COMPANY RESEARCH AND ANALYSIS REPORT

Fuyo General Lease Co., Ltd.

8424

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Summary

Posted sharply higher revenues and profits (all-time highs) in 1H FY3/18, healthy start toward attainment of new medium-term management plan goals

Fuyo General Lease Co., Ltd. <8424> (hereinafter, the Company) is a comprehensive leasing company affiliated with Mizuho Financial Group, Inc. <8411> (formerly The Fuji Bank, Limited) that was established in 1969 by six Fuyo Group companies, including Fuji Bank and Marubeni Corporation <8002>. Its strengths are information and office equipment and real estate leasing. The Company ranks sixth in the industry at ¥834.1bn in annual newly executed contract volume (FY3/17 result) and ¥2,081.3bn in operating assets (1H FY3/18). It has steadily accumulated operating assets and expanded income results by leveraging advanced solution capabilities for customer challenges, including asset management, cost control, and know-how from expertise.

In FY3/18, the Company started the medium-term management plan Frontier Expansion 2021, which lasts through FY3/22. With a slogan of “Going where no one has gone before,” it aims to be a corporate group with sustainable growth, despite major changes in the environment for domestic leasing business, through expansion of the business portfolio’s “frontier” by pursuing new business areas and business models. Its goals for five years from now are ¥2.5tn in operating assets (4.1% average annual growth), 2.0% ROA (+0.4ppt), and ¥50bn in ordinary profit (9.8% average annual growth). While the ordinary profit goal presents a tough hurdle, the Company hopes to reach this level through the combined impact of expanded operating assets and improved ROA.

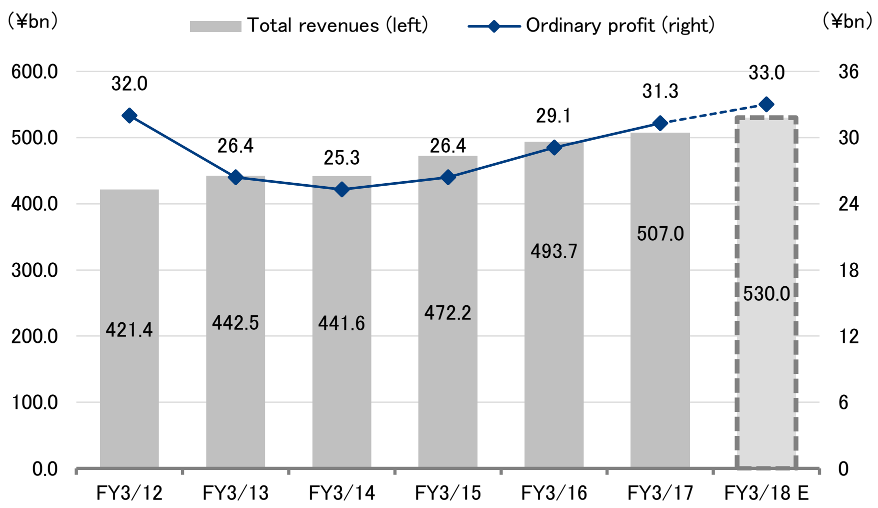
In 1H FY3/18, the first year of the new medium-term management plan, the Company posted ¥302.6bn in total revenues (+23.6% YoY) and ¥17.5bn in operating profit (+23.3%). Both revenues and profits rose at double-digit paces, and profits reached all-time highs (on a half-year basis). We think these results show a robust start toward realization of the new medium-term management plan. While the leasing industry modestly eased, the Company still achieved upbeat growth thanks to 1) expansion of newly executed contract volume and build-up of operating assets as a result, 2) improved gross margin on assets, and 3) profits booked on cancellation (sales) of major leasing deals. In particular, it benefited from healthy growth in aircraft and real estate businesses, which are strategic areas, and received an income boost from Accretive Co., Ltd. <8423> given its addition as a consolidated subsidiary in January 2017.

The Company maintained initial targets for FY3/18 that project higher revenues and profits with a 4.5% YoY rise in total revenues to ¥530bn and an 8.3% gain in operating profit to ¥31bn. We think it kept its initial forecast, despite the upbeat 1H results, due to taking a conservative stance in light of rapid changes in the business environment and uncertainties. We see room for upside considering high progress rates in 1H results and healthy advances in the Company’s initiatives, such as build-up of operating assets. Progress in strategic areas toward attainment of medium-term management plan goals is an important focus from a longer-term perspective. We will be paying close attention to the approach taken by the Company to improve ROA.

Key Points

- Started the new medium-term management plan Frontier Expansion 2021 (five-year plan) in FY3/18
- Posted sharply higher revenues and profits (all-time high profits on a half-year basis) in 1H FY3/18, a healthy beginning
- Achieved growth in aircraft and real estate businesses, which are strategic areas, and received an income boost from consolidation of Accretive
- Maintained FY3/18 forecast (projecting higher revenues and profits)
- Focus on progress in strategic areas and the approach to improving ROA from a longer-term perspective

Trends in total revenues and ordinary profit



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

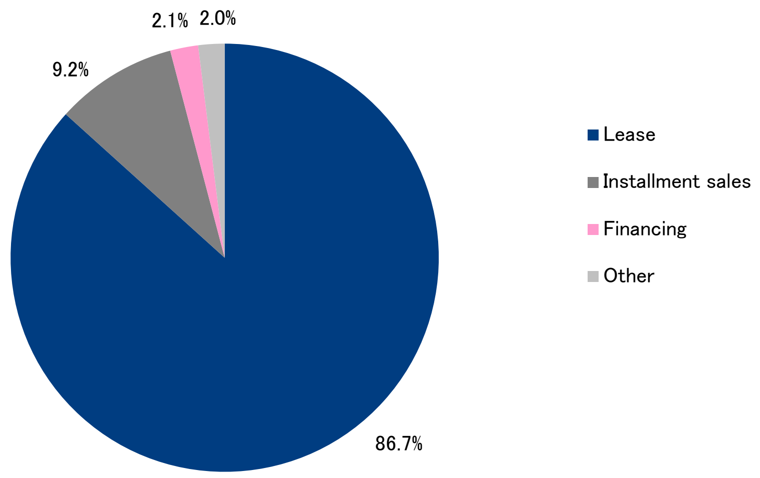
Company profile

Comprehensive leasing company with strengths in real estate, aircraft, and other areas, aggressively pursuing expansion into new domains

