COMPANY RESEARCH AND ANALYSIS REPORT

Fuyo General Lease Co., Ltd.

8424

Tokyo Stock Exchange First Section

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Index

Summary

In FY3/18, the Company posted sharply higher sales and profits (all-time high profit) that exceeded forecast. Healthy progress in strategic areas toward meeting goals in the new medium-term management plan

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 ¥1,105.0bn in annual newly executed contract volume and ¥2,168.7bn in operating assets (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 five-year 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 the final year are ¥2,500.0bn in operating assets (4.1% average annual growth), 2.0% ROA* (return on assets) (+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.

* Ordinary profit (annualized) / Operating assets (average balance)

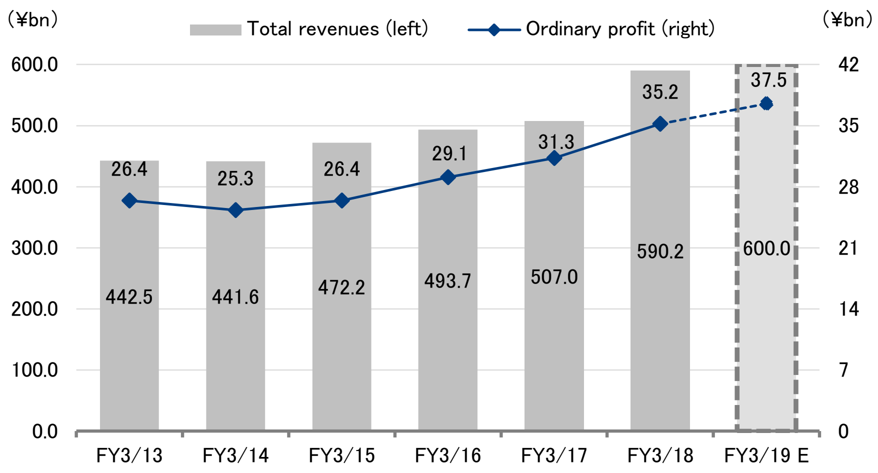
In FY3/18, the first year of the new medium-term management plan, the Company posted ¥590.2bn in total revenues (+16.4% YoY) and ¥35.2bn in ordinary profit (+12.2%). Both revenues and profits rose sharply and beat the forecast, with profits reaching all-time highs. We think these results show a robust start toward realization of the 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 finance assets and 3) profits booked on cancellation (completions) of major leasing deals. In particular, it benefited from healthy growth in real estate and aircraft 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 expects higher revenues and profits in FY3/19 with a 1.7% YoY gain in net sales to ¥600.0bn and a 6.5% increase in ordinary profit to ¥37.5bn. While growth rates are slower than in the previous fiscal year due to exhaustion of the consolidation effect for Accretive Co., Ltd., the Company continues to forecast steady accumulation of operating asset value, mainly in upbeat real estate and aircraft areas, as overall drivers. Furthermore, it intends to pay an annual dividend of ¥156, an increase of ¥10 YoY, that reflects anticipated profit growth. We think the Company is capable of attaining these targets because of substantial build-up in operating asset value and robust advances in strategic areas. We will maintain focus on progress in strategic areas and efforts to improve ROA.

Key Points

- Started the new medium-term management plan Frontier Expansion 2021 (five-year plan) in FY3/18
- Posted sharply higher sales and profits (all-time high profit) that exceeded forecast in FY3/18, the first fiscal year of the new medium-term plan
- Achieved growth in the strategic area of real estate businesses and received an income boost from consolidation of Accretive
- Focus on progress in strategic areas and the approach to improving ROA

