Q & A at Earnings Call (FY2022) and
Briefing Session on Medium-Term Management Plan 2027 held on May 16, 2023

Tokyo Century Corporation

[Profit plan]

Q.

How much capital gains do you expect with regard to the financial target of ¥100.0 billion in net income, which is the financial target of the medium-term management plan? Please give us specifics on the assets you are planning to sell.

A.

Capital gains in the fiscal year ended March 31, 2023 (previous fiscal year: FY2022) increased from past levels due to one-time factors, but we aim for a level of around 10% of ordinary income. In this medium-term management plan, we believe placing even greater emphasis on profitability and asset efficiency is necessary; therefore, we will strongly commit to improving ROA by strengthening core earnings, including capital gains. Major capital gains targets include real estate, aviation, shipping, and principal investments.

Q.

Regarding ROA by operating segment in the medium-term management plan, you expect ROA to increase, except in the Specialty Financing segment. Please explain the specific factors behind the expected increase.

A.

Let me explain by operating segment.

For Equipment Leasing, we expect an increase in equity in earnings of affiliates due to the growth in performance of joint ventures with partner companies, as well as an increase in profits due to higher ROA in the leasing business on TC's non-consolidated basis.

For Automobility, while we cautiously factored in a decline in gains on sales of used vehicles, which had been strong until the previous fiscal year (FY2022), as well as higher maintenance costs and personnel expenses for vehicle repair and servicing, we expect an increase in ROA and profits from ongoing organic growth of Nippon Car Solutions and growth in the business performance of Nippon Rent-A-Car Service.

In Specialty Financing, while one-time capital gains recorded in the previous fiscal year (FY2022) will disappear, we expect organic growth in each field as we pursue our strategy of replacing low-profit assets with a certain degree of asset turnover, including revenue growth of Aviation Capital Group LLC (ACG).

In International Business, we recorded an impairment loss on operational investment securities of ¥17.3 billion out of negative ¥5.9 billion in net income for the previous fiscal year (FY2022). Therefore, the level of net income at the beginning of the fiscal year ending March 31, 2024 (FY2023) will be a little more than ¥10.0 billion. We expect that the main factors behind the increase in profits will be the continued, strong growth of CSI Leasing, Inc., the expansion of the auto business in Asia, which has been strengthened through M&As, and the expansion of the business in North America, which will lead to improved profitability.

In Environmental Infrastructure, regarding the net income of ¥0.2 billion for the previous fiscal year (FY2022), we recorded a one-time loss of about ¥4.0 billion including the cost of test operation of a newly built power plant that started operating in FY2022. Therefore, the profit level at the beginning of the current fiscal year (FY2023) will be about ¥4.0 billion. We expect that the main factors for the increase in profit are the pipeline that we are currently working on and future growth investments.

Profits appear to expand relative to the increase in asset size, but we intend to promote the replacement of low-profit assets to improve asset efficiency. In the plan, total assets will increase by approximately ¥1 trillion by FY2027 compared to FY2022. This is a net figure that takes growth investment and asset replacement into account.

Q.

What are the risk factors that affect profit targets in the medium-term management plan, such as rising interest rates, credit concerns, or inflation?

A.

Although we do not anticipate any specific risks or losses, we have formulated our plan based on the assumption that any changes in the macroeconomic environment, including interest rates, credit concerns, as well as inflation-related, rising personnel expenses, will have a certain degree of impact on our business performance. As a result, we indicate a loss of ¥16.1 billion as a factor in the increase or decrease to achieve a net income of ¥100.0 billion, of which about half has been factored in as a loss buffer.

【ACG】

Q.

How much does ACG account for in the projection of a net income of ¥48.0 billion for the Specialty Financing segment in the medium-term management plan?

A.

For ACG, we assume that over the five-year period of the medium-term management plan, ROA will recover to approximately over 2%, and profit levels will exceed the pre-COVID level of approximately US$250 million (pre-tax basis). Before the COVID-19 pandemic, we had a reasonable profit from the sale of aircraft, resulting in a high ROA level. However, passenger demand is still on the way to recovery in Asia and other regions, the number of aircraft in storage is higher than before the pandemic worldwide, and there is an oversupply of aircraft on the whole. Thus, the trade market for aircraft has not fully recovered. In addition, our forecasts are conservative, as there will be a time lag before the recovery of the lease rates to an appropriate level due to the impact of the rapid rise in interest rates in the U.S.