1. Business overview

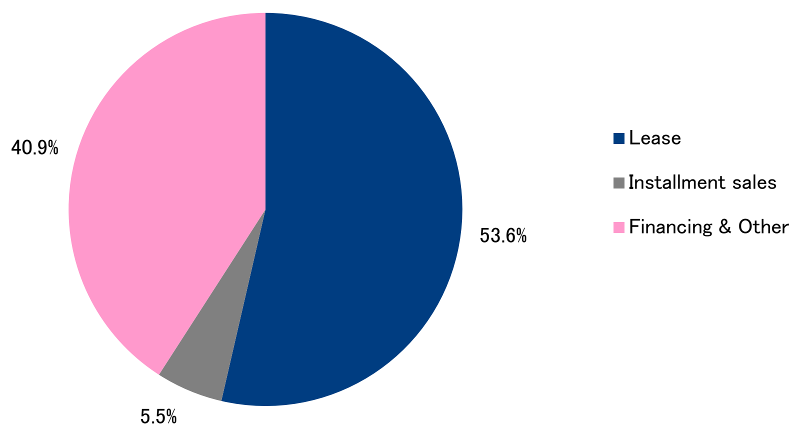
The Company has three business segments - lease and installment sales, financing, and other – and also provides disclosure of lease and installment sales separately. Mainstay lease business accounts for 86.7% of total revenues, 53.6% of newly executed contract volume, and 67.9% of operating assets (as of 1H FY3/18).

Revenue composition by segment



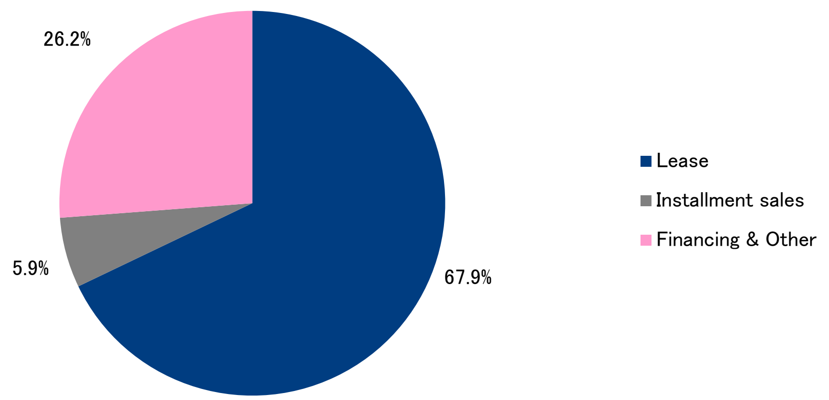
Source: Prepared by FISCO from the Company's financial results

Ratio of newly executed contract volume by segment



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

Ratio of operating assets by segment



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

Below, we review the Company's business segments.

(1) Lease and installment sales

This segment handles leases of information and communications equipment, office equipment, industrial machine tools, and other equipment and installment sales of commercial facilities, production facilities, hospital facilities, and other facilities. Operating assets amount to ¥1,412.9bn in leases and ¥122.9bn in installment sales.

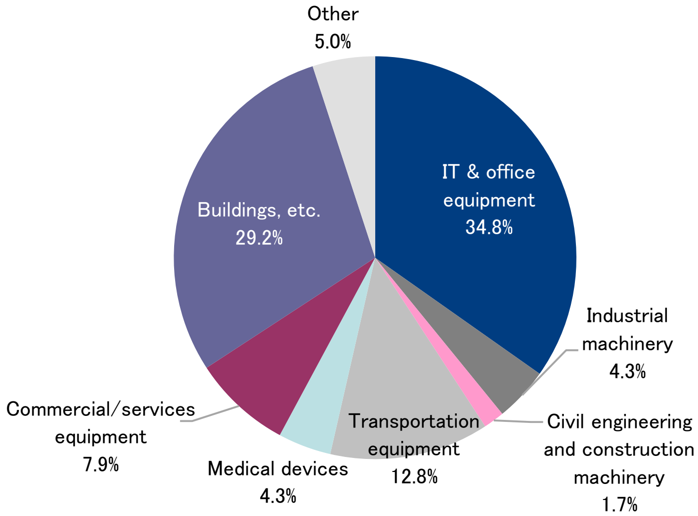
In lease business, the leasing company purchases and leases machinery, equipment, or other facilities selected by customers for a certain leasing fee over a relatively long period. In other words, leases constitute a fundraising method (financial transaction) that focuses on facility deployment. Benefits to customers, versus outright purchase (and ownership) of facilities, include efficient utilization of capital, reduction of administrative burden, avoidance of risk from outdated facilities, and cost control. Leasing companies, meanwhile, confront less collection risk than ordinary loan transactions because they possess ownership rights to the leased items. Leases come in two main types – finance leases*1 and operating leases*2. Finance leases account for just over 75% of lease operating assets.

*1 This type of lease transaction cannot be cancelled and requires effective coverage of all costs incurred in usage of lease items (item acquisition costs, funding costs, fixed asset tax, insurance premiums, etc.).
*2 This type of lease transaction refers to leases other than finance leases.

Installment sales are used for items that do not qualify as leasing for tax purposes and cases in which the customer wants direct ownership.

Information and office equipment hold a high percentage of newly executed contract volume in the breakdown by item. Furthermore, categories with strong growth recently are buildings, etc. (real estate leases) and transportation equipment. Key drivers in real estate leases are commercial properties (such as large shopping centers), an area of expertise, and business hotels, which have been growing recently thanks to rising inbound demand. The Company leverages its experience of over 30 years and an extensive network in this business given the need for expertise and know-how with tough legal hurdles and complex rights relationships. Furthermore, aircraft leases are driving growth in transportation equipment and the Company holds advantages in this area as well with its lengthy track record and robust know-how.

