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

(Q) You said that the monopolization of the marine container leasing business by the top five companies is progressing. How will you grow your business in such a market environment?
Also, CAI as a group company of MHC Group, I understand that there are limitations on expanding your assets, but will it be possible for you to incorporate the growth of the market?

(A) By leveraging CAI's high market intelligence and marketing capabilities, we can incorporate the needs and growth of the market, so I believe it is possible for us to grow the business at least at the same pace as the growth of the market itself. I hope to raise our absolute amount of profit while maintaining our high utilization.
Our current utilization is high at around 99%, well above historical standards, and we have reached the limit of profit growth that can be gained by raising the utilization. I'd like to increase sales gains from used containers after the end of the lease term, but we are also working hard on our trading business, which buys and sells newly manufactured containers. In this business model, we record our assets once at the purchasing stage, however because turnover is fast, we can effectively post profits without inflating our assets. For this reason, it also contributes to improving our ROA.
We also have a business which we call "one way." In this business, when newly manufactured containers are purchased by customers and forwarded by us, by loading those containers and transporting them, we can acquire margins from both the customer who purchased the containers and the shipper. We are working proactively on this business, too.
With these kinds of initiatives, I hope to improve our ROA without greatly expanding our assets, and achieve profit growth.

(Q) Are there any risks in the North American railcar leasing business relating to the U.S. presidential election to be held in November?

(A) Looking at past trends in the volume of railroads traffic in North America, we are aware that the rail market is not greatly affected by economic fluctuations or politics, so we believe that the impact of the presidential election will be limited. However, if interest rates increase with the change of the presidency, we think that this will result in a headwind not only in railcar leasing business, but also in marine container leasing business. When formulating our business plan for this year, we expected that interest rates in the U.S. would fall a little faster, so while the current situation is not something we anticipated, we hope to strike back against that impact and successfully carry out our plan. The two specific areas that could impact railcar activity is if a new administration imposes additional trade restrictions or commits to further infrastructure spend – both of which could benefit railcar demand.

(Q) I think that monopolization has progressed in the marine container leasing business, which benefits from the advantage of scale. However, if this monopolization continues to progress further in the future, what changes can you foresee in the competitive environment?
And how do you plan to come out on top in such a competition?

(A) I do not think that monopolization progress any further. I also believe that from the perspective of Antitrust law, the possibility of change in industry structure is low. Given that CAI has established strong relationships with the shipping companies that are our customers, I hope to continue to steadily accumulate high quality assets so that we do not get caught up in price wars.
Also, as major competitor companies are affiliated with infrastructure funds, their approach to this business is probably mid or short term. On the other hand, we have committed to this business for the long term, and so our evaluations from customers are high. We are aiming for stable business growth while maintaining these good relationships with our customers.

(Q) What is the ratio of long-term contracts in railcar leases?

(A) The market environment began to improve from last year. When renewing leases, we have been able to raise lease rates by 20 to 30% compared to existing rents, and so we are negotiating to extend lease term as much as possible. With that said, it is difficult to obtain higher lease rates when market conditions are deteriorated, so in those situations we negotiate to shorten lease term as much as possible. The market environment was tough for the past several years until it began to improve last year.

(Q) What is the utilization in railcar leases?

(A) In August of this year, we will complete the conversion program for certain underperforming car types, which has been underway since 2022. Converted cars are being leased and operated one by one, and current utilization has returned to roughly 97%.

(Q) How do you determine the lease rents for marine container and railcar leases?

(A) Lease rents for both containers and railcars are basically decided by negotiation between us and the relevant customers without any particular indicator. Prices of newly manufactured containers and railcars typically correlates with steel prices but it can also be affected by other factors.

(Q) How many years does it take for the depreciation of marine containers and railcars?

(A) For reefer containers, it is 12 years, and for dry containers it is 13 years. For railcars, it is 40 years, though railcars can have a life as long as 50 years.

(Q) Are you taking on any corporate risk from customers in the marine container business?

(A) Yes, we are.

(Q) Is that because marine containers are not something that can easily be repossessed?

(A) We do repossess marine containers as well. Looking at our past results, we have been able to collect more than 90% of the defaulted amounts by repossession. So, while we are taking on corporate risks, we won't incur a total loss even if a customer defaults.

(Q) So is that the same as in general asset finance?

(A) Yes, it is.

(Q) In leases for marine containers, which are essentially just steel boxes, what are the relative merits of CAI which cause you to be chosen by customers?

(A) Shipping companies are in possession of their own containers and leased containers. These containers are mainly used to address baseload demand, whereas leased containers are used to respond to sudden demand for freight.