Trends in total revenues and ordinary profit



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

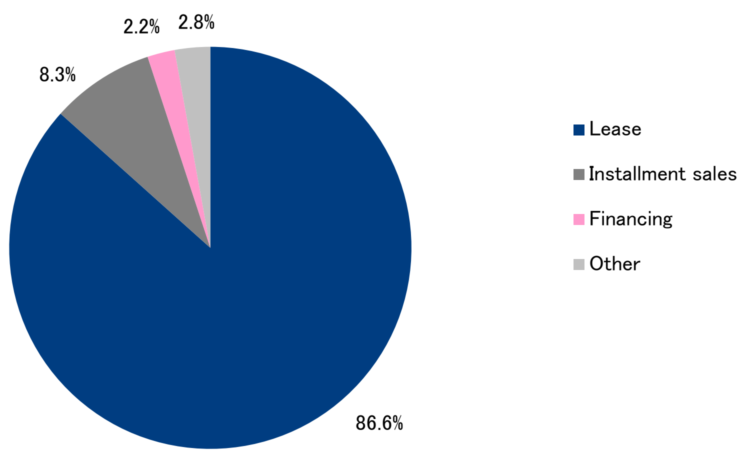
Company profile

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

1. Business overview

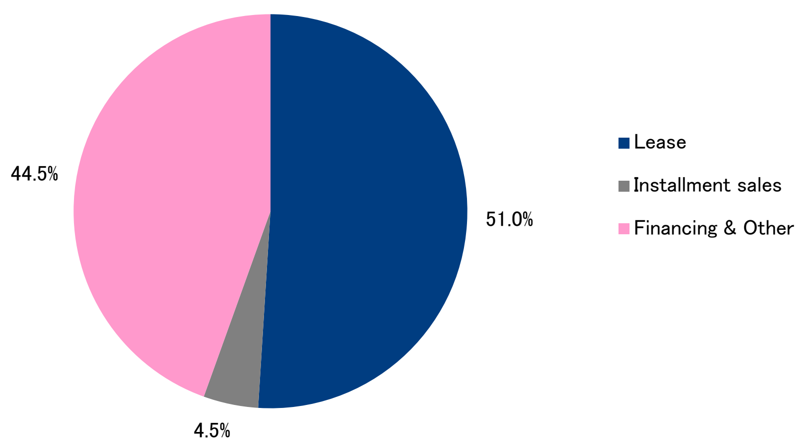
The Company has three business segments - lease and installment sales, financing, and other – and also provides disclosure of lease and installment sales separately. Mainstay lease business accounts for 86.6% of total revenues, 51.0% of newly executed contract volume, and 68.0% of operating assets (FY3/18).

Revenue composition by segment



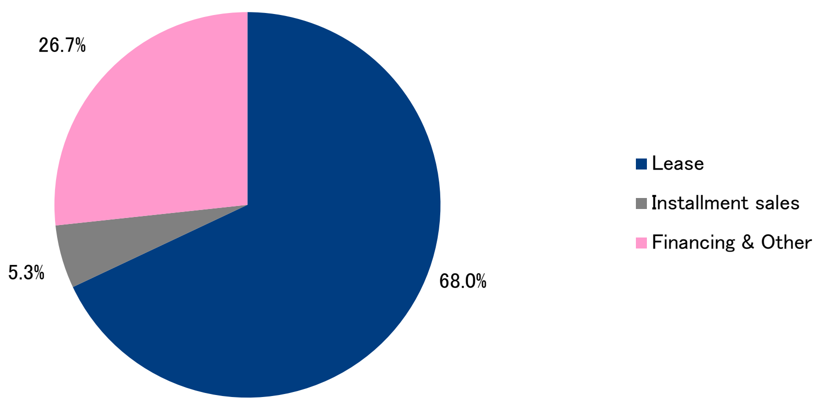
Source: Prepared by FISCO from the Company's results briefing materials

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 ¥1,474.4bn in leases and ¥115.0bn in installment sales.

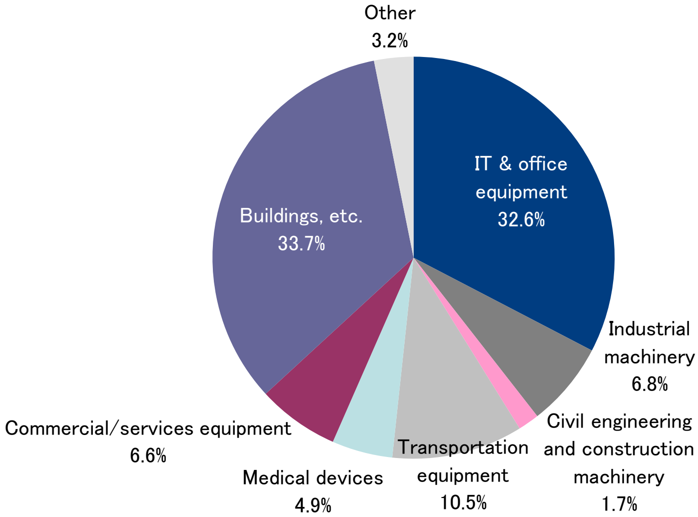
In lease business, the leasing company purchases and leases machinery, equipment, or other facilities selected by customers for a certain leasing fee over a relatively long period. In other words, leases constitute a fundraising method (financial transaction) that focuses on facility deployment. Benefits 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 approximately 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.