Newly executed lease contract volume (by type of equipment)



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

(2) Financing

This segment covers capital investment funding and other business loans, real estate financing, and securities-related management tasks. It has ¥526.3bn in operating assets, including corporate operating loans (such as syndicate loans) and retail funding through consolidated subsidiary Sharp Finance Corporation. The Company added factoring business* handled by Accretive, which became a consolidated subsidiary in January 2017.

* This business mainly handles FPS (early payment service for accounts receivable) for small businesses and FPS Medical (early payment service for medical and care fee credits) for medical institutions. It has a high turnover rate with execution and recovery in a short period, which the Company lacked up to now, and should contribute substantially to expansion of newly executed contract volume and improvement of gross margin on assets.

(3) Other

This segment includes megasolar operations (renewable energy business) handled directly by the Company, anonymous partnership set-up paperwork for aircraft leases and other business, and life insurance agent business. Operating assets total ¥19.1bn.

2. History

The Company was established in 1969 with six companies from the Fuyo Group as shareholders led by Fuji Bank (now, Mizuho Bank, Ltd.) and Marubeni-Iida Co., Ltd. (now, Marubeni).

It steadily broadened business scope thereafter and created a local entity in the US in 1988. It established a local entity in Ireland (Dublin), a major center for aircraft leases, in 1999. The Company was relatively early in its entry to aircraft business, which has recently attracted attention from many companies, and accumulated a track record and know-how with leveraged leases (aircraft leases with investor subscriptions) and other formats.

The Company has also teamed up with other companies to establish joint ventures, such as Yokogawa Rental & Lease Corporation (holds a large share in measuring instruments) with Yokogawa Electric Corporation <6841> in 1987 and Nihon Credit Lease Co., Ltd. (holds a large share in medical equipment and welfare equipment) with NICHIIGAKKAN CO., LTD. <9792> in 1999.

Major turning points were listing shares on the First Section of the Tokyo Stock Exchange in December 2004 and acquisition of Sharp Finance as a consolidated subsidiary (buying a 65% stake) in April 2008. Sharp Finance controls a strong share in the retail (vendor lease) area that is highly profitable and contributed substantially to broadening business scope and increasing scale.

In June 2014, the Company acquired ALM 2010 Limited (it changed the name to Fuyo Aviation Capital Europe Limited), a UK-based aircraft-related services companies, as a consolidated subsidiary (buying all shares) and thereby strengthened its ability to expand aircraft business.

In January 2017, it acquired Accretive, a subsidiary of Don Quijote Holdings <7532> that operates a factoring (purchase of accounts receivable) business mainly for small businesses, as a consolidated subsidiary via a tender offer (it owns shares with 51% of voting rights). It hopes to realize synergies from cross-selling with Group companies in addition to strengthening initiatives in new domains (including entry into the FinTech area) and collaborating with overseas sites.

Financial results

Healthy expansion of profit excluding the acquisition cost of leased items, which reflects actual growth in business income, through build-up of operating assets

1. Key points for assessing results

The Company's sales consist of lease fee revenue, which is roughly 85% of overall sales, revenue from installment sales, and interest income on operating loans. Since revenues fundamentally fluctuate with operating assets, the Company needs to increase newly executed contract volume and accumulate more operating assets in order to expand revenues. However, it should be noted that accounting of mainstay lease fee revenue reflects the purchase transaction and includes the price of the leased item. We hence think profit excluding the acquisition cost of leased items from revenues (hereinafter, profit excluding acquisition costs) is the suitable indicator for assessing income growth as business. This value corresponds to the asset balance multiplied by gross margin on assets. Movement in both of these amounts has an impact.

To ascertain profitability of the Company's main business, meanwhile, we think the most rational approach is monitoring ordinary profit that deducts interest expenses (fundraising costs), personnel and equipment costs, credit-related costs (including reversals)*, and other items from profit excluding acquisition costs.

* This is the net value of the bad-credit allowance provision (SG&A expenses) and bad-credit allowance reversal profit (non-operating income).

2. Past results trends

Looking at past results, revenues steadily trended upward thanks to build-up of operating assets (particularly lease operating assets). While profit excluding acquisition costs temporarily slipped in FY3/13 to FY3/14, it restored an upward trend from FY3/15. The setback in profit excluding acquisition costs mainly occurred because of decline in gross margin on assets accompanying reduction of lease fee rates due to tougher competition. The Company pursued income recovery through accumulation of operating assets and improvement in gross margin on assets. We think expansion of real estate leases and aircraft leases with relatively large yields contributed to improvement in gross margin on assets.

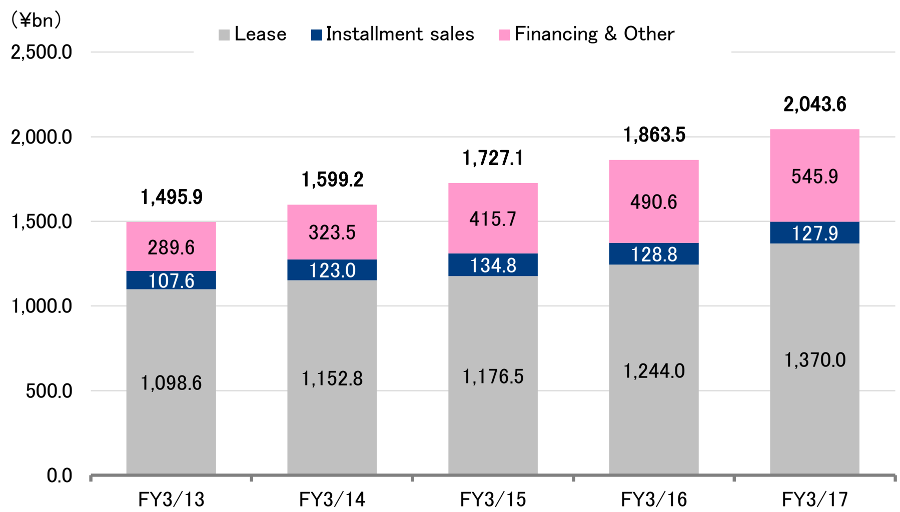
From a cost perspective, meanwhile, fundraising costs have been largely flat. This trend, despite growth in total fundraising value, is driven by decline in funding costs due to the impact of market rates. Additionally, the Company keeps personnel costs and equipment costs at a certain level and has low bad-credit costs. Low-cost operations, a strength, are paying off. Ordinary profit hence has risen for three straight fiscal years.