As a leasing company, we must provide these containers to our customers when they need them, in the quantity required, and at the required place, in order to handle such sudden demand. However, holding more than the required number of containers results in inventory risk, so professional knowledge is needed to maintain that balance. CAI is excellent at gathering that information.

Before the business integration, the former BIL and former CAI were positioned 6th and 5th in the industry, respectively. They both held roughly the same number of containers, but CAI took appropriate levels of inventory risk, so its profitability was higher. By maintaining inventory to meet demand surges, we are able to achieve premium lease rates and favorable terms.

Thanks to the business integration, not only did we enjoy the advantage of scale, but gaining CAI's intelligence also became a strength for new CAI.

(Q) I'd like you to tell us about your target ROA and net income for marine container leases and railcar leases.

(A) Our ROA in marine container leases is already over 2%.

In railcar leases, although we have been in the red for a time, we are working on the conversion program for non-utilized assets to improve utilization and concluding long-term contracts with favorable conditions, among other things. Through this, we have been improving our ROA each year, with a long-term target of between 2 and 2.5%.

We envision a long-term target ROA of between 2 and 2.5% for the Logistics Business

Division.

(Q) The Logistics business is one with a comparatively low level of volatility, but is there any volatility in lease rents due to fluctuations in funding costs?

(A) Because lease rents in both businesses are influenced by market supply and demand, they are somewhat different from other leasing businesses which respond to fluctuations in interest rates.

Furthermore, both businesses deal in assets that are held for long periods, so funding periods do not perfectly align with lease periods. By diversifying loan maturities while maintaining a balance of various funding methods, such as long and short term loans and fixed rate and floating rate loans, we are aiming to reduce funding risk and increase profitability.

(Q) The composition of the assets held by PNW is almost in line with that of the market overall, but ownership share of covered hoppers is slightly high. Is there any reason for this?

(A) Covered hoppers are not only represent the largest portion of the U.S. market but also their demand is steady and their sale liquidity is high. That is why our ownership share of Covered hoppers is higher than the entire North American fleet. That said, PNW's ownership of Covered Hoppers is not drastically different than many large operating lessors.

We have already started selling off coal cars included in "Other", which our ownership share is lower than the market, because of the risk that the cars could becoming a stranded asset in the decarbonization trend. "Other" also includes flat cars which carry marine containers, but many of these are owned by railroads, and few are owned by leasing companies. As such, liquidity is low at the time of sale, and we are keeping the ownership share of these cars in our portfolio at a lower level.

Further, railcars such as legacy tank cars which transport oil, for example, will no longer be able to meet regulations in the future, and are at risk of becoming stranded assets. Our stance is not to possess these assets, which is why their ownership share is somewhat small.

These factors also have led our ownership share of covered hoppers being relatively high.

(Q) Utilization at CAI is 99%. Is roughly 1% inventory an appropriate level? What is the reason for the current extremely high level of 99% utilization?

(A) The 1% off lease represent used containers that have been off-hired and are either being repaired to be re-leased or will be sold, depending on age, condition and location. Historically utilization averages close to 98% and we consistently strive to keep at close to 100% as possible as off-lease boxes are a significant drain on profits. Competitors also maintain utilization of above 95%, but CAI maintains the highest utilization in the industry today.

Current high utilization levels are driven by two factors – one is the disruption in the supply chain caused by the effective closure of the Suez Canal and the second is the organic growth of exports as China looks to enhance economic growth.

(Q) You say that 1% of your inventory is in depots, but doesn't that mean that there is hardly any inventory that you can provide to customers quickly?

(A) At MHC and CAI, inventory of newly manufactured containers refers to the inventory of newly manufactured containers without lease contracts at the time of the order. This does not include newly manufactured containers that are ordered based upon inquiries from customers, as lease contracts are concluded for such containers in advance.

While there are some cases of inquiries that require containers immediately, in most cases customers are willing to wait for two to three months, so we enter into lease contracts until the delivery of the newly manufactured containers.

Even in cases of an inquiry requiring inventory immediately, we have been able to receive some orders by negotiating for the customer to wait until the following month, for example. Being able to have these kinds of negotiations is important.

The 1% in depots represents inventory that must be remarketed to other lease customers or sold as quickly as possible to minimize costs.

(Q) While I understand that it is difficult to predict market conditions in marine transport, do you place orders for containers while estimating demand for one or two months down the road?

(A) There are a number of factors in fluctuations in demand for marine containers. One of them is the extent to which trade is increasing. Aside from this, we are seeing the impact of detours due to the worsening of the situation in the Red Sea which has been ongoing since last October, restrictions to shipping through the Panama Canal due to water shortages, the collapse of the bridge in Baltimore, and other circumstances. CAI's expertise in quickly anticipating the changing needs of our customers in light of such conditions, and reading future demand, is very strong.