When categorizing the volume of newly executed lease contracts by item, buildings, etc. (real estate leases) and transportation equipment have been experiencing substantial growth in recent times. 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 ¥559.5bn in operating assets, including corporate operating loans (such as syndicate loans) and retail funding through consolidated subsidiary Sharp Finance Corporation (SFC). 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 ¥19.6bn.

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 SFC as a consolidated subsidiary (buying a 65% stake) in April 2008. SFC 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 Co., Ltd. <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 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 due to accelerated effect of a fall in profits in accordance with changes to the lease accounting standard in 2008 and the 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 four straight fiscal years.

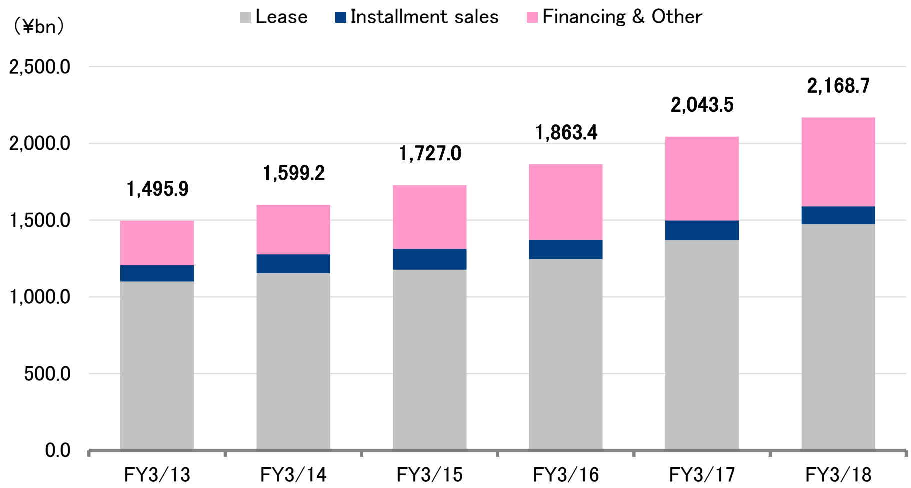
Interest-bearing debt has been growing because of build-up in operating assets, but the equity ratio remains steady at about 10%. The 10% range does not lag other companies in the leasing industry and should not spark concerns about stability of the Company's financial base.

ROA* stayed at around 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.

* Ordinary profit / Total assets (average balance)

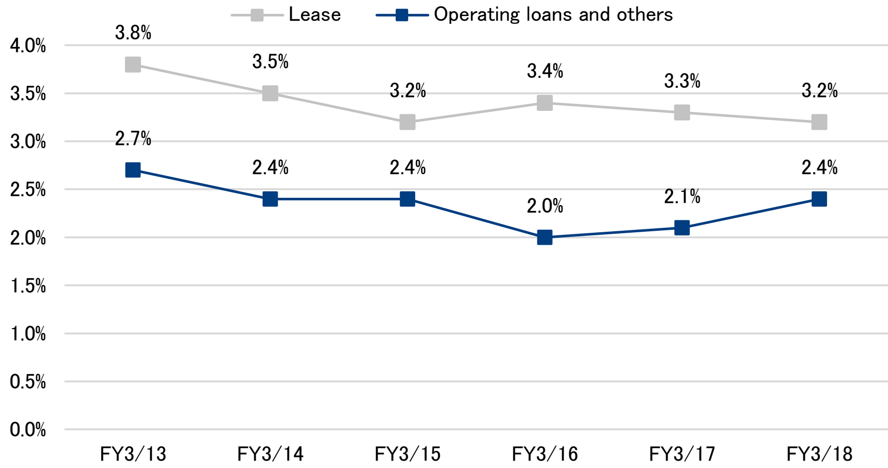
Operating cash flow remains negative and the size of this deficit has grown in the past three fiscal years. We think it is reasonable to interpret this as a reflection of the Company's growth potential because the main cause is aggressive build-up of operating assets, which are future income sources.