Interest-bearing debt has been growing because of build-up in operating assets, but the equity ratio remains steady at about 10%. The 10% range does not lag other companies in the leasing industry and should not spark concerns about stability of the Company's financial base.

ROA stayed at 1.4% even with intensification of interest rate competition. ROE, which reflects capital efficiency, however, trended lower, though it has offered signs of improvement since FY3/16.

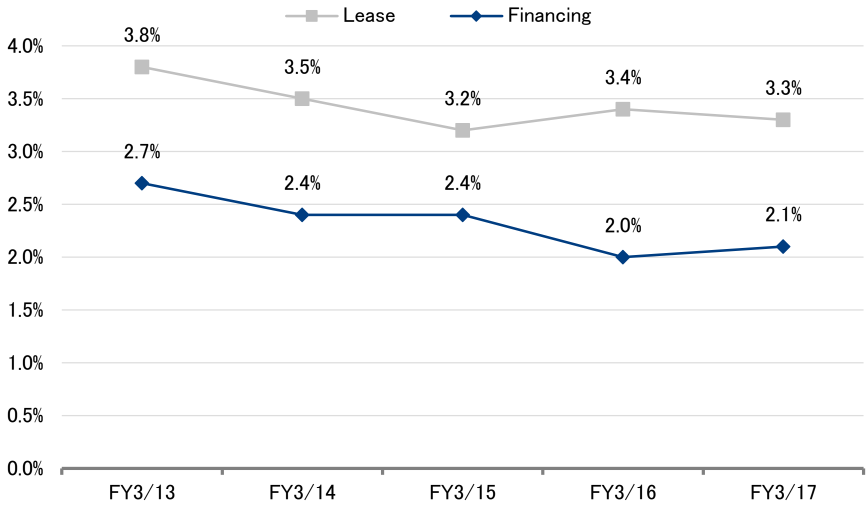
Operating cash flow remains negative and the size of this deficit has grown in the past three fiscal years. We think it is reasonable to interpret this as a reflection of the Company's growth potential because the main cause is aggressive build-up of operating assets, which are future income sources.

Trend in operating assets



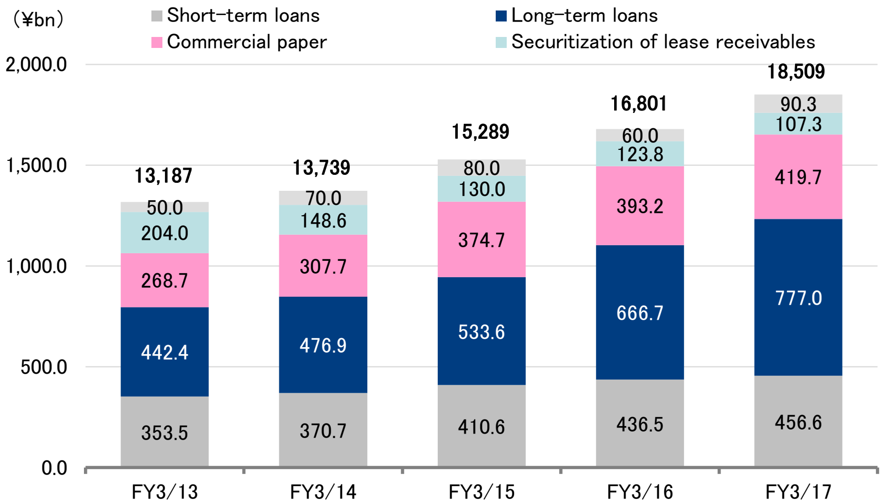
Source: Prepared by FISCO from the Company's results briefing materials

Trend in gross margin on assets



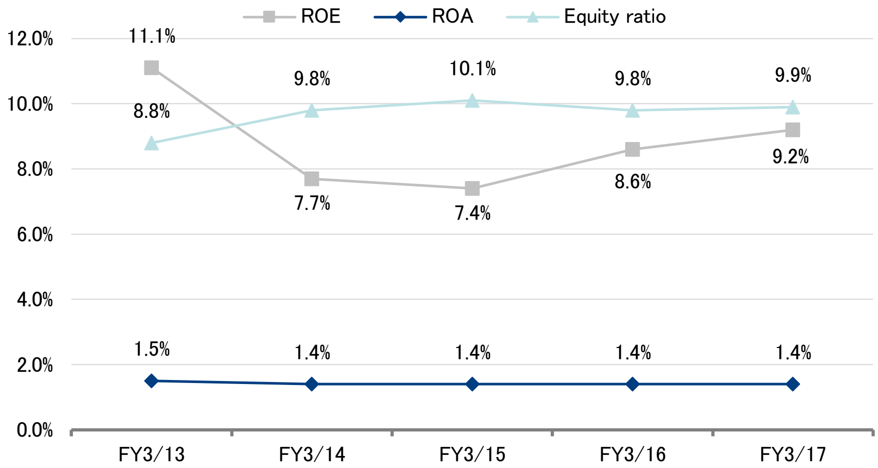
Source: Prepared by FISCO from the Company's results briefing materials

Trend in funding balance



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

Trend in equity ratio, ROA, ROE



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

Posted sharply higher revenues and profits (all-time high profits on a half-year basis) in 1H FY3/18, a healthy beginning toward realization of the new medium-term management plan

3. Overview of 1H FY3/18 results

In 1H FY3/18, the Company posted ¥302.6bn in total revenues (+23.6% YoY), ¥17.5bn in operating profit (+23.3%), ¥18.8bn in ordinary profit (+20.3%), and ¥11.7bn in profit attributable to owners of parent (+14.0%). Both revenues and profits rose at double-digit paces, and profits reached all-time highs on a half-year basis. We think these results show a robust start toward realization of the new medium-term management plan.

Revenues climbed significantly on accumulation of operating assets (lease assets), but also one-time additions totaling about ¥40bn from bulk recognition of cancellation (sales) income on large lease deals (real estate lease and bridge-type project).

