Q&A Session on Financial Results for the Fiscal Year Ended March 31, 2024

(Q) As the Bank of Japan announced the removal of its negative interest rate policy in March, and yen interest rates are expected to rise, please tell us what you will do to keep funding costs low in the future.

(A) We expect domestic interest rates to rise in the future, and a major challenge is how to efficiently raise funds in yen, which is our home currency. However, since there is no secret solution to this problem, we intend to raise funds optimally through a combination of corporate bonds and bank loans as in the past.

(Q) Please tell us about your sales strategy and how you plan to pass on the increase in funding costs to lease payments if interest rates rise.

(A) Overseas (Europe and Americas), the sharp rise in interest rates from the year before last to the last year has created the challenge of compressing margins in Europe and Americas of Global Business segment. In Japan, on the other hand, we expect interest rate increases to be gradual, and we do not anticipate any major pressure on earnings as we pass on any funding interest rate increase to our customers in lease payments. However, as this is the first time in about 30 years that interest rates have risen in Japan, we believe that a major issue is how to expand our business while skillfully negotiating with customers in a period of rising interest rates. We believe that by working together with the sales force, we can successfully meet this challenge.

(Q) You said that the funds will be raised through a combination of corporate bonds and bank loans; do you have any strategies to reduce the risk of interest rate fluctuations in your financing?

(A) Our company's ALM (Asset Liability Management) is conservative. Fixed-rate funds are allocated to fixed-rate assets. In principle, we do not take any maturity mismatch risk. We have ALM across the entire portfolio and raise funds without taking risks, and we will continue to do so in the future.

(Q) Regarding the progress of the 2025 Medium-Term Management Plan (2025 MTMP), the ROE target for next fiscal year (FY2025) is set at approximately 10%, but I feel that there is a large gap between this year's (FY2024) projected ROE of 8.0%. Please explain why the ROE will not increase much in the current fiscal year and why the ROE will improve rapidly in the next fiscal year.

(A) As you mentioned, we need to make a big jump from the projected ROE of 8.0% for the current fiscal year to the target of approximately 10% for the next fiscal year. The exchange rate assumption in the 2025 MTMP, which was formulated about 18 months ago, was 130 yen to the U.S. dollar. Assets and liabilities denominated in foreign currencies make up a very large portion of our balance sheet, and if the yen continues to depreciate, shareholders' equity, the denominator of ROE, will swell. Because the yen has depreciated more than expected, although profits have progressed steadily compared with the plan, equity has been higher than expected, and as a result the company has fallen slightly short of its ROE target.
We believe it is important to achieve a net income of 160 billion yen as the bottom line in order to achieve the ROE target for the next fiscal year. In addition, although it is a factor beyond our control, we believe that if the yen appreciates against the U.S. dollar, we will be able to achieve approximately 10%. In any case, we would like to firmly achieve the target for return (net income), which is the numerator.

(Q) There is a large gap between the net income targets of 135 billion yen for the current fiscal year and 160 billion yen for the next fiscal year. Is the target for the current fiscal year conservative? Or are there elements in the next fiscal year that will enable a leap forward?

(A) The net income target for the previous fiscal year (FY2023) was 120 billion yen. Since the target for the next fiscal year is 160 billion yen, I imagine that many of you are expecting 140 billion yen for the current fiscal year.
We also believe that our actual performance for the current fiscal year is at the 140 billion yen level. In the previous fiscal year, we had planned to spend 10 billion yen on "Sowing Seeds" and "Gaining a Solid Foothold," but in reality only about half of that amount was actually spent. We plan to record the remaining half as expenses in the current fiscal year. After taking these expenses into account, the net income target was set at 135 billion yen, which is the level around 140 billion yen in terms of actual performance, and we believe that we are making steady progress toward the 2025 MTMP target. We are also forecasting a dividend of 40 yen per share for the current fiscal year, based on the payout ratio of more than 40 %, and a net income of around 140 billion yen in terms of actual performance.
As for achieving the net income target of 160 billion yen for the next fiscal year, we believe that the entire company must work together to achieve this goal. In Customer Solutions segment, to improve profitability by driving the "Evolution and Layering of Business Models". In Aviation segment and Logistics segment, aim for further growth by taking advantage of favorable market conditions. The businesses in Europe and Americas, which struggled last fiscal year, are expected to increase profits in the current and next fiscal years due to a recovery in margins and lower credit costs. Environmental & Energy segment is expected to generate synergies with European Energy, in which we have invested. With each segment growing in this way, we believe it is possible to achieve a net income of 160 billion yen.

(Q) You have said that there is a lack of speed in the “Evolution and Layering of Business Models”. What are the reasons for this? And what specific measures will you take to address this issue in the future?

(A) The need to promote the “Evolution and Layering of Business Models” is particularly important in the Customer Solutions segment. Although it has the largest amount of revenue in the Company, it needs to improve profitability as its ROA is only 1.1–1.2%.

The reason for the lack of speed in the “Evolution and Layering of Business Models” in Customer Solution segment is that many of the managers and employees in this segment have been involved in the leasing business for a long time, and they have been doing business exposed to price competition. This has made it difficult to change their mindset of competing on price. For this reason, the Company is focusing on promoting this change in mindset through the “Frameworks to Promote Transformation” (as described on page 33 of the Financial Results Summary).