Trend in operating assets



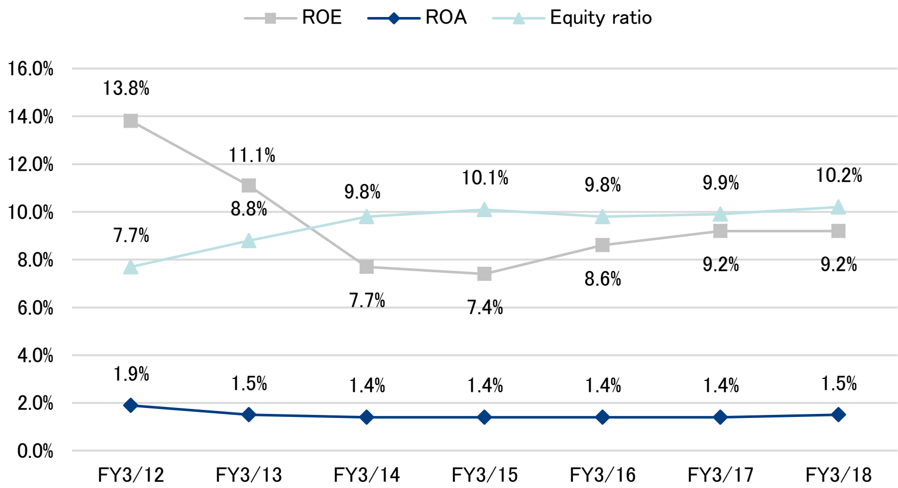
Source: Prepared by FISCO from the Company's financial results

Trend in gross margin on assets



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

Trend in equity ratio, ROA, ROE



Note: ROA = Ordinary profit / total assets
Source: Prepared by FISCO from the Company's financial results

Reached all-time high profits on sharp sales and profit gains in FY3/18, including Accretive consolidation and healthy advances in strategic areas

3. Overview of FY3/18 results

The Company reached all-time high total revenues in FY3/18, the first year of the new medium-term plan, on sharp sales and profit gains that exceeded initial forecast, with net sales at ¥590.2bn (+16.4%), operating profit at ¥32.6bn (+13.9%), ordinary profit at ¥35.2bn (+12.2%), and profit attributable to owners of parent at ¥21.9bn (+9.9%). We think this was an impressive start toward realization of medium-term plan goals.

Revenues climbed significantly on accumulation of operating assets, but also one-time additions*1 from bulk recognition of cancellation (completions) income on large lease deals (real estate lease and bridge-type project*2).

*1 Estimated one-time impact from selling large-scale assets (primarily real estate leases though includes the sale of one aircraft for an aircraft lease) is about ¥70bn.
*2 The Company temporarily owns the asset (as an intermediary) in real estate and other asset transactions to adjust mismatches in the buyer's desired purchase timing and the seller's sales timing. It obtains a new income opportunity (expansion of the scheme) by capitalizing on advantages of owning real estate (the Company does not face constraints of the Banking Act).

Profit excluding acquisition costs, which reflects actual income growth, climbed at a healthy pace of 8.8% (+¥5.5bn) YoY to ¥67.8bn thanks to 1) expansion of newly executed contract volume and related build-up of operating assets, 2) improved gross margin on assets in financing, and 3) profits booked on cancellation (completions) of major leasing deals and bridge-type projects. The first two items include the Accretive consolidation effect (adding about ¥1.9bn to profits).

The Company's hefty increase in newly executed contract value to ¥1,105.0bn (+32.5% YoY; first time to surpass ¥1trn) and resulting gain in operating asset value to ¥2,168.7bn (+6.1% vs. the previous year-end), despite modest slowdown in the leasing industry as a whole, contributed to higher net profit. Newly executed contract value rose substantially due to factoring (*) at Accretive, which was added as a consolidated unit. Mainstay leasing, meanwhile, posted robust growth led by buildings, etc. (real estate leases), a strategic area. Newly executed contract value excluding Accretive expanded by an upbeat 12.2% YoY.

* The ¥228.1bn (of that number, an addition of ¥175.4bn YoY) in newly executed contract volume from Accretive, acquired as a consolidated subsidiary in January 2017, was a new addition and accounted for about 65% of the overall increase in newly executed contract volume (¥270.8bn). Accretive reported ¥16.4bn in operating assets at the end of March 2018 (+17.1% 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.

Profitability (asset gross margin), on the other hand, modestly declined to 3.2% for leases (vs. 3.3% a year earlier) on an increase in bridge-type deals (*), but improved significantly to 2.4% for financing (vs. 2.1%). Financing asset gross margin improved on deal selection and Accretive consolidation.

* Bridge transactions generally offer facilitate highly efficient management in a short period, but do not deliver strong asset gross margin. Nevertheless, the Company plans to select deals with better margin aided by increase in the number of deal inquiries.

