771

Tokyo Stock Exchange First Section

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Index

Summary

Sales Credit Guarantee Services Enter the Spotlight With the Spread of COVID-19

The core business of eGuarantee, Inc., <8771> (hereafter, also “the Company”) is to provide credit risk guarantee services targeting the 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 has a recurring revenue business model in which its net sales are calculated as the balance of outstanding guarantees multiplied by the guarantee fee ratio. A strength is being able to set an optimal guarantee fee ratio due to its capabilities of gathering corporate information from more than 25,000 companies per month and advanced screening capabilities. It mainly acquires new customers through partner financial institutions and the like and has maintained growth by continuing to increase its balance of credit guarantees outstanding.

1. FY3/20 results

In its FY3/20 consolidated results, the Company reported higher profits on higher sales, with net sales increasing 6.9% year-on-year (YoY) to ¥5,956mn, and ordinary profit growing 7.8% YoY to ¥2,751mn. The balance of credit guarantees increased steadily, up 13.0% from the end of the previous fiscal year to ¥439.1bn. The main reasons for the increase were efforts to strengthen measures with sales channels to increase new customers, along with measures to improve the contract renewal rate through penetration of web services. There was also an increase in requests to add companies covered by guarantees and to increase the amount of credit guarantee limits toward the end of the fiscal year, due to the impact of coronavirus disease 2019 (COVID-19). In comparison to the Company’s forecasts, net sales were 3.9% below forecast, because the average guarantee fee ratio was slightly lower than initially expected. However, ordinary profit was in line with forecast due to an improvement in the SG&A expenses ratio. The Company has continuously achieved higher profits on higher sales in every year since its listing.

2. FY3/21 outlook

The forecasts for the FY3/21 consolidated results are for higher profits on higher sales, with net sales to increase 29.3% YoY to ¥7,700mn and ordinary profit to rise 9.1% to ¥3,000mn. The Company’s sales credit guarantee service has been rapidly attracting interest amid the heightened risk of uncollectible sales credits in B2B transactions due to the rapid deterioration in economic conditions caused by COVID-19. Based on this, the Company foresees an increase in new customers, as well as growth in the balance of credit guarantees among existing customers. In addition, sales are projected to increase based on a rise in the guarantee fee ratio against the backdrop of an increase in the risk of bankruptcy. The Company also expects an increase in the cost of securitizing risk in connection with an increase in the guarantee execution amount due to a higher number of bankruptcies. The higher cost is expected to reduce the ordinary profit margin. Recently, inquiries from small and medium-sized enterprises about the Company’s guarantee services have been up sharply. As its top priorities, the Company plans to fulfill its roles to support business infrastructure by providing optimal services to meet these kinds of needs, and encourage greater penetration of guarantee services.

3. Medium-term outlook

At the current time, the Company's numerical management target is consolidated ordinary profit of ¥5,000mn, and the balance of credit guarantees necessary to achieve this level will be in the range of ¥700bn to ¥800bn, which is almost double the amount at the end of the previous fiscal year. While growth at the 20% level is anticipated in the current fiscal year, assuming that growth continues at a pace in the lower-10% range, which was the level until the previous fiscal year, the target is expected to be within reach by FY3/24. General interest in sales credit guarantee services is expected to increase as business continuity, financial and other risks are reassessed due to the spread of COVID-19. With its expertise in gathering and analyzing credit data on companies, the Company is expected to continue to develop the market as an industry frontrunner, as it keeps on achieving sustainable growth.

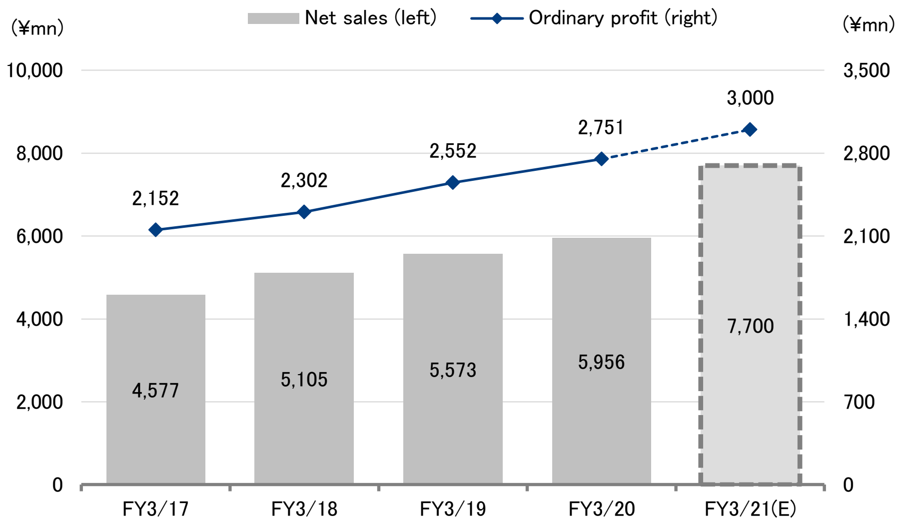
4. Shareholder return policy

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 FY3/21, eGuarantee plans to issue an annual dividend of ¥14.0 per share, the same as in FY3/20, representing a dividend payout ratio of 30.5%. 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

