Q & A at Earnings Call on November 8, 2022 (FY2022 Q2)

Tokyo Century Corporation

<Business Environment>

Q.

Could you share your thoughts on the current external economic environment, whether you view the changing macro environment, including rising interest rates, particularly in the United States, as a risk or a business opportunity?

A.

We recognize a sharp rise in interest rates as a risk. As stated on page 58 of the presentation material for our consolidated financial results for the six months of the fiscal year ending March 31, 2023, the funding cost increased by ¥4.2 billion year on year, and we need to continue to carefully monitor the rate hikes in fiscal 2023.

We are also closely monitoring the impact of supply chain trends. Tokyo Century develops its business operations centered on handling assets, and its business expansion is based on the fact that a wide variety of commercial products, such as automobiles and aircraft, can be distributed without delay. Therefore, we will keep an eye on the international situation going forward.

<Financial Outlook for Fiscal 2023>

Q.

What is your outlook for the financial performance in fiscal 2023, including the impact of rising interest rates as a risk factor?

A.

We believe that a loss on valuation of operational investment securities and an extraordinary loss related to aircraft for Russian airlines recorded in fiscal 2022 are transient situational factors resulting from changes in the macro environment. Thus, we do not expect such significant negative factors in fiscal 2023 and beyond. However, the most recent U.S. policy interest rate has continued to rise, with markets speculating that the terminal rate will exceed 5%; therefore, we will carefully see interest rate trends with whether interest rates will remain high in the future or plateau due to recession concerns. Among our operating segments, we are closely monitoring the impact on procurement costs of Aviation Capital Group LLC (ACG), a U.S. aircraft leasing subsidiary.

<Next Medium-Term Management Plan>

Q.

I believe that discussions are progressing toward formulating the next medium-term management plan.

Could you describe how you see the level of potential earnings and future growth areas to the extent possible?

A.

Various discussions on the Fifth Medium-Term Management Plan have been held at the management level, including external directors. Our basic policy plans to continue expanding our assets, and we believe there are many business opportunities to continue our investment in growth. From a quantitative perspective, we aim to increase the balance of segment assets to about ¥6,000 billion. Also, from the standpoint of return on assets (ROA), we seek to achieve a 2.5% to 3% level by returning to its original growth trajectory. ROA has recently fallen to the 2% level due to the slow recovery in the Specialty Financing segment. We are discussing the period of the medium-term management plan, including whether to set it at three or five years.

In terms of assets, expecting the growth of equity method affiliates such as NTT TC Leasing (NTL) and NITTSU Lease & Finance in the Equipment Leasing segment while we will continue our efforts to focus on asset efficiency for leased assets of TC (non-consolidated basis) and manage them in a balanced manner with the remaining three operating segments.

<Management Strategy>

1. Overall

Q.

Regarding the risk of the loss on valuation of operational investment securities, could you tell us if there is a possibility of recording a loss on a new company in the future?

A.

Basically, we believe there is no risk of a loss on the scale of the two companies recorded in fiscal 2022.

Q.

Please tell us about your future funding policies for the Japanese yen and foreign currencies.

A.

As an entire policy, we have been working to improve the long-term funding ratio in recent years from the standpoint of financial stability and liquidity, which had risen to 85.6% at the end of September. In terms of the policy of procuring the Japanese yen, even if there is a timing for an increase in the yen interest rate, the portion affected by changes in yen interest rate will be equally passed on to lease rates due to the nature of the leasing business. However, it is expected to have a slightly delayed effect. Regarding our policy on foreign currency funding, we consider timely and appropriate funding methods while looking at the balance, given the cost increase in the case of short-term funding and the downside of a future rate cut if the interest rate is fixed at the current level.

Q.

Regarding the status of collaboration with the NTT Group, please tell us if there are any updates on the earnings scale if the pipeline piles up and new initiatives in the future.

A.

As for the future pipeline, we have jointly established an investment fund in environment and energy businesses and plan to build up our portfolio within that framework. In addition, we have already made two investments in data center businesses in India. As we have successfully attracted customers, I believe we will be able to make an earnings contribution sooner than expected. Various considerations are underway, including expansion into other countries and regions, while we discuss with the NTT Group. In the real estate business, now I cannot say anything specific, but we can expect to achieve future results because we have some pipeline projects in progress. Overseas business is an area where we can make great use of CSI's strengths in providing consultative managed services in handling ICT equipment. I also feel rapid progress in our collaboration in the last six months.