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. In particular, decline in "bad-credit costs" helped in beating forecast.

Financially, the Company's equity ratio slightly increased to 10.2% (vs. 9.9% at the end of FY3/17) as total assets expanded 5.7% (from the end of FY3/17) to ¥2,430.8bn on the gain in operating assets while shareholders' equity grew 9.3% to ¥249.1bn due to retained profit and other factors. Interest-bearing debt rose 6.2% to ¥1,964.9bn 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 51.1% (vs. 51.5% at the end of FY3/17) and a liquidity ratio of 141.0% (vs. 143.7%).

Summary of FY3/18

(¥bn)

	FY3/17		FY3/18		Change	
	Results	Ratio	Results	Ratio	Value	% change
Total revenues	507.0		590.2		83.2	16.4%
Lease	423.2	83.5%	511.2	86.6%	88.0	20.8%
Installment sales	62.3	12.3%	49.1	8.3%	-13.2	-21.2%
Financing	10.2	2.0%	13.0	2.2%	2.7	27.1%
Other	11.2	2.2%	16.8	2.8%	5.5	49.7%
Profit excluding acquisition costs	62.3	12.3%	67.8	11.5%	5.5	8.8%
Lease	43.0	10.2%	46.1	9.0%	3.1	7.2%
Installment sales	2.2	3.5%	2.1	4.3%	-0.1	-4.5%
Financing	10.3	100.0%	12.9	99.2%	2.6	25.2%
Other	6.9	61.1%	6.7	39.9%	-0.2	-2.9%
Interest expenses	7.1	1.4%	7.3	1.2%	0.2	2.8%
Gross profit	55.1	10.9%	60.4	10.2%	5.2	9.6%
SG&A expenses	26.5	5.2%	27.8	4.7%	1.2	4.9%
Operating profit	28.6	5.6%	32.6	5.5%	3.9	13.9%
Ordinary profit	31.3	6.2%	35.2	6.0%	3.8	12.1%
Profit attributable to owners of parent	19.9	3.9%	21.9	3.7%	1.9	9.9%
Newly executed contract volume	834.1		1,105.0		270.8	32.5%
Lease	523.4	62.7%	563.5	51.0%	40.1	7.7%
Installment sales	62.6	7.5%	49.9	4.5%	-12.7	-20.4%
Financing & Other	248.0	29.7%	491.5	44.5%	243.4	98.2%
Newly executed lease contract volume by type of equipment						
IT & office equipment	221.3		183.9		-37.4	-16.9%
Industrial machinery	42.2		38.4		-3.8	-9.0%
Civil engineering and construction machinery	9.1		9.6		0.5	5.5%
Transportation equipment	53.9		59.4		5.5	10.2%
Medical devices	23.1		27.5		4.4	19.0%
Commercial/services equipment	41.2		37.1		-4.1	-10.0%
Buildings, etc.	108.2		189.8		81.6	75.4%
Other	24.4		17.8		-6.6	-27.0%
Total	523.4		563.5		40.1	7.7%

	March 31, 2017		March 31, 2018		Change	
	Results	Ratio	Results	Ratio	Value	% change
Operating assets	2,043.5		2,168.7		125.1	6.1%
Lease	1,369.8	67.0%	1,474.4	68.0%	104.5	7.6%
Installment sales	127.8	6.3%	115.0	5.3%	-12.7	-10.0%
Financing & Other	545.8	26.7%	579.2	26.7%	33.3	6.1%
Gross margin on assets						
Lease	3.3%		3.2%		-0.1pt	
Financing & Other	2.1%		2.4%		0.3pt	
Total assets	2,300.0		2,430.8		130.7	5.7%
Shareholders' equity	227.8		249.1		21.2	9.3%
Equity ratio	9.9%		10.2%		0.3pt	
Interest-bearing debt	1,850.9		1,964.9		114.0	6.2%
Short-term	897.8		959.9		62.1	6.9%
Long-term	953.1		1,005.0		51.9	5.4%
Long-term debt ratio	51.5%		51.1%		-0.3pt	

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.

(1) Real estate

Operating asset value at the end of FY3/18 increased sharply YoY to ¥362.0bn (+50.7% or ¥121.8bn). We think the Company accumulated attractive assets thanks to gains in retail facilities (large shopping centers and others), its strength, including major deal contracts, and bridge-type transactions* via collaboration with real estate companies. ROA, however, modestly declined to 1.8% (vs. 1.9% a year earlier) accompanying the rise in bridge transactions (including one-time impact from large projects), as explained earlier. Yet the Company achieved some progress in activities aimed at raising profitability, such as proposal sales including land information. While operating asset value is currently ahead of the cruising pace for medium-term plan goals (¥380.0bn in FY3/20 and ¥480.0bn in FY3/22), the Company did not change its outlook because it expects to finish large bridge-type deals.