- Built a recurring revenue business model that accumulates net sales from "the balance of outstanding guarantees x the guarantee fee ratio"
- Aiming for higher profits on higher sales in FY3/21 by focusing on the provision of services to small and medium-sized enterprises, for which demand will increase due to the spread of COVID-19
- The Company has significant long-term growth potential. Its medium-term target of ¥5.0bn in consolidated ordinary profit is only a milestone

Results trends



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

Company overview

eGuarantee guarantees companies' risk of irrecoverable sales credits and other claims 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 strengthen its ability to undertake risk, thereby accelerating growth. As of March 2020, the fund association consisted of six 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 in-house system development and 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 in 2017, it separated the sales-related administrative work from eGuarantee Solution, Inc. and newly established eGuarantee Shared Services, Inc. In October 2019, the Company established eGuarantee Investment, Inc. to undertake investments in startup companies and acquire, hold and manage securities.

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 (currently, Credit Link Fund I), 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 <8793>. 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 RG Guarantee, Inc. 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 2 fund
December 2017	Established the subsidiary eGuarantee Shared Services, Inc. to carry out various administrative work
March 2018	Arranged the Credit Guarantee 3 fund
May 2019	Arranged the Credit Guarantee 4 fund
June 2019	Capital and business alliance with H.I.S. Impact Finance Co., Ltd., a financial subsidiary of H.I.S. <9603>
October 2019	Established the subsidiary eGuarantee Investment, Inc. to conduct corporate venture capital operations
March 2020	Began a sales credit purchasing service
March 2020	Arranged the Credit Guarantee 5 fund

Source: Prepared by FISCO from the Company's materials

Consolidated subsidiaries (investment stakes, business content)

Company name	Investment stake (%)	Main business
eGuarantee Solution, Inc.	100.0	Systems development
RG Guarantee, Inc.	80.1	Small-ticket sales credit guarantee service
eGuarantee Shared Services, Inc.	80.1	Administrative outsourcing services
eGuarantee Investment, Inc.	100.0	Corporate venture capital operations

Note: excluding silent partners
Source: Prepared by FISCO from the Company's securities report

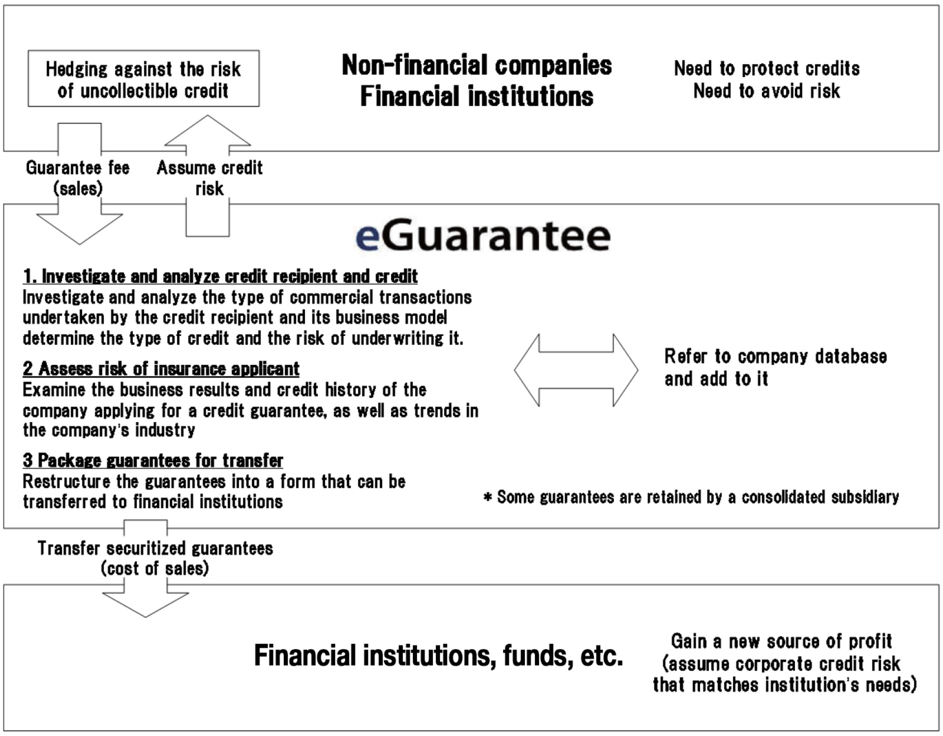
Built a recurring revenue business model that accumulates net sales from "the balance of outstanding guarantees x the guarantee fee ratio"

2. Business overview

(1) Description of businesses

eGuarantee's main business is to guarantee the credit risk associated with sales credit and other claims arising through transactions among companies. This business is illustrated graphically below.