Profit excluding acquisition costs, which reflects actual income growth, climbed at a healthy pace of 13.7% (+¥4.2bn) YoY to ¥34.8bn thanks to 1) expansion of newly executed contract volume and related build-up of operating assets, 2) improved gross margin on assets, and 3) profits booked on cancellation (sales) of major leasing deals. The first two items include the Accretive consolidation effect (adding about ¥1.3bn to profits).

While the leasing industry modestly softened during this period, the Company's profit excluding acquisition costs still increased because of a large 39.5% YoY rise in newly executed contract volume to ¥523.5bn and a 1.8% gain in operating assets from the end of FY3/17 to ¥2,081.3bn. A key source of the strong rise in newly executed contract volume was factoring activity* at Accretive, which was newly added to scope of consolidation. In mainstay lease business, meanwhile, transportation equipment (aircraft leases) and buildings, etc., which are strategic areas, exhibited healthy growth.

* The ¥104.5bn in newly executed contract volume from Accretive, acquired as a consolidated subsidiary in January 2017, was a new addition and accounted for about 70% of the overall increase in newly executed contract volume (¥148.3bn). Accretive reported ¥14.9bn in operating assets at the end of September 2017 (+6.4% from the end of FY3/17). Large newly executed contract volume compared to operating asset scale and growth is a unique aspect of factoring business that involves repeated execution and recovery in a short period (high turnover rate). This business also has a positive effect on profitability and efficiency.

In profitability (gross margin on assets), the Company realized improvements, even amid fierce interest rate competition, to 3.4% in lease business (vs. 3.3% at the end of FY3/17) and 2.4% in financing business (vs. 2.1%). The strong gain in gross margin on assets in financing business comes from consolidation of Accretive*. Lease business sustained a high level thanks to growth in assets with stronger profitability.

* We estimate that gross margin on assets in Accretive's factoring business is more than 17% (annualized) based on ¥14.9bn in operating assets at the end of September 2017 and ¥1.3bn in profit excluding acquisition costs (1H).

Furthermore, ordinary profit climbed sharply on increase in profit excluding acquisition costs as well as flat fundraising costs and curtailment of the rise in SG&A expenses to a certain level.

Financially, the Company's equity ratio slightly increased to 10.1% (vs. 9.9% at the end of FY3/17) as total assets expanded 2.4% (from the end of FY3/17) to ¥2,354.3bn on the gain in operating assets while shareholders' equity grew 4.5% to ¥238bn due to retained profit and other factors. Also, interest-bearing debt rose 3.4% to ¥1,803.4bn accompanying expansion of operating assets, but we think the Company is sustaining a stable financial position with the long-term debt ratio of interest-bearing debt at a high level of 61.9% (vs. 60.3% at the end of FY3/17) and a liquidity ratio of 144.7% (vs. 143.7%).

Summary of 1H FY3/18

(¥bn)

	1H FY3/17		1H FY3/18		Change	
		Ratio		Ratio		% change
Total revenues	2,449		3,026		577	23.6%
Lease	2,064	84.3%	2,624	86.7%	560	27.1%
Installment sales	282	11.5%	279	9.2%	-3	-1.1%
Financing	45	1.8%	64	2.1%	19	42.2%
Other	58	2.4%	60	2.0%	2	3.4%
Profit excluding acquisition costs	306	12.5%	348	11.5%	42	13.7%
Lease	215	10.4%	236	9.0%	21	9.8%
Installment sales	11	3.9%	11	3.9%	0	0.0%
Financing	45	100.0%	64	100.0%	19	42.2%
Other	35	60.3%	38	63.3%	3	8.6%
Interest expenses	36	1.5%	36	1.2%	-0	-0.3%
Gross profit	270	11.0%	312	10.3%	42	15.6%
SG&A expenses	128	5.2%	137	4.5%	9	7.1%
Operating profit	142	5.8%	175	5.8%	33	23.3%
Ordinary profit	157	6.4%	188	6.2%	32	20.3%
Profit attributable to owners of parent	103	4.2%	117	3.9%	14	14.0%
Newly executed contract volume	3,752		5,235		1,483	39.5%
Lease	2,570	68.5%	2,807	53.6%	237	9.2%
Installment sales	281	7.5%	285	5.4%	4	1.5%
Financing & Other	901	24.0%	2,143	40.9%	1,242	137.9%
Newly executed lease contract volume by type of equipment						
IT & office equipment	1,071		976		-95	-8.9%
Industrial machinery	236		122		-114	-48.3%
Civil engineering and construction machinery	27		47		20	74.1%
Transportation equipment	241		359		118	49.0%
Medical devices	119		120		1	0.8%
Commercial/services equipment	207		223		17	8.2%
Buildings, etc.	562		819		257	45.7%
Other	109		141		32	29.4%
Total	2,570		2,807		237	9.2%

	March 31, 2017		September 30, 2017		Change	
						% change
Operating assets	20,436		20,813		377	1.8%
Lease	13,698	67.0%	14,129	67.9%	431	3.1%
Installment sales	1,279	6.3%	1,229	5.9%	-50	-3.9%
Financing & Other	5,459	26.7%	5,455	26.2%	-4	-0.1%
Gross margin on assets						
Lease	3.3%		3.4%		0.1pt	
Financing & Other	2.1%		2.4%		0.3pt	
Total assets	23,001		23,543		542	2.4%
Shareholders' equity	2,278		2,380		102	4.5%
Equity ratio	9.9%		10.1%		0.2pt	
Interest-bearing debt	17,436		18,034		598	3.4%
Short-term	10,875		11,136		261	2.4%
Long-term	6,561		6,898		337	5.1%
Long-term debt ratio	60.3%		61.9%		1.6pt	

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

Below we review results and activities in the Company's strategic business areas.

a) Real estate

Operating assets increased by a hefty 16.4% (+¥39.4bn) from the end of FY3/17 to ¥279.6bn at the end of September 2017. The Company exhibited upbeat momentum in commercial facilities (such as large shopping centers), a strength, including finalization of a contract for a major site*1, and building leases for business hotels sustaining high occupancy rates amid vibrant inbound demand. It also already concluded a contract for a major deal in 2H*2 that is likely to raise operating assets to over ¥300bn. While ROA is slightly weak at 1.8% (vs. 1.9% in the previous fiscal year), the Company achieved some success in activities to improve profitability, such as proposal sales with land information and the start of rental business.