* An example is the multi-purpose building Hulic Minato Mirai with Colette Mare as the core retail facility (location in Chuo ward, Yokohama) through an alliance with Hulic Co., Ltd. <3003>.

(2) Energy/environment

Operating asset value in the solar power business at end-March 2018 rose 14.5% YoY to ¥19.7bn. The Company currently operates megasolar sites in 30 locations nationwide (for a total of 102MW) following the addition of a site in the Fukushima area (power output of 25MW) in FY3/18. It is developing large megasolar facilities at two other sites in Fukushima and Miyagi (total of 38MW) too (both should be ready in September 2018). These sites should enable the Company to reach its interim goal from the medium-term plan (135MW by the end of FY3/20) one year ahead of time. Furthermore, the Company is looking at a site in Fukushima as its largest operation (adjustments are taking place with an aim of beginning work this summer). If the new site is added, total capacity would move well above the FY3/22 goal (165MW). ROA, meanwhile, slipped to 5.1% (vs. 6.1% a year earlier), but mainly because of upfront costs for development sites. We think ROA for existing sites (excluding developments) was roughly 6.1%, on par with the previous year.

(3) Medical/social welfare

While it has not given detailed numerical goals, major activity results were 1) investments in R&D-type venture companies, 2) promotion of building leases for senior facilities, and 3) consolidation of FUJITA Co., Ltd. For 1), it invested in RIVERFIELD Inc., which is developing Japan's first surgical assistance robot (aiming for commercialization in 2020), CREWT Medical Systems Inc., which developed the world's first head-mounted visual field inspection device, and Lily MedTech Inc., which is working on a breast cancer inspection system that utilizes medical ultrasound technology. The Company plans to support equipment rollouts with leases and other financing schemes. For 2), it provides building leases for paid nursing homes with care services run by Nichii Carepalace Corporation. The Company's initiatives in building leases for senior facilities lead the industry. For 3), it acquired more shares in FUJITA (provides one-stop outsourcing of the process from dismantling and removal to purchase and sale of mainly used large medical equipment), with which it concluded a capital and business alliance contract in December 2016. It intends to go further in collaboration and promote development of new products and services.

(4) Aircraft

Operating asset value at end-March 2018 expanded 29.9% YoY to ¥97.6bn. Despite an impact from delivery delays, the Company increased the number of planes it owns to 24 planes (up by five planes from a year earlier) by arranging six self-ownership leases during the year (one plane was sold). It also newly added aircraft engine operating leases and broadened scope with the aim of business expansion. ROA was flat at 1.9% (matching the previous year's 1.9%). The Company intends to expand total aircraft volume, while maintaining and raising ROA, by increasing counterpart airlines (including super LCCs) via clarification of risk amid market overheating and by setting up packages (multiple aircraft), including using Japan-type operating leases (JOL)*.

* Investors (including ordinary businesses) generally utilize a Japan-type operating lease as a management tool for the purpose of "postponing profits (and thereby taxes)," mainly with depreciation costs. The Company plans to arrange package deals and handle some as Japan-type operating leases for sale to investors and others.

(5) Overseas

Operating asset value at end-March 2018 grew 3.5% from a year earlier to ¥87.1bn. The Company wants to expand business, including inorganic growth (primarily investments, acquisitions, and alliances), mainly in North America and Asia. In FY3/18, it successfully lifted non-Japanese assets with the acquisition of a pick-up truck (compact commercial vehicles for corporate use) rental and leasing company in Canada as an equity-method affiliate (joint business with Marubeni in which it owns a 50% stake). This business should contribute to profits from FY3/19. Additionally, Accretive invested in a local entity of Sinanen Co., Ltd. in Thailand. The Company aims to meet financing needs in the energy field. ROA remains flat at 0.6% (it was also 0.6% in the previous fiscal year).

(6) New domains

Flex Payment Service (FPS; faster payment of sales receivable credits) and FPS Medical (faster payment of medical treatment and care fee receivable credits) provided by Accretive contributed significantly to income. FPS began transactions with the Company's close business partners*1, while FPS Medical is steadily increasing transactions in medical and care fields thanks to business agreements for customer introductions and other assistance with regional banks and other close counterparts of the Company. There were also some results in assistance (alliances, investments, etc.) for research and development in cutting-edge technologies*2 and used business*3.