2. Equipment Leasing

Q.

What is your quantitative target for future earnings from NTL?

A.

Since NTL launch in July 2020, it has expanded both segment assets and earnings beyond expectations. As of the end of March 2022, we had ¥1,600 billion in segment assets, which we hope to increase to around ¥2,000 billion as early as possible by accelerating collaboration with Tokyo Century going forward and aim to exceed ¥20.0 billion in ordinary income. In our Equipment Leasing segment, as we have long worked to improve profitability and asset efficiency, we hope to establish a structure enabling NTL to generate high returns through efficient asset management.

3. Mobility & Fleet Management

Q.

With regard to consolidated subsidiary Nippon Rent-A-Car Service (NRS), it is expected that the benefits of gain on the sale of used cars due to the sharp rise in used car prices will gradually disappear from fiscal 2023 onward, so please tell us your management strategy for how you plan to increase the earnings level in the future.

A.

One of the measures we will take to improve our earnings levels is to continue implementing low-cost operations that worked well during the COVID-19 pandemic. If we index expenses in fiscal 2019 before the pandemic at 100, they are now down to about 86% of that, and the break-even point has reduced. The second is higher sales with a focus on dynamic pricing. In the past, we only applied it to special events such as the New Year's holiday, Golden Week and Bon Festival, but we would like to adjust our pricing to be a little more precise. And the third is an improvement in profitability by increasing the direct sales ratio. As a result of our dedicated efforts to improve the booking application used by customers, the number of those who book directly from the application has increased, leading to an improvement for better profitability. We believe that advancing customer service will be a major management strategy. In terms of future earnings levels, we intend to aim at a level that is one digit above the current level.

4. Specialty Financing

Q.

Could you tell us about the rise in funding costs of ACG in the following fiscal year (fiscal 2023) and the impact on its performance?

A.

As indicated in "Unsecured debt maturities" on page 28 of our presentation material, refinancing of $1.6 billion will occur in fiscal 2023. If the terminal rate for the U.S. policy rate for fiscal 2023 is set at 5%, the total funding rate could be between 6% and 7%. Given this, we recognize that procurement costs will rise to some extent, but we need to keep a close eye on whether interest rates will remain high or plateau at the current level, depending on the timing.

Q.

With improvements in ACG's cash collection rate and collection of lease receivables that are not recognized as revenue, including this progress, could you explain the business environment for the aircraft leasing industry and the outlook for a recovery in ACG's performance?

A.

The cash collection rate has recovered to an average of 97% and close to 100% in the period from January to June, and the balance of lease receivables that are not recognized as revenue has also decreased, indicating that operating lease revenue has generally recovered by overcoming the pandemic. However, looking at the current aviation market as a whole, since airline performance is on the path to recovery and aircraft value has yet to fully recover, we believe that it will take time for ACG to recover its gain on the sale of aircraft, which used to contribute several billion yen before COVID-19. In addition, we need to keep a close eye on future risk factors, such as increased funding costs associated with rising interest rates, as well as possible delays in aircraft delivery schedules from aircraft manufacturers due to labor shortages and supply chain issues.

Q.

Please tell us if there are any changes in the insurance claims situation for aircraft for Russian airlines.

A.

As previously reported, ACG has exercised its claims and will promptly inform you if circumstances change.

5. International Business

Q.

What is the outlook for the performance of CSI Leasing (CSI), a U.S. subsidiary, in fiscal 2023, as it is expected to be affected by a decline in demand for IT investment in the face of the global recession?

A.

At the end of the lease term for IT equipment, if customers refrain from renewing new equipment, they can choose to extend the lease as an option. However, we do not expect a significant decline in performance because many customers are willing to extend the lease due to the strong demand for continued use of existing IT equipment amid supply chain disruptions such as semiconductors. Furthermore, as a trend in the past, CSI's assets and contract volume have continuously increased, and we have secured a source of revenue to support our future performance. However, we believe it is necessary to continue to monitor the risk that the supply of new IT equipment will stagnate due to prolonged supply chain disruptions and that equipment will not be delivered smoothly to customers.

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