Business flow



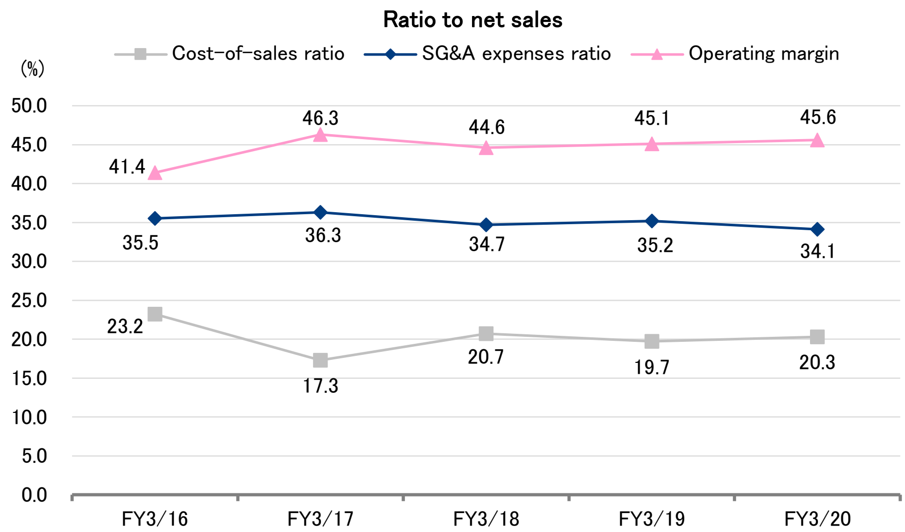
Source: Prepared by FISCO from the Company's securities report

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. 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 determined by its balance of outstanding guarantees multiplied by the 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 increasing, the credit risk is higher. This means that the guarantee fee ratio will also be set higher. 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 cost-of-sales ratio depends mainly on the spread between the guarantee fee ratio agreed upon by the Company and its clients and the re-guarantee 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 re-guarantee fee ratios by diversifying and upgrading its methods of transferring credit risk, along with strengthening its ability to undertake risk by forming funds at a subsidiary and cutting costs by shrinking the amount of guarantee fees paid to third parties. Each fund can accept risk to the scale of ¥20bn-¥100bn and is funded by the likes of financial institutions. Over the past few years maintenance and improvement of operating performance have become difficult as interest rates have continued to be ultra-low, but there is strong demand for the funds and the Company has been able to procure funding under favorable terms. Due to the aforementioned measures, as well as a lower than anticipated default ratio, the Company has managed to keep the cost-of-sales ratio at a low level of around 20% over the past few years.



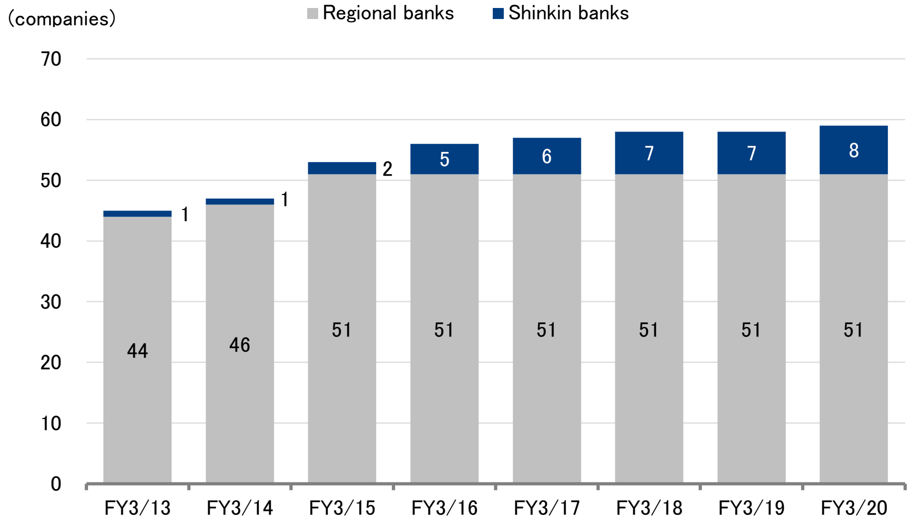
Source: Prepared by FISCO from the Company's financial results

(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 2020, 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. 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 8 shinkin banks at the end of March 2020.

The Company has a total of more than 3,500 customers, ranging from SMEs to major companies, over a wide range of industries, including wholesale, retail, and manufacturing, so its results are not affected by economic fluctuations in specific industries. From these customers, the Company collects information on the companies it will target to screen in its services, and it creates a database of this information. The number of screened companies exceeds 25,000 every month, and it creates a database not only of management information, but also of information such as manager-attributes data and peripheral information, and analyzes the degree of risk and sets the optimum guarantee fee ratio. The database also contains other information, including on the managers' gender, age group, and the evaluation status of external word-of-mouth sites, and finally, it sets the optimal credit guarantee rate taking into consideration factors like the screener's experience. There is no other company that conducts such as thorough analysis to this extent, and it has become one of the Company's strengths.