Q.

How much of an increase do you expect with regard to the balance of ACG segment assets in the medium-term management plan?

A.

As of the end of FY2022, ACG segment assets stood at approximately ¥1.5 trillion, with 121 aircraft on order (approximately ¥840.0 billion). The ordered aircraft will be delivered sequentially over the next five years, so the asset scale will expand by simple calculation. However, we will pursue turnover-oriented management by replacing assets through sales and other means.

[Management strategy]

Q.

The current PBR is below 1x. Please explain the specific measures you are planning to take to reduce the cost of shareholders' equity.

A.

We believe that the measures are to reduce the volatility of our performance by ensuring a solid growth rate and increasing predictability. To this end, it is important to carefully explain our measures to investors. In this medium-term management plan, we have devoted a suitable number of pages to risk management items. We believe that we need to steadily implement these items.

Q.

Do you envision growth through M&As?

A.

This medium-term management plan does not include large-scale M&As. Our basic policy is to grow through the businesses we have built and the progress of post-merger integration in the businesses we have acquired in the past. Of course, we will consider M&As if there are projects that align with our strategy by following major changes and developments worldwide.

[Return to shareholders]

Q.

Please explain the background behind the dividend payout ratio of about 35% in the medium-term management plan and the dividend policy in the event that profits increase or decrease due to one-time factors.

A.

We set the dividend payout ratio at around 35%, taking into account various factors in managing the company in compliance with a certain level of discipline. That includes the need to continue making growth investments, the increase in foreign currency funding associated with the expansion of overseas operations such as ACG, and the relationship with the guideline level of the capital utilization ratio. We hope you will understand that the ratio will be around 35% for the time being, in line with our policy of continuing to increase dividends through profit growth and providing long-term, stable returns to shareholders.

[Risk management]

Q.

I would like to know the specifics of the review and monitoring system for the projects in the investment management framework.

A.

I will explain two main processes of the investment management framework.

First, in deciding whether or not to invest in an individual project, we examine the economic rationality of the investment, considering the cost of capital calculated based on the business characteristics of each project and its consistency with the overall strategy of the Tokyo Century Group. The Investment Management Committee discusses the feasibility of the project, holding a series of discussions among related parties, including those from our operating segments, in light of the method of exit. Second, we list the investments that have been made, conduct fixed-point observations over a certain period, and implement a monitoring process for growth potential, earnings content, cost of capital, and other factors, utilizing a four-quadrant analysis. We implement a PDCA (plan–do–check–act) cycle in these two major processes.

[Business environment]

Q.

Please tell us about the status of passing on the increase in cost of funds to lease rates, separately for domestic and overseas operations.

A.

As for domestic operations, we do not see any major interest rate increases that will lead to passing on an increase on lease rates, but we recognize that we are in a severely competitive environment.

Overseas, in U.S. operations, in the auto leasing and financing business, including trucks, increases in interest rates had a considerable impact on the cost of funds. However, we see that the current situation is generally being reflected in the lease rate improvement. For ACG, although there will be a time lag for the time being, we believe that the situation will improve in the future.

[Period of the Medium-term Management Plan]

Q.

Please explain why you decided to extend the term of the medium-term management plan to five years from three years.

A.

We considered trends in the performance of the aircraft leasing business and the investment period for major real estate redevelopment projects. In the aircraft leasing business, we will follow the trend of ACG's profitability recovery for a reasonable period, as shown in the passenger demand forecast released by International Air Transport Association as a reference indicator. In addition, since several large-scale redevelopment projects in which we are participating will be completed around 2028, we have an image of a bridge to that fiscal year.

We will continue to steadily monitor the performance from short- and medium-term perspectives and thoroughly manage our business performance on a year-to-year basis and progress over a five-year period.

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