*1 It completed a contract for the TOC Minato Mirai multipurpose building with Colette Mare, a retail facility, as the centerpiece (Naka Ward, Yokohama) in May 2017.
*2 It completed a contract for PRIMETREE AKAIKE, a large shopping mall developed by Seven & i Holdings Co., Ltd. <3382> (Nisshin City, Aichi Prefecture), in November 2017.

b) Energy/environment

Operating assets in the solar power business increased 11.0% (from the end of FY3/17) to ¥19.1bn at the end of September 2017 (the Company did not launch any new operations). This business operates 29 megasolar sites nationwide (77MW in total power output) and is currently building massive megasolar facilities in three locations (60MW in total power output)* mainly in the Fukushima area (planned for completion in FY3/19). While ROA improved significantly to 7.9% (vs. 6.1% in FY3/17), this largely stems from seasonality (solar power facilities operate at a higher rate in the summer) and the full-year result should be roughly on par with the previous year.

* This includes facilities based on the Fukushima concept for a new energy society supporting the Fukushima Renewable Energy Promotion Vision that targets supplying renewable energy throughout the prefecture by around 2040.

c) Medical/social welfare

While specific numerical goals have not been given, main activity results were 1) investment in an R&D-type venture and 2) promotion of building leases for senior facilities. For 1), the Company invested in RIVERFIELD Inc., which develops surgical assistance robots. RIVERFIELD is targeting commercialization of the first domestic-made surgical assistance robots by 2020. The Company intends to support utilization of the robots with leasing and other financing schemes. For 2), the Company provides building leases for paid senior homes with care services operated by Nichii Carepalace Company. This is one of the first initiatives in the industry aimed at building leases for senior facilities.

d) Aircraft

Operating assets increased 18.0% (vs. the end of FY3/17) to ¥88.6bn at the end of September 2017. The Company arranged ownership of 5 aircraft (and sold 1), lifting ownership by 4 (vs. the end of FY3/17) to 23 aircraft. It is also concluding contracts for four Airbus A321neo aircraft, which are equipped with the latest engine and being deployed for the first time in Japan. It booked results for one of these aircraft in 1H and plans to book the other three in 2H FY3/19. Furthermore, it is newly pursuing airplane engine operating leases and broadened its scope to expand the business. ROA, meanwhile, was flat at 1.9% (vs. 1.9% in FY3/17). The Company aims to expand scale (fill out the portfolio) and raise profitability.

e) Overseas

Operating assets narrowed 3.0% (vs. the end of FY3/17) to ¥81.6bn at the end of September 2017. While the Company seeks expansion, including inorganic growth (investments, acquisitions, alliances, etc.) mainly in North America and Asia, it remains at a preparatory stage. However, it is dispatching people to a local entity in Singapore, which had been unmanned, and strengthening efforts to support business initiatives in nearby countries and collect information.

f) New domains

FPS (early payment service for sales receivables) and FPS Medical (early payment service for medical and care fee credits) for medical institutions operated by Accretive contributed substantially to the Company's results. FPS business started transactions with the Company's close customers*1, and FPS Medical business has concluded business agreements, such as customer introductions, with regional banks and other key counterparties*2. Pursuit of cross-selling and other synergies is progressing smoothly. While it will take some time to realize full-fledged income contributions in the accounting service with SAP Japan K.K. having started in April 2017, the service appears to have ramped up well. Assistance for cutting-edge technology research and development (alliances, investments, etc.)*3 and used equipment business*4 also delivered some results.

*1 Established transactions (FPS) with Trial Company Inc. (No. 2 ranked discount store), which operates discount stores mainly in the Kyushu and Kanto areas
*2 Introductions to hospitals, clinics, and other medical entities
*3 Besides the investment in RIVERFIELD, which develops and manufactures surgical assistance robots, the Company invested in venture-business investment fund Mirai Sozo 1 (providing investment and management assistance mainly to venture companies utilizing cutting-edge technologies originating from the Tokyo Institute of Technology) and established Japan's first industry-academia alliance GAP Fund (supporting business development and commercialization of research results from the Tokyo Institute of Technology).
*4 Increased space at used-item processing yard Tokyo 3R Center (Hachioji City, Tokyo) and developed infrastructure to expand business in used items

Business outlook

Retained initial FY3/18 forecast, steadily adding to operating assets mainly in the robust real estate and aircraft businesses

The Company retained its FY3/18 forecast at initial levels of ¥530bn in total revenues (+4.5% YoY), ¥31bn in operating profit (+8.3%), ¥33bn in ordinary profit (+5.2%), and ¥20.5bn in profit attributable to owners of parent (+2.6%). This outlook projects higher revenues and profits.

Management continues to expect build-up of operating assets mainly in the upbeat real estate and aircraft businesses to drive profit growth. It also factors in contributions from Accretive's consolidation from the beginning of the fiscal year (approximately nine months).

We think the Company kept its initial forecast, despite the upbeat 1H results, due to taking a conservative stance in light of rapid changes in the business environment and uncertainties.

We see room for upside considering high progress rates in 1H (vs. full-year forecast) of 57.1% in total revenues, 56.3% in operating profit, 57.1% in ordinary profit, and 57.1% in profit attributable to owners of parent and healthy advances in initiatives, including accumulation of operating assets.

FY3/18 outlook

(¥bn)

	FY3/16 results		FY3/18 forecast		Change	
		% of total revenues		% of total revenues		% change
Total revenues	5,070		5,300		230	4.5%
Operating profit	286	5.6%	310	5.8%	24	8.3%
Ordinary profit	313	6.2%	330	6.2%	17	5.2%
Profit attributable to owners of parent	199	3.9%	205	3.9%	6	2.6%

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

Industry environment

Facing tougher competition, including direct entry by banks, amid modest softening of the domestic lease market

A survey conducted by the Japan Leasing Association reported a 6.3% YoY decline in lease handling volume in 1H FY3/18 (April-September 2017) to ¥2,273.5bn, continuing a downward trend at the half-year level from 2H FY3/17. Looking at trends in the business environment in past years, the domestic lease market steadily contracted due to cutbacks in capital investments after the Lehman Shock, then achieved a moderate recovery on improved economic activity and higher capital investments, including help from the government's capital investment promotion measures, and has been softening recently because of uncertainty and lackluster interest in leases.