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

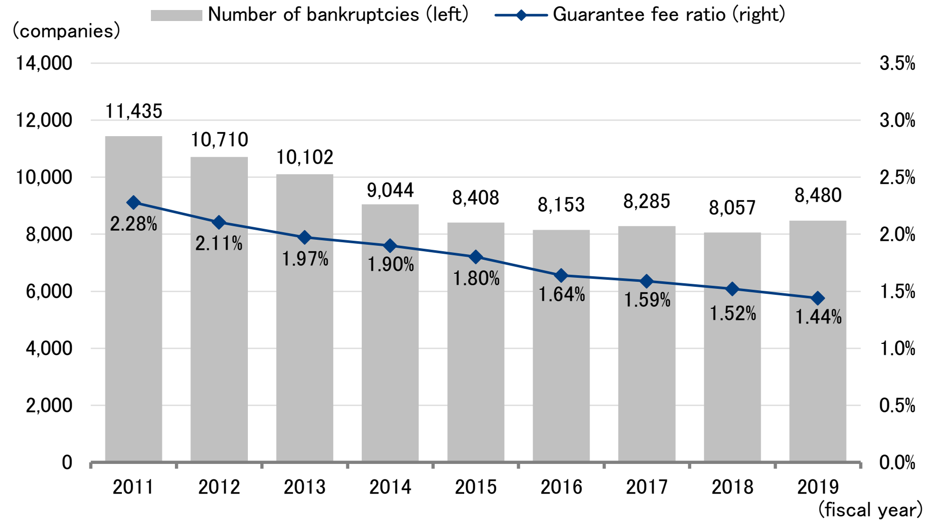
3. Market size

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 FISCO believes that these services have robust growth potential.

In addition, the number of corporate bankruptcies, which has an impact on the guarantee fee ratio, had been in continuous decline since peaking out at 13,234 in fiscal 2008. In fiscal 2019, the number of corporate bankruptcies rose 5.3% YoY to 8,480, turning upwards for the first time in two years. On a monthly basis, the number of corporate bankruptcies has continued to increase compared with the same month of the previous year since September 2019. This trend reflects the global economic slowdown, and the gradual deceleration in the Japanese economy due to a consumption tax hike in October 2019. Also, with the recent declaration of a state of emergency in connection with the spread of COVID-19 and related factors, the number of corporate bankruptcies has been increasing further. Looking at the trend in the average guarantee fee ratio, which is the Company's guarantee fee divided by the average balance of guarantees outstanding, the average guarantee fee ratio had continued to decline to 1.44% in fiscal 2019. Recently, however, the Company has raised the guarantee fee ratio in step with the increase in the number of corporate bankruptcies (from 1.62% in December 2019 to 2.13%* in March 2020). In fiscal 2020, the guarantee ratio is forecast to increase in line with the increase in the number of corporate bankruptcies. While an increase in the guarantee fee ratio is a factor that will push up net sales, there will also be an increase in costs paid to counterparties to whom the Company transfers risk because of an increase in the guarantee execution amount due to bankruptcies of companies with sales credits covered by guarantees. For this reason, a greater than expected increase in the number of corporate bankruptcies and similar factors could be a factor that reduces the gross margin.

* The average guarantee fee ratio for new contracts only.

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 risk factors 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 the guarantee fees it receives from customers as net sales, and it records the payments it makes to financial institutions and others to which the Company transfers risk as cost of sales, with the difference between these two amounts being the Company's profits. The payments to the counterparties to whom the Company transfers risk 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. Moreover, while demand for the Company's services could increase due to a rise in bankruptcy risk during economic recessions, the balance of guarantees outstanding could decrease due to a decline in the number of contracts and a reduction in the contract renewal rate.

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 to which the Company transfers risk.

(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 RACCOON FINANCIAL, Inc., which is a subsidiary of RACCOON HOLDINGS, Inc. <3031>. But small-ticket sales credit guarantees constitute only a small percentage of the Company's total business, 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

Continued to achieve higher profits on higher sales since listing based on steady growth in the balance of credit guarantees

1. Summary of FY3/20 results

In the FY3/20 consolidated results, net sales increased 6.9% YoY to ¥5,956mn, operating profit rose 8.2% to ¥2,718mn, ordinary profit grew 7.8% to ¥2,751mn, and profit attributable to owners of parent increased 39.3% to ¥2,301mn, and the results were once again record highs with higher profits on higher sales. The balance of credit guarantees grew steadily, increasing 13.0% from the end of the previous fiscal year to ¥439.1bn.

Several measures to build up the balance of credit guarantees met with success. For example, the Company strengthened measures with sales channels such as partner financial institutions and others to increase new customers, along with expanding consulting sales activities, such as proposing ways to streamline operations carried out by companies such as credit management and credit collection. The Company also expanded the breadth of its customers to new sectors such as companies providing third-party payroll payment services through such means as partnerships with FinTech-related companies. Moreover, in measures for existing customers, the Company worked to improve the renewal rate by forming a specialist team of slightly more than 10 members, and strove to improve user convenience by, for example, enabling customers to submit additional applications online. With the spread of COVID-19 from March, there was also an increase in requests from existing customers concerned about the risk of uncollectible sales credits to add companies covered by guarantees and to increase the amount of credit guarantee limits, among other requests. These increased requests also led to an increase in the balance of credit guarantees.