*1 Established transactions (FPS) with Trial Company Inc. (No. 2 ranked discount store), which operates discount stores mainly in the Kyushu and Kanto areas Demonstrating a pattern of real contribution to performance from here on.
*2 Includes venture investments in the medical and welfare field mentioned earlier (three companies), a business alliance for sales promotion with Optical Comb, Inc. (offers non-contact 3D measuring equipment that utilizes "optical comb" technology that received a Nobel prize), and establishment of the GAP Fund (supports business development and commercialization of Tokyo Institute of Technology's research results), the first collaborative fund between industry and academia in Japan.
*3 Consolidated FUJITA, which operates in the medical and welfare field, as explained earlier and improved infrastructure to expand used business by increasing space at Tokyo 3R Center (located in Hachioji city, Tokyo), a used equipment processing yard.

Besides advances in strategic areas, the Company achieved steady results in new initiatives involving group collaboration as part of "pursuing group synergies," which is one of the key strategies in the medium-term plan. In particular, it is creating synergies with SFC, which performs well in retail areas. Some examples are SFC's application of building leases, which use the Company's knowhow, to its own customer base and conclusion of the first contract since starting collaboration and pursuit of better efficiency through consolidation of insurance agencies, vendor leases, and other overlapping businesses in the group at SFC. In auto leases, SFC formed the Auto Lease Promotion Office and is strengthening collaboration with Fuyo Auto Lease Co., Ltd. (resulted in a 47% YoY rise in annual joint contract value). These efforts seek to maximize synergies via cross-selling for products and services as well as markets (customer bases).

Business outlook

Expected increase in sales and profits in FY3/19 Steadily adding to operating assets mainly in the robust real estate and aircraft businesses

For FY3/19, the Company forecasts ¥600.0bn in total revenues (+1.7% YoY), ¥34.0bn in operating profit (+4.3%), ¥37.5bn in ordinary profit (+6.5%), and ¥23.0bn in profit attributable to owners of parent (+4.8%). This outlook projects higher revenues and profits.

While projected growth rates are slower than in the previous fiscal year due to exhaustion of the Accretive consolidation effect, the Company continues to forecast steady accumulation of operating asset value, mainly in upbeat real estate and aircraft areas, as overall drivers.

We think the Company is capable of attaining these targets because of substantial build-up in operating asset value, even after adjusting for temporary impact from large projects, and robust advances in strategic areas. We will maintain focus on progress in strategic areas and efforts to improve ROA.

FY3/19 outlook

(¥bn)

	FY3/18		FY3/19		Change	
	Results	% of total revenues	Forecast	% of total revenues	Value	% change
Total revenues	590.2		600.0		9.7	1.7%
Operating profit	32.6	5.5%	34.0	5.7%	1.3	4.3%
Ordinary profit	35.2	6.0%	37.5	6.3%	2.3	6.5%
Profit	21.9	3.7%	23.0	3.8%	1.0	4.8%

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 2.9% YoY decline in lease handling volume in FY3/18 to ¥4,875.8bn, continuing a downward trend for two years. 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>, Mitsubishi UFJ Lease & Finance Company Limited <8593>, Sumitomo Mitsui Finance and Leasing Co., Ltd., Tokyo Century Corporation <8439>, and Hitachi Capital Corporation <8586>. 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 March 2018)

(¥bn)

	Code	Operating assets	Change from the end of the previous fiscal year
ORIX	8591	9017.2	0.7%
Mitsubishi UFJ Lease & Finance	8593	4909.2	0.7%
Sumitomo Mitsui Finance and Leasing	-	4795.9	-2.1%
Tokyo Century	8439	3230.6	0.5%
Hitachi Capital	8586	3179.1	6.2%
Fuyo General Lease	8424	2168.7	6.1%
IBJ Leasing	8425	1683.0	4.6%

Source: Prepared by FISCO from the Company's materials

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 ¥2,500.0bn in operating assets (+¥456.4bn), 2.0% ROA (+0.4ppt), and ¥50.0bn 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	FY3/18 results	FY3/20 interim target	FY3/22 target	Five-year increase
Asset balance	¥2,043.5bn	¥2,168.7bn	¥2,300-¥2,400bn	¥2,500bn	¥456.4bn
ROA	1.6%	1.6%	1.7%-1.8%	2.0%	0.4pt
Ordinary profit	¥31.3bn	¥35.2bn	¥38.0-42.0bn	¥50.0bn	¥18.6bn

Source: Prepared by FISCO from the Company's 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 areas 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 SFC, and Accretive with a factoring platform that links large companies and small businesses.