Competition is fierce with 10 listed companies, mainly independent companies, bank-affiliated companies, and manufacturer-affiliated companies. Leading participants in terms of operating assets are ORIX Corporation <8591>, Sumitomo Mitsui Finance and Leasing Co., Ltd., Mitsubishi UFJ Lease & Finance Company Limited <8593>, Hitachi Capital Corporation <8586>, and Tokyo Century Corporation <8439>. The Company ranks sixth in the industry but posts strong growth rates among major companies. Bank affiliates expanded their scale through mergers as part of bank reorganizations. The top group has not changed much recently. Additionally, competition is likely to become even tougher with direct entry by banks in response to the impact of the negative interest rate policy.

Main leasing companies (ranking by operating assets as of the end of September 2017)

(¥bn)

	Code	Operating assets	Change from the end of the previous fiscal year
ORIX	8591	91,161	1.8%
Sumitomo Mitsui Finance and Leasing	-	48,946	-0.1%
Mitsubishi UFJ Lease & Finance	8593	48,616	-0.3%
Tokyo Century	8439	31,869	-0.9%
Hitachi Capital	8586	30,772	2.8%
Fuyo General Lease	8424	20,813	1.8%
IBJ Leasing	8425	16,063	-0.1%

Source: Prepared by FISCO from 1H FY3/18 materials of each company

In recent years, leasing companies have been focusing on solar power and other environmental and energy areas, aircraft leases, and overseas business in light of maturation of the domestic market. Solar power, however, appears to have entered a lull at this point because of the government's reduction of the feed-in tariff. Overseas business is confronting uncertainty in Asian economies and other areas. These trends present difficult business conditions.

Growth strategy

Aims to increase asset balance and raise ROA through expansion of businesses with high profitability and frontier (new domains) initiatives

1. Medium-term management plan

The Company started the medium-term management plan Frontier Expansion 2021, which covers FY3/18 through FY3/22. With a slogan of "Going where no one has gone before," it aims to become a corporate group with sustainable growth, despite major changes in the environment for domestic leasing business, through expansion of the business portfolio's "frontier" by pursuing new business areas and business models. The plan is a five-year long-term outlook for expansion of the frontier.

Its business goals for five years from now are ¥2.5tn in operating assets (+¥456.4bn), 2.0% ROA (+0.4ppt), and ¥50bn in ordinary profit (+¥18.6bn). Average annual growth rates for the five years are 4.1% in operating assets and 9.8% in ordinary profit. While the ordinary profit goal presents a tough hurdle, the Company hopes to reach this level through the combined impact of expanded operating assets and improved ROA.

Numerical targets of the medium-term management plan

	FY3/17 results	FY3/20 interim target	FY3/22 target	Change
Asset balance	¥2,043.6bn	¥2,300bn–¥2,400bn	¥2,500bn	¥456.4bn
ROA	1.6%	1.7%–1.8%	2.0%	0.4pt
Ordinary profit	¥31.4bn	¥38bn–¥42bn	¥50bn	¥18.6bn

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

Core strategies include 1) selection and focus in strategic areas, 2) pursuit of frontier opportunities, and 3) pursuit of Group synergies.

(1) Selection and concentration in strategic areas

The Company intends to concentrate business resources in strategic areas as growth drivers – a) real estate, b) energy/ environment, c) medical and social welfare, d) aircraft, e) overseas, and f) new domains. It also positions the following areas as core areas where it aims to maintain and expand the market (customer base) via group collaboration and other improvements in efficiency – g) auto leases, h) vendor leases, i) domestic corporate, and j) finance.

(2) Challenge the frontier

The Company plans to shift emphasis to added value, services, and business areas that banks cannot offer in order to clarify differentiation with rivals (bank-affiliated leasing companies and banks themselves). It aims to expand into operating leases, real estate leases, and other products that place value (business value) on goods. In new domain expansion, it is mainly considering utilization of M&A and capital and business alliances and seeking non-asset businesses that contribute to higher asset efficiency (ROA), such as through fee income.

(3) Pursue Group synergies

It aims to maximize Group synergies by rolling out products (services) from Group companies to the markets (customer bases) of other Group companies. It hopes to dramatically enhance sales performance by effectively connecting “functions” and “customer bases,” including its main operations with strength in large corporate transactions, retail-oriented Sharp Finance, and Accretive with a factoring platform that links large companies and small businesses.

2. Direction in strategic areas

a) Real estate

The Company set goals of ¥480bn in operating assets in five years (roughly doubling value over five years) and 2.2% in ROA (+0.3ppt) that it intends to achieve by maintaining and expanding upbeat newly executed contract volume. It plans to continue recruitment of customer needs by offering land information, expansion of risk-taking activities, such as finding tenants on its own, and broadening the frontier with real estate financing, investments in REITs, and real estate investments. It is also promoting Group initiatives, such as real estate lease proposals at Sharp Finance.

b) Energy/environment

In the mainstay solar power business, the Company seeks to expand scale by multiple times, while reducing the number of projects, as phase two that emphasizes large solar power sites unfolds. Over the next five years, it plans to expand power output to 165MW (doubling electricity supply in five years) and operating assets to ¥34bn (roughly doubling in five years) and sustain ROA at a strong 6.0%. We think the Company is making healthy progress in this direction with the start of projects in three sites (totaling 60MW in output capacity), including a large solar power plant based on the Fukushima concept for a new energy society, as explained above.

c) Medical/social welfare

While it has not presented specific goals, the Company expects growing demand, including wide adoption of community-based integrated care systems promoted by the national government, and views this as an area where it can create synergies among Group companies. In medical business, it is taking steps to expand the frontier by offering consulting services for hospital revitalization, business management, and other areas, utilizing know-how in alliances with companies that sell used medical equipment*, and promoting Accretive’s factoring service for medical and care fees. In social welfare (care) business, it plans to further pursue building leases for senior homes and other care facilities, an area where it led the industry, through the partnership with NICHIIGAKKAN, a major company in the care industry.