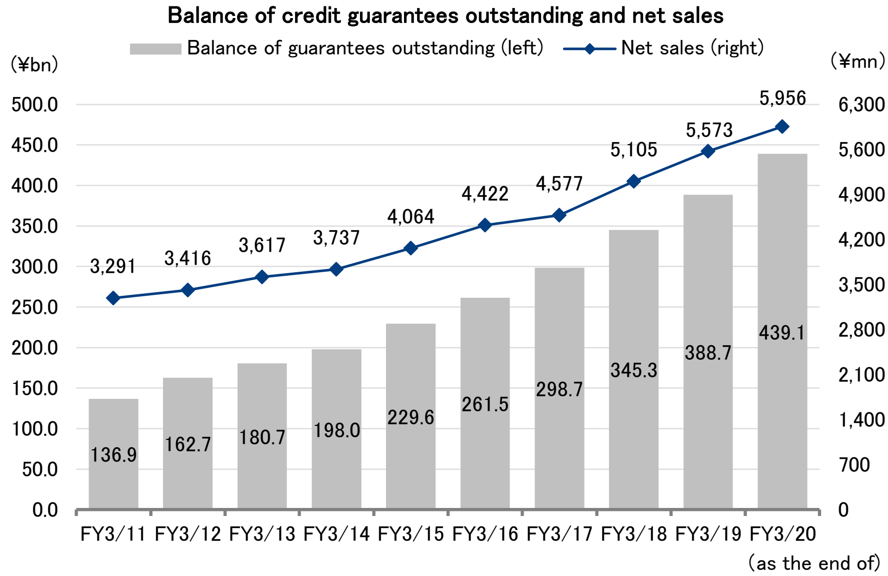
In comparison to the Company's forecasts, net sales underperformed by 3.9%, because the average guarantee fee ratio was slightly lower than initially expected. However, every level of profit was in line with forecast as the Company managed to hold down the SG&A expenses ratio. The operating margin rose from 45.1% to 45.6%. SG&A expenses rose YoY because of increases in personnel expenses and rent expenses on land and buildings. Profit attributable to owners of parent rose substantially YoY, reflecting a decrease in corporate tax due to an Employee Stock Ownership Plan (ESOP) Trust distribution (which is included in deductible expenses).

Consolidated financial results for FY3/20

(¥mn)

	FY3/19		FY3/20				
	Results	Ratio to net sales	Forecasts	Results	Ratio to net sales	YoY change	vs. forecast
Net sales	5,573	-	6,200	5,956	-	6.9%	-3.9%
Cost of sales	1,098	19.7%	-	1,208	20.3%	10.0%	-
SG&A expenses	1,962	35.2%	-	2,029	34.1%	3.4%	-
Operating profit	2,512	45.1%	2,700	2,718	45.6%	8.2%	0.7%
Ordinary profit	2,552	45.8%	2,750	2,751	46.2%	7.8%	0.0%
Profit attributable to owners of parent	1,651	29.6%	2,200	2,301	38.6%	39.3%	4.6%

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



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

Looking at news topics for FY3/20, the Company entered into a capital and business alliance with H.I.F. Co., Ltd., a finance subsidiary of HIS Co., Ltd. <9603> in June 2019, as part of efforts to expand its sales channels (the investment ratio was almost 10%). Under this alliance, the Company has started undertaking credit risk for FinTech-related services such as the payment agency services developed by H.I.F. Specifically, the Company undertakes credit risk for third-party payroll payment services and third-party payment services for the purchases of construction businesses. In anticipation of the widespread adoption of the FinTech market, the Company had planned to focus on credit risk undertaking services in this market, but it is now proceeding with a cautious stance due to a heightened degree of risk.

Moreover, in December 2019, the Company announced a business alliance with Daiwa House Industry Co., Ltd. and its group company acca international Co., Ltd. (acca). Under this alliance, the Company has started a new loan guarantee service using the inventory data of logistics facility tenants. Specifically, the Company screens companies that are using the logistics facilities of Daiwa House Industry and the ALIS (integrated e-commerce data management system) of acca. In the event of a default in sales credits due to bankruptcy or other reasons, eGuarantee is contracted by each company to pay guarantee money to financial institutions up to a payment limit set by each company. The system is designed to allow the Company to determine the degree of risk based on factors such as the daily inventory data of logistics facility tenants, and to provide guarantees for irrecoverable sales credits. By taking a different approach than conventional financial systems, the Company provides credit to logistics facility tenants. This initiative thus paves the way for the Company to fulfill new needs for loans and expand its customer base. While the impact on business performance is negligible, this is one example that shows how the Company is working to expand its sales channels to acquire customers.

In March 2020, the Company started a new sales credit purchasing service. It is an optional service for existing customers expected to face cash flow problems due to the spread of COVID-19. The service supplies temporary funds to these customers by having the Company's subsidiaries or partner financial institutions purchase the customer's sales credits that have a maturity date in the future. Although the service works in almost the same way as factoring services, the service stands out because the purchase rate is set at 0.18%*, which is much lower than the purchase rate for factoring services. In addition, given that many inquiries have been received from companies that do not use eGuarantee's guarantee services, the Company will provide a new product for such companies under the service name "eG Settlement Service." For the "eG Settlement Service," the purchase rate will be set at 0.3 to 3.5% (the rate will vary with screening results).