In addition, the “Evolution and Layering of Business Models” to improve the profitability of Customer Solutions is being promoted through three main measures. First, we are already discussing new business with the Hitachi Group and other partners, and building services through PoC (Proof of Concept: Verifying the feasibility of new ideas and technologies), and will promptly launch these services upon completion.

Second, starting with a small number of customers from our customer base, we will develop a proposal business to address their management issues, in other words, a problem-solving proposal business. This is not an easy task, but by providing such high value-added services, the business will not be exposed to price competition.

The third point is similar to the first two, but from a different angle, and that is to transform existing businesses into high-value-added services by adding services to conventional simple finance and operating leases, which are highly competitive, and by providing businesses that combine the use of data.

(Q) I believe that the decline in earnings of Americas in Global Business segment and the U.S. business in Real Estate segment is due to an increase in bad debts and a decline in real estate prices due to macroeconomic effects, but are there any measures that your company can actively take to improve this situation?

(A) In terms of real estate in the U.S., we have not experienced any major problems in the Residence, which accounts for 60% of our segment assets of Real Estate of approximately 44 billion yen. On the other hand, the office market as a whole is deteriorating, as reported in the newspapers and other media, and we also consider this part of the market to be a risk factor. However, with 9.7 billion yen of office assets remaining, the maximum loss will be in this range. In addition, the Company is not handling any new projects, so the impact of additional losses in the future will be limited.

Similarly, the commercial truck sales financing business that we are developing in Americas of the Global Business segment is not a problem specific to our company, but rather a decline in earnings due to the overall deterioration of the market. In fact, statistics show that our delinquency ratio is lower than the market average. However, we are not sitting on our hands. Since the spring of this year, the entire corporate division, including the Tokyo-based credit division and the Americas Division, has been involved in formulating countermeasures and implementing the following four measures.

The first is to strengthen the governance of local subsidiaries. This time, a significant loss was incurred not only from the U.S. portfolio, but also from the Canadian portfolio. Since the governance of the subsidiaries in Canada was particularly distinctive among the subsidiaries in the Americas, the management and administrative structures in the U.S. and Canada have been unified, and the structure has been changed to one in which the various committees are jointly implemented.

Second, the credit screening model and business process is also being reviewed based on the third party diagnosis.

Third, a large portion of the loss was due to a loss on the sale of trucks returned by carriers in financial distress and sold in the used truck market due to an imbalance between supply and demand in that market. We are currently dependent on third parties for our sales function, which means that we are not always able to sell at the price and in the manner we prefer. To address this, we are working to strengthen our sales function by moving away from our dependence on external parties and bringing the process in-house, collaborating with dealers with whom we do business, or forming joint ventures.

The fourth is to change the portfolio mix. In the Americas of Global Business segment, commercial truck sales financing accounts for approximately half of the portfolio. Since the assets are heavily weighted toward large trucks, which have relatively high volatility, the Company should increase the proportion of medium-size and small trucks, which have relatively low volatility, to achieve better diversification. In addition, the Company is considering reviewing the Americas portfolio, which is heavily weighted toward commercial trucks, and increasing the proportion of leasing and financing businesses other than commercial trucks in order to achieve better diversification.

(Q) Please explain the outlook for asset-related gain/loss in the logistics segment for marine containers and railway freight cars, respectively.

(A) Marine container leasing is a business in which both income and capital gains can be expected in nature, but currently the proportion of capital gains is low and the Company earns primarily from income gains. In the last fiscal year and the year before, the market for marine containers remained strong. Originally, we had assumed that the utilization rates would decline from the 99% level in the year before the previous fiscal year as the overheated market normalized in the last fiscal year. However, thanks to steady sales efforts by CAI, our container leasing company, to lease returned containers and negotiate extensions of expiring contracts, we were able to maintain the utilization rates of nearly 99% last fiscal year. The market was also supported by longer container ship operating periods and increased demand for containers due to the unstable situation around the Suez Canal, low water levels in the Panama Canal and the accident in the port of Baltimore, USA, which caused a logistical bottleneck this year. While it remains to be seen whether these favorable market conditions are temporary or will continue for some time, CAI's excellent asset management capabilities should prevent the utilization rates from falling too far in the future. In addition, capital gains will gradually increase, and we believe that this business will be able to generate stable earnings along with income gains. Railway freight car leasing is similar to marine container leasing, but this business targets longer-term assets. Asset turnover has only recently begun, and the business will be developed in combination with the income gains. We recognize that demand for leasing is growing due to rising commodity prices and the retirement of old freight cars. We believe that we can achieve stable growth for the time being by taking advantage of this stable market.

(Q) Your Company's domestic real estate portfolio is heavily weighted toward office properties. Real estate prices have been rising recently, and it is expected that office space will continue to increase over the next five years, especially in the Tokyo metropolitan area. In such a market environment, what is your Company's business policy for real estate in Japan?

(A) In the office market, operating rates declined due to changes in work styles under COVID-19, but have recently recovered. In particular, demand for buildings with high convenience and quality has returned, and we believe that our holdings of buildings with such characteristics have recovered from COVID-19.

In addition to office buildings, the Company owns various other assets, including commercial properties, logistics facilities, residential properties and hotels. We are developing logistics facilities through CenterPoint Development, which became a wholly owned subsidiary last fiscal year. While the market for logistics facilities is said to be close to saturation in the short term, the market is also diversifying into regional areas, and we intend to seize this opportunity to develop and grow our business. In addition, hotels are also expected to grow steadily due to extremely strong inbound demand.

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