* The Company concluded a capital and business alliance on March 29, 2017 with FUJITA Co., Ltd., which disassembles and removes used medical equipment and handles related transactions.

d) Aircraft

The Company intends to accelerate arrangement of ownership to about 10 aircraft per year and expand the number of aircraft that it owns by fourfold to 70 (an increase of 51) in five years. With these additions, it is targeting expansion of operating assets to ¥280bn (+¥204.9bn) and ROA of 2.3% (+0.4ppt). While competition has heated up with Chinese rivals and others amid growth in global demand, the Company hopes to expand scale and improve asset efficiency through provision of added value that leverages its strengths, similar to real estate leases. In particular, it will seek to expand transactions with US airlines and realize inorganic growth (through investments, joint ventures, and other activities).

e) Overseas

The Company presented goals in five years of a roughly 1.5-fold expansion of operating assets to ¥120bn (+¥35.9bn) and ROA of 1.8% (+1.2ppt) driven by further promotion of non-Japanese business mainly in North America and Asia and inorganic growth (including investments, acquisitions, and alliances). Its inorganic strategy appears to be targeting non-Japanese lease companies located in North America and Asian emerging countries (with specialized businesses that focus on transportation equipment leases, medical equipment leases, auto loans, and other areas). In organic growth, it is aiming for expansion of overseas sites and utilization of Accretive's overseas sites (offering small-sum financing services in Thailand and Cambodia).

f) New domains

New domains generally refer to "business that involves new initiatives," such as expansion of new businesses and business areas. The Company seeks to expand its frontier mainly in non-asset businesses and raise ordinary profit to about ¥4bn in five years. Its strategy targets improved profitability and asset efficiency through initiatives in Accretive's factoring, salary prepayment system, and other services; businesses from new M&A deals and capital and business alliances; development of a lease scheme that incorporates used equipment sales and used values; lease asset monetization business; and accounting services, mainly using FLOW Cube+ which it developed jointly with SAP, and other related services.

Numerical targets in strategic areas

	FY3/17 results	FY3/20 interim target	FY3/22 target	Change
Real estate				
Operating assets	¥240.2bn	¥380bn	¥480bn	¥239.8bn
ROA	1.9%	2.0%	2.2%	0.3pt
Energy/environment				
Operating assets	¥17.2bn	¥29bn	¥34bn	¥16.8bn
ROA	6.1%	6.0%	6.0%	-0.1pt
Output (MWdc)	77	135	165	88
Aircraft				
Operating assets	¥75.1bn	¥210bn	¥280bn	¥204.9bn
ROA	1.9%	2.0%	2.3%	0.4pt
Self-owned aircraft	19	49	70	51
Overseas				
Operating assets	¥84.1bn	¥110bn	¥120bn	¥35.9bn
ROA	0.6%	1.5%	1.8%	1.2pt
New domains				
Ordinary profit	¥1.7bn	Approx. ¥3bn	Approx. ¥4bn	Approx. ¥2.3bn

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

Given these efforts, we expect expansion of operating assets and profitability improvement led by real estate and aircraft areas to continue to play a major role in attainment of the Company's goals in the medium-term management plan. We also anticipate contributions to improved ROA from expansion of "new domains" with strong asset efficiency.

We believe the Company is capable of reaching its goal for expansion of operating assets in light of upbeat external conditions in strategic areas, its results up to now, and its advantages. Our main focus is how the Company increases ROA. Progress in lifting ROA should be assessed in terms of 1) expansion of business in areas with high ROA (change in mix), such as real estate, aircraft, and renewable energy, and 2) improvement of ROA in the real estate and aircraft businesses. We see healthy prospects for boosting ROA through change in mix by expanding businesses with high profitability and obtaining income in new domains with high asset efficiency. For the latter effort (finding ways to raise ROA in the real estate and aircraft businesses), we think it is important to pay close attention to the external environment and internal measures.

Shareholder returns

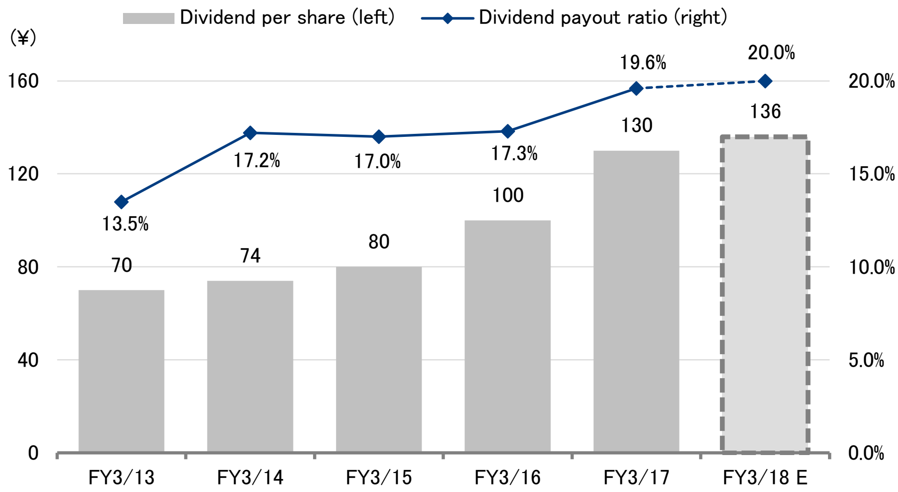
Steadily raising the dividend with support from upbeat profits and plans to increase it again in FY3/18 by ¥6 to ¥136

The Company follows a fundamental policy of reinforcement of shareholders' equity to ensure a solid business foundation and robust financial conditions and provision of profit compensation to shareholders via continuation of long-term, stable dividends in light of its profits and business goals. It appears to be aiming for a dividend payout ratio of about 20.0%.

In FY3/18, the Company plans to increase the dividend by ¥6 YoY to ¥136 for the full year (¥68 interim dividend, ¥68 year-end dividend), putting the estimated dividend payout ratio at 20.0%.

The Company has been steadily increasing its annual dividend each year, and we see room for further increases accompanying growth in profits.

Dividend per share and dividend payout ratio



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

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