* This purchase rate assumes the closing of the account at the end of the month and payment at the end of the following month. Purchase rates will vary with payment conditions. It is said that the purchase rate for ordinary factoring services is set at no less than the 1% level.

Realizing high profitability and stability through a recurring revenue model, with financial soundness

2. Financial condition and indicators

Looking at the financial condition at the end of FY3/20, total assets were up ¥17mn from the end of the previous fiscal year to ¥16,444mn. The main changes in current assets were decreases of ¥239mn in cash and deposits and ¥383mn in prepaid expenses, and increases of ¥1,802mn in securities and ¥279mn in accounts receivable – other. In non-current assets, investment securities decreased by ¥1,548mn and software declined by ¥79mn.

Total liabilities decreased ¥1,820mn from the end of the previous fiscal year to ¥3,646mn. Advances received, which represent the source of future net sales, rose ¥412mn, while deposits received decreased ¥1,891mn due to an Employee Stock Ownership Plan (ESOP) Trust distribution. In addition, income taxes payable decreased by ¥463mn. Net assets rose ¥1,838mn from the end of the previous fiscal year to ¥12,798mn. This increase was mainly because of an increase of ¥1,749mn in retained earnings.

Looking at the financial indicators, the equity ratio, which is an indicator of financial stability, rose substantially to 70.3%, up 10.6 PP from the end of the previous fiscal year. This increase partly reflected a decrease in deposits received due to an ESOP Trust distribution. Considering that the Company is practicing debt-free management and has an abundant level of cash and deposits of more than ¥9.0bn, the Company can be judged to be highly financially sound. Looking at the indicators of profitability, with an operating profit margin of 45.6%, ROE of 21.5%, and ROA of 16.7%, the Company has steadily maintained a high level of profitability across each of these indicators over the past few years. The main reasons for this performance are that the Company has a recurring revenue business model that records guarantee fees as net sales in even monthly amounts, provides a service for which there is steady demand regardless of strong or weak economic conditions, and has a solid competitive advantage with virtually no competitors.

Consolidated balance sheet

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20	YoY
Current assets	7,443	8,809	10,828	12,036	13,645	1,609
(Cash and deposits)	5,403	6,627	8,453	9,471	9,232	-239
Non-current assets	3,202	2,924	3,540	4,390	2,799	-1,591
Total assets	10,645	11,733	14,368	16,427	16,444	17
Current liabilities	3,389	3,342	4,812	5,350	3,531	-1,819
(Advances received)	2,233	2,389	2,549	2,647	3,059	412
Non-current liabilities	146	115	115	115	115	0
Total liabilities	3,536	3,457	4,928	5,466	3,646	-1,820
(Interest-bearing debt)	70	5	-	-	-	-
Net assets	7,109	8,275	9,440	10,960	12,798	1,838
(Stability)						
Equity ratio	56.7%	60.4%	58.0%	59.7%	70.3%	10.6pt
Interest-bearing debt ratio	1.2%	0.1%	-	-	-	-
(Profitability)						
ROA	18.3%	19.2%	17.6%	16.6%	16.7%	0.1pt
ROE	19.9%	20.4%	19.0%	18.2%	21.5%	3.3pt
Operating margin	41.4%	46.3%	44.6%	45.1%	45.6%	0.5pt

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

Business outlook

Continuing to target higher profits on higher sales in FY3/21, by focusing on services for small and medium-sized enterprises for which there are growing needs due to the spread of COVID-19

1. FY3/21 outlook

Economic conditions continue to rapidly deteriorate due to the spread of COVID-19. In this environment, the Company's policy is to expand services based on cautious risk-taking decisions and implement measures to strengthen its operational structure to address surging needs. Concurrently, the Company will closely monitor trends in corporate bankruptcies and changes in the economic environment. In addition, the Company will strive to achieve greater penetration of guarantee services so that these services can fulfill their role as economic infrastructure. This will be done by reviewing risk assessments to reflect any economic deterioration going forward and providing timely services at prices that justify the risks. Notably, many small and medium-sized enterprises, which employ about 70% of Japan's domestic workforce, have been forced to cope with a challenging business environment, particularly in the restaurant, services and other sectors. In response, the Company's policy is to support small and medium-sized enterprises from many different angles, to ensure that they are able to overcome the current crisis situation.

Based on the aforementioned management policies, the Company's outlook for consolidated results in FY3/21 is as follows. Net sales is forecast to increase 29.3% YoY to ¥7,700mn. Operating profit is expected to rise 9.6% YoY to ¥2,980mn, and ordinary profit to increase 9.1% YoY to ¥3,000mn. Profit attributable to owners of parent is forecast to decrease 15.3% YoY to ¥1,950mn. As in previous years, the Company aims to increase the balance of credit guarantees at a pace of growth in the lower 10% range in comparison to the end of the previous fiscal year.

