Q&A Session at the Business Segment Meeting 2024 - Aviation -

(Q) On page 12 of the materials, it seems that MHC intends to increase its aircraft fleet at a CAGR of around 5% in the future. Is this due to capital limitations? Or is it a natural progression as part of MHC's strategy to maintain a young average age for its aircraft through portfolio replacement?

(A) MHC is striving for well-balanced and sustainable growth in our Aviation business. Over the past decade, since acquiring JSA, we have achieved growth by maintaining a balance between aircraft acquisitions and sales. However, this does not mean that our target growth rate is limited. If market conditions change or if we discover new ways to balance our portfolio, we may aim for an even higher growth rate.

(Q) You mentioned the possibilities under favorable market conditions. Although the current market seems favorable, will MHC continue to maintain an annual increase of around 5% in its aircraft fleet?

(A) While the current market conditions are favorable, there have been supply chain issues affecting aircraft production and a slower growth in sale and leaseback (SLB) of new aircraft. However, engine leasing business is different. As new generation engines have undergone large-scale inspections and repairs, demand of engine leasing has significantly increased. Taking advantage this opportunity, elfc has drastically expanded its portfolio.

(Q) When do you expect the return on assets (ROA) to reach pre-COVID-19 levels of around 2%? Or is it unlikely to reach that level?

(A) The SLB competition for new aircraft remains fierce compared to pre-COVID-19, and our ROA is still in the process of recovering. However, we believe that by leveraging the integrated capabilities and collaboration among JSA, elfc, INAV, and Japanese Operating Lease (JOL), we can achieve an ROA of over 2%. Asset sales also have a significant impact on ROA, and MHC Aviation Services, through the sale and purchase of aircraft and aircraft engines to Japanese investors, will contribute to improving ROA. It is important to maintain a balance for sustainable growth in the medium to long term. We also anticipate improved ROA with the growth of INAV and JOL.

(Q) What is the size of the SLB market? And what is the ratio of SLB among all leases?

(A) Approximately half of the world's commercial aircraft are leased. Among these, about half are acquired through SLB, while the other half comes from direct lessor orders. As lease demand remains stable, we consider the SLB market as a growth market where the number of leased aircraft increases along with the overall aircraft market. While our leasing strategy primarily focuses on SLB for new aircraft, we are diversifying our product offerings to meet the evolving needs of airlines, including direct orders and certain debt financing products.

(Q) Is there a possibility of JSA's ranking changing within the industry?

(A) JSA has been experiencing continuous growth over the years, and pursuing fleet scale is not JSA’s strategy. We compete by leveraging the integrated capabilities and collaboration between JSA, elfc, INAV, and JOL. As the market continues to grow, we aim for sustained growth while maintaining an overall balance among these entities and pursuing profitability.

(Q) In terms of engine leases, you mentioned that elfc is a leading company. Do you feel that its branding differs from that of JSA?

(A) While both aircraft leases and engine leases fall under the aviation industry, their market structures are different. In aircraft leases, there are many players all over the world, whereas there are comparatively fewer players in engine leases as it is a somewhat niche field. And there is also the fact that because the price of aircraft is higher than the price of engines, investments in aircraft are more efficient.

elfc owns more engines than JSA owns aircraft, but the portfolio balance between aircraft and engines is well-maintained. JSA is recognized as one of the leading companies focusing on SLB for new generation aircraft. Our aim is not solely to pursue scale, but rather to achieve growth while balancing scale, risk, and profitability.

(Q) Could you share with us the frontline initiatives and ideas aimed at increasing profitability in aircraft leases? I understand you have a top-down strategy and an overall direction in aircraft leases, for example keeping the average fleet age young, but would like to know more about frontlines’.

(A) Each of JSA, elfc, and INAV is considering and implementing measures to enhance profitability, such as Origination & Distribution, while engaging in strategic discussions with MHC.

(Q) What is the return on equity (ROE) of the Aviation business?

(A) MHC manages ROE on a consolidated basis for financial purposes, while individual businesses is evaluated with return on invested capital (ROIC) based on weighted average cost of capital (WACC). Since each business has different risk profiles, capital allocation is determined accordingly, and profitability is assessed. We do not disclose the ROIC spread for each business.

(Q) Despite the increasing competitive environment, it seems that new aircraft lease rates have not changed significantly compared to five years ago. What, in your opinion, is driving the decrease in ROA? I think it may be something other than the competitive environment.

(A) Lease rates for new transactions have returned to the level of five years ago. However, supply chain issues have disrupted the balance of supply and demand, which does not necessarily translate to an increase in the number of SLB transactions for new aircraft. We believe that the market environment is gradually recovering to the level seen five years ago.

(Q) In the past, it was said that Chinese leasing companies disrupted the SLB market. Even if that environment is resolved, will lease spreads not recover?

(A) The lease spreads for newly acquired transactions are gradually recovering. While the momentum of Chinese leasing companies has slowed down, investments in aircraft remain active due to Middle Eastern leasing companies and new entrants in the market. Therefore, we understand that the SLB prices are on the path to recovery.

(Q) The price of used engines is skyrocketing. Given this environment, is it an option to increase the number of engine sales and gain substantial capital gains?

(A) elfc regularly sells its engines, and the number of engine sales is increasing in line with business growth. However, our aim is to ensure medium to long-term commitment and achieve sustainable growth. Therefore, we are not currently considering large-scale selling off of engines.

(Q) Could you provide us with the profit composition among the four businesses in the Aviation segment?

(A) We do not disclose the specific profit levels of each business. In recent years, the ratio of engine leases has increased, but aircraft leases still account for the majority.

(Q) What do you think is necessary to achieve an ROA of more than 2%? And what impact will be expected from rising interest rates?

(A) To improve our ROA, it is important to strike a balance between effective asset management and consistent origination of new leases. We aim to increase ROA by enhancing our competitiveness and profitability in each transaction through collaboration across our group companies, such as INAV's engine parts out business and JOL business. The impact of rising interest rates will be taken into consideration in our overall financial management.

(Q) Can it be said that the Aviation business has a relatively high return on invested capital (ROIC)?

(A) Yes, that is correct.

(Q) Is the MHC Group considering allocating more capital to businesses with high ROIC, such as the Aviation business, to accelerate growth? And why don't you invest more capital into the Aviation business to accelerate the expansion of your asset scale?

(A) The Aviation business was part of the former Mitsubishi UFJ Lease & Finance. Before its integration with Hitachi Capital, its total consolidated assets were smaller than what we currently have. Since FY21, our capital buffer has increased due to the integration, and the scale of our assets is expanding, partly due to the impact of a weaker yen. While we are expanding the scale of our assets, our focus is on improving profitability rather than significantly expanding the size of our consolidated assets. Capital allocation is determined based on the risk profiles and profitability of each business.

(Q) On page 7 of the materials, the expansion of assets beyond FY24 appears to be moderate. Are you planning to make substantial investments?

(A) Our key theme in the 2025 Mid-Term Management Plan is to improve profitability rather than significantly expand the scale of our consolidated assets by, for example, 200%. We are making progress with the replacement of assets, and in the Aviation and Logistics businesses, we aim to gradually expand the scale of our assets. Overall, we maintain a well-balanced and diversified business portfolio and we have no plans for sudden expansion in any particular business.