Q & A at Earnings Call on November 14, 2023 (FY2023 Q2)

Tokyo Century Corporation

Financial Outlook for Fiscal 2023

Q.

The gain on sales in the first half was only ¥2.8 billion. What is your forecast for the gain on sales in the second half?

A.

As explained previously, we target a gain on sales of around 10% of ordinary income. Due to the timing of recognition, the gain on sales recorded in the first half was ¥2.8 billion, but we expect it to achieve a level of around 10% of ordinary income for the full year.

Q.

What is your outlook for credit costs in the domestic and global businesses, respectively?

A.

In the domestic businesses, almost no credit costs were incurred in the first half of the year, and currently, we have no significant concerns for the second half. As for the global businesses, we recorded extraordinary losses associated with Russia last fiscal year in the aircraft leasing business and valuation losses on operational investment securities in the International business segment. However, we expect that such a situation is unlikely to occur in the current fiscal year. In particular, credit costs in aircraft leasing were limited due to improved airline financial conditions and the recovery in aircraft values.

Equipment Leasing Segment

Q.

What is your outlook for interest rates in Japan and how will a rise in interest rates affect the Equipment Leasing segment?

A.

Given the movement of wage increases and inflation in Japan, interest rates may rise moderately. In the Equipment Leasing segment, we will take measures to minimize the impact of interest rate risk, including reviewing lease rates in consideration of the future interest rate movement.

Q.

Do you expect the ROA in the Equipment Leasing segment to improve in the medium to long term through the expansion of the ITAD service business in Japan, as mentioned in the IR Presentation on page 13?

A.

Incorporating the strength of CSI Group such as the services and know-how associated with expired lease properties into the Equipment Leasing segment will enable us to expand the range of services offered to existing customers in Japan and increase transactions with new customers, which will lead to an increase in the number of expired properties handled by us and revenues. We aim to increase the number of units we handle to approximately 200,000 units or more per year and to expand annual revenues to approximately ¥5 billion, more than double the current level. This approach will contribute to improving ROA of the Equipment Leasing segment as it increases profitability in the form of asset-light and strengthens our customers' information security.

Automobility

Q.

I understand that the progress rate in Automobility was high in the second quarter thanks to the strong profit from used car sales. What is your outlook for the used car market?

A.

Statistics show that used car prices were below last year's record highs, but with new car prices also high, we do not expect a sharp decline in the market. We will continue to conduct flexible sales activities, keeping an eye on market movements.

Specialty Financing (ACG)

Q.

The supply-demand balance for aircraft is tight as deliveries from aircraft manufacturers have been delayed. In this situation, what elements do you expect will positively affect ACG's performance?

A.

As of the end of June 2023, ACG committed an order book of 119 aircrafts worth approximately ¥900 billion. ACG has received many inquiries from airlines looking to capture passenger demand as well as leasing companies that do not have an order book. It will be an advantage for ACG that they have already secured orders. Aircraft lease rates and values are rising due to the tighter supply-demand balance. We expect that this will have a positive impact on ACG’s business performance.

Q.

Based on global passenger demand and interest rate movements, how do you expect ACG’s business to perform over the next fiscal year?

A.

As for the market, the number of air passengers has almost recovered to the pre-COVID-19 level, although geopolitical risks are emerging. As for ACG's performance, quarterly revenues from operating leases have recovered to the pre-COVID-19 level, exceeding $250 million in the current Q2. However, we are also closely watching the increase in interest expense due to the rising interest rates. Since most of

ACG's debts are at fixed interest rates, we expect operating lease revenue to grow and spreads to improve in the next fiscal year. We also expect a recovery in gains on sale of aircraft.

Q.

How are aircraft lease rates and aircraft sales activities recovering?

A.

The aircraft lease rates have been rising in line with rising US interest rates. The recovery has been particularly pronounced in the new narrow-body aircraft, which are ACG's mainstay. Gains on sale of aircraft in ACG were not much in the first half of the year. However, as the market condition is recovering, we expect to see a double-digit level for the full year.

Q.

What is the progress in cash collections from airlines for which you use the cash basis accounting for revenue recognition?

A.

The cash collection of deferred lease payments will peak in the current year. In the next fiscal year, we expect new lease contracts for both of ordered aircraft and off-lease aircraft will progress steadily, leading to an increase in revenue.

Q.

What are the prospects for collecting insurance for aircraft associated with Russian airlines?

A.

As previously announced, we are in the process of taking legal action to collect insurance claims and would like to refrain from providing details at this time.

Q.

What are your medium- to long-term plans to improve ROA?

A.

We have two major plans. The first measure is to charge lease rates that sufficiently cover the financing costs. The second is to operate the business with an awareness of asset turnover by selling aircraft according to the market conditions. Since ACG has committed 119 aircraft for orders as of the end of June 2023, we will control these assets by balancing the procurement and sale of aircraft.

Specialty Financing (other than ACG)

Q.

Over the medium to long term, at what pace do you plan to accumulate real estate assets?

A.

As shown on page 24 of the IR Presentation, real estate assets as of the end of September 2023 were approximately ¥640 billion. Although the assets has increased considerably due to foreign exchange effects, we will continue to increase the assets over the medium-term management plan period. In Japan, we plan to gradually increase the asset balance while closely monitoring the trends in office rents and utilizing the pipeline of TC Kobelco Real Estate Co., Ltd., our consolidated subsidiary, among others. As for our overseas real estate business, since the majority of our portfolio consists of logistics facilities, residential facilities, and data centers, the impact of the recent decline in the commercial real estate market in the U.S. has been limited. We will continue to increase the asset balance while paying attention to the diversification of asset types.

Progress in Medium-Term Management Plan 2027

Q.

How much progress have you made towards the financial target of 1.4% ROA (ratio of net income to total assets) in the Medium-Term Management Plan 2027?

A.

Our basic policies of “TCX" and "Fully Commit to increase ROA" as explained in the Medium-Term Management Plan 2027, have been spreading among officers and employees, and the entire organization is making progress with asset efficiency in mind. In the Automobility segment, as announced in the previous Q1 results, Orico Auto Leasing Co., Ltd. (OAL) was reclassified from a consolidated subsidiary to an equity-method affiliated company, resulting in a decrease in segment assets of ¥147.9 billion compared to the end of the previous fiscal year. This measure contributed to the ROA improvement. As for ACG, which accounts for a relatively large portion of our assets, ROA was over 2% before the COVID-19 crisis. We think it is important to get it back to that level first.

End