Consolidated results outlook for FY3/21

(¥mn)

	FY3/20		FY3/21		
	Results	Ratio to net sales	Forecasts	Ratio to net sales	YoY change
Net sales	5,956	-	7,700	-	29.3%
Operating profit	2,718	45.6%	2,980	38.7%	9.6%
Ordinary profit	2,751	46.2%	3,000	39.0%	9.1%
Profit attributable to owners of parent	2,301	38.6%	1,950	25.3%	-15.3%
Earnings per share (¥)	54.14		45.88		

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

The main reason for the large increase in net sales is that the Company expects the number of applications from new customers to increase based on the heightened need to hedge the risk of uncollectible sales credits due to the impact of COVID-19. The Company also expects business with existing customers to increase slightly. Another reason for the increase in net sales is that the Company has raised the guarantee fee ratio for contracts with new customers (from 1.62% in December 2019 to 2.13% in March 2020)* to reflect recent trends in corporate bankruptcies. This means that even if the guarantee amount stays the same, guarantee fees (=net sales) will increase by 31% from March 2020 onward in comparison with December 2019. Given that guarantee fees are recorded as net sales in even monthly amounts over the guarantee period, the rate of sales growth tends to increase in step with an increase in new contracts. That is why, in its semi-annual sales forecasts, the Company expects net sales to show an additional increase from 1H to 2H FY3/21, from ¥3,500mn in 1H, up 20.4% YoY, to ¥4,200mn in 2H, up 37.7% YoY. The Company has also noted that it could increase the guarantee fee ratio again depending on trends in the number of corporate bankruptcies going forward.

* The guarantee fee ratio for new customers. A separate guarantee fee ratio is set for existing customers at a different rate.

Despite the large projected increase in net sales, the growth rate in operating profit is forecast at only 9.6%. This is mainly because the Company expects an increase in the guarantee execution amount due to an increase in the number of corporate bankruptcies, and an increase in the cost of securitizing risk in connection with the increased guarantee execution amount, given that most of the risk undertaken by the Company is securitized. That said, the need for sales credit guarantee services has been increasing in a wide range of sectors, including the restaurant and other service sectors and the retail sector, due to the recent rapid deterioration in business sentiment and the uncertain outlook for the future. Considering this, FISCO believes that there is upside potential for operating profit. Profit attributable to owners of parent is forecast to decrease mainly because of the absence of impacts such as the decrease in corporate tax attendant to the end of the ESOP Trust. The number of employees as of the end of FY3/20 was around 150, with 24 new graduates joining the Company in April 2020.

Plans for FY3/21 call for a focus on providing services to meet the strong needs of small and medium-sized enterprises

2. Key policies

The Company is working on three key policies for FY3/21 as outlined below.

(1) Strengthen the operational structure to address heightened risk hedging needs

The need to hedge the risk of uncollectible sales credits has been increasing rapidly due to the spread of COVID-19. Against this backdrop, the Company intends to expand the range of companies using sales credit guarantee services by raising market recognition of those services through the placement of advertisements in newspapers and other media. In addition, the Company will approach customers that it did not have the opportunity to interact with previously, and it will work to re-engage with customers with whom it has had interactions in the past. Notably, the Company believes that there is a heightened need for its services among small and medium-sized enterprises. Based on this belief, the Company will strive to acquire those customers.

Conversely, the Company is not currently taking proactive steps to win orders for services to replace credit management work with sales credit guarantee services, which had contributed to a build-up in the balance of credit guarantees until the previous fiscal year as a service for large companies. The Company recognizes that in the current market environment, small and medium-sized enterprises, which serve as the backbone of the Japanese economy, are facing a crisis situation. With this in mind, the Company believes that its most important priority at this time is to support small and medium-sized enterprises.

The Company also plans to develop and supply in-demand services in a timely manner. One example of such services is the sales credit purchasing service launched in March 2020. Since March, customers have approached the Company about this service in many ways through inquiries, consultations and other means. The Company's stance is to propose that its clients first make use of public assistance programs such as government subsidy, zero-interest loan and other schemes announced by the government and municipalities. Next, the Company recommends that its clients negotiate extensions in payment deadlines with their business partners and if the cash flow situation is still difficult, the Company provides the sales credit purchasing service. The Company positions the sales credit purchasing service as a support service to help existing customers manage their businesses, not as a measure to expand its own earnings.

In other areas, from FY3/20 the Company has rolled out a service for existing customers that allows all processes from company screenings, applications and the issuance of bills to be completed online. This is an effective service even under a teleworking framework. By proposing this service, the Company will work to improve the usage rate of its sales credit guarantee services. For new customers, the Company does not offer a completely online service, because there are many documents that need to be confirmed when they enter into their first contracts. Offering such a service will be an issue to address in the future.

(2) Review of risk assessments of companies taken onboard

In consideration of the impact of COVID-19 on future economic conditions, the Company plans to review the risk assessments of each company covered by guarantee services and reset guarantee limits, as well as reflect risk assessment reviews in the guarantee fee ratios presented to customers. In addition, for existing customers, the Company seeks to improve renewal rates by making proposals according to risk conditions so that it can provide the guarantee limit amounts desired by customers while setting guarantee fee ratios that reflect the aforementioned reviews. In order to enhance the risk assessments of these companies, the Company plans to implement measures to obtain more detailed information when conducting screenings by increasing the number of personnel involved in corporate research.