2. Direction in strategic areas

(1) Real estate

The Company set goals of ¥480.0bn 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 SFC.

(2) 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 mega-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 ¥34.0bn (roughly doubling in five years) and sustain ROA at a strong 6.0%. As already explained, the Company is making healthy progress in its construction of large-scale solar plants at three sites (63MW in combined electricity output) and is also reviewing its biggest-event project.

(3) 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 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 consolidated subsidiary FUJITA Co., Ltd., which sells 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.

(4) 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 ¥280.0bn (+¥204.9bn) and ROA of 2.3% (+0.4ppt). While competition has heated up 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, as discussed above, it will seek expansion of transactions with airlines, arrange package deals, and realize inorganic growth (through investments, joint ventures, and other activities).

(5) Overseas

The Company presented goals in five years of a roughly 1.5-fold expansion of operating assets to ¥120.0bn (+¥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).

(6) 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 ¥4.0bn in five years. Its strategy targets improved profitability and asset efficiency through initiatives in Accretive's factoring 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	FY3/18 results	FY3/20 interim target	FY3/22 target
Real estate				
Operating assets	¥240.2bn	¥362.0bn	¥380.0bn	¥480.0bn
ROA	1.9%	1.8%	2.0%	2.2%
Energy/environment				
Operating assets	¥17.2bn	¥19.7bn	¥29.0bn	¥34.0bn
ROA	6.1%	5.1%	6.0%	6.0%
Output (MWdc)	77	102	135	165
Aircraft				
Operating assets	¥75.1bn	¥97.6bn	¥210.0bn	¥280.0bn
ROA	1.9%	1.9%	2.0%	2.3%
Self-owned aircraft	19	24	49	70
Overseas				
Operating assets	¥84.1bn	¥87.1bn	¥110.0bn	¥120.0bn
ROA	0.6%	0.6%	1.5%	1.8%
New domains				
Ordinary profit	¥1.7bn	-	Approx. ¥3.0bn	Approx. ¥4.0bn

Source: Prepared by FISCO from the Company's 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, as shown by the performance in FY3/18 as the first year of the medium-term management plan. 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

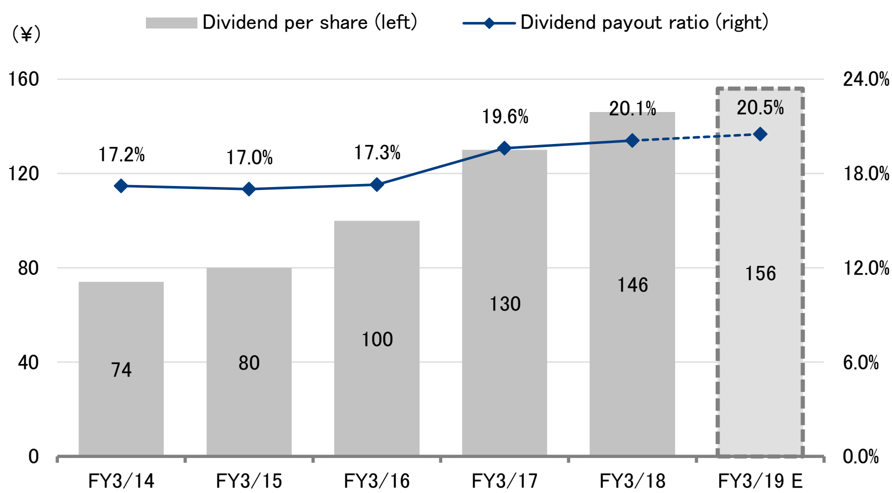
Steadily raising the dividend with support from upbeat profits and plans to increase it again in FY3/19 by ¥10 to ¥156

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%.

The Company paid a ¥146 annual dividend in FY3/18 (¥68 interim dividend, ¥78 year-end dividend), an upward revision from the period-start target and increase of ¥16 YoY. This put the dividend payout ratio at 20.1%. In FY3/19, the Company plans to raise the dividend again to ¥156 (¥78 interim, ¥78 year-end), an addition of ¥10 YoY that reflects anticipated profit growth.

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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