(3) Building a foundation for expanding the information gathering system and new services that utilize information

Currently, the Company conducts corporate research on approximately 25,000 companies per month, and registers around 500,000 items of data per day covering various types of data registrations, including transaction and payment data. Through an increase in the number of customers, this amount of information will be increased all at once. Moreover, the Company will bolster its information gathering system by instituting ways of gathering even more information. For example, the performance evaluation criteria for sales staff has been augmented with a new criterion, volume of information gathered, in addition to the number of contracts sold. Furthermore, the Company has set its sights on providing new services using this information in the future and has plans to move forward with building the foundation for these services. While the specific details of the new services have not yet been determined, the Company is expected to develop services related to purchasing and sales in the e-commerce field.

The Company has significant long-term growth potential. Its medium-term target of ¥5.0bn in consolidated ordinary profit is only a milestone

3.Medium-term outlook

As its medium-term management target, the Company is aiming for consolidated ordinary profit of ¥5bn. In terms of the standard to achieve this target, the balance of guarantees outstanding must approximately double the current amount to just under ¥700bn to ¥800bn. While growth at the 20% level is anticipated in the current fiscal year, assuming that growth continues at a pace in the lower-10% range, which was the level until the previous fiscal year, the target is expected to be within reach by FY3/24.

In the course of growing the guarantee balance, in FY3/21, the Company plans to focus on providing services to small and medium-sized enterprises, which have a heightened need for its services due to worsening economic conditions, as mentioned earlier. The Company will push ahead with efforts to increase the guarantee amount for existing customers, through such means as providing online services. It appears possible for the Company to increase the guarantee balance, and the Company will continue working to expand sales channels through business alliances.

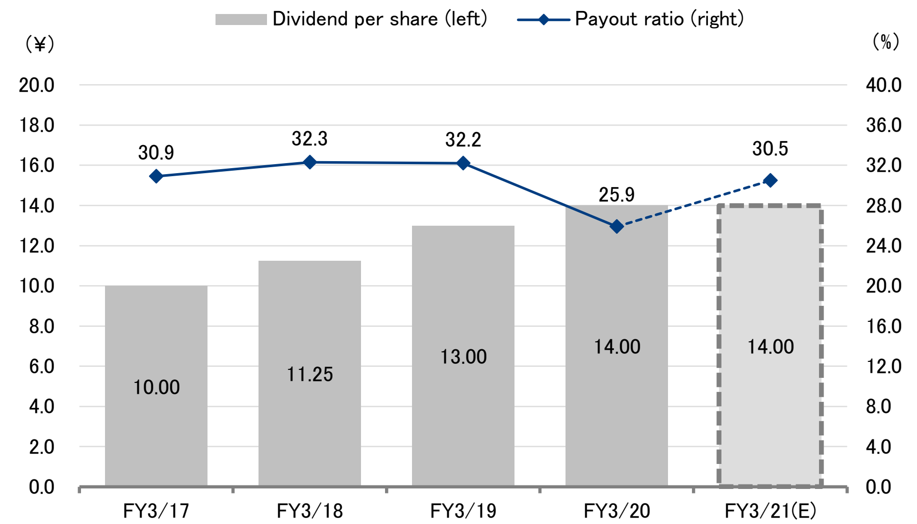
As a result of the recent spread of COVID-19, business continuity risk and financial risk will be reviewed once again, and credit risk guarantee services are expected to attract even more attention than in the past. Meanwhile, there are still very few competitors in this sector at present. As mentioned earlier, a key source of competitiveness in these services is the ability to gather the information needed to properly conduct risk assessments of companies. This means that the Company has a large early-mover advantage because it has established systems to store and evaluate immense amounts of credit information before others. FISCO expects that the target for ordinary profit of ¥5.0bn is only a milestone, and that the Company will continue to achieve steady growth over the long term.

Shareholder return policy

Dividends are paid targeting a dividend payout ratio of around 30%, with a shareholder gift program also in place

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 target for the dividend payout ratio is around 30%. In FY3/20, the Company paid a dividend of ¥14.0, an increase of ¥1.0 from the previous fiscal year, marking a dividend payout ratio of 25.9%. Excluding the impact of the decrease in corporate tax attendant to the end of the ESOP Trust, it is estimated that the dividend payout ratio would have been around the 30% level. In FY3/21, the Company plans to pay a dividend of ¥14.0, the same as in FY3/20, for a dividend payout ratio of 30.5%. If business results surpass the Company's forecasts, the chances of an increase in the dividend will be higher. 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 FY3/20, so a key focus will be whether the Company is able to continue this record of sustained dividend increases. 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.

Dividend trend



Note: The Company implemented 2-for-1 stock splits in March and August, 2018. The dividend was adjusted retroactively.
Source: Prepared by FISCO from the Company's financial results

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 charge and the managerial position, and providing education and training on information management.

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