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Summary

In 1H FY3/19, the Company posted a record-high profit due to the increase in non-asset earnings and other factors. The Company is also bolstering its BPO business through new M&A activity.

Fuyo General Lease Co., Ltd. <8424> (hereinafter, the Company) is a comprehensive leasing company affiliated with Mizuho Financial Group, Inc. <8411> (formerly The Fuji Bank, Limited) that was established in 1969 by six Fuyo Group companies, including Fuji Bank and Marubeni Corporation <8002>. Its strengths are information and office equipment and real estate leasing. The Company ranks sixth in the industry at ¥1,105.0bn in annual newly executed contract volume and ¥2,172.6bn in operating assets (FY3/18 result). It has steadily accumulated operating assets and expanded income results by leveraging advanced solution capabilities for customer challenges, including asset management, cost control, and know-how from expertise.

The Company is promoting its five-year medium-term management plan Frontier Expansion 2021, which lasts through FY3/22. With a slogan of “Going where no one has gone before,” it aims to be a corporate group with sustainable growth, despite major changes in the environment for domestic leasing business, through expansion of the business portfolio’s “frontier” by pursuing new business areas and business models. Its goals for the final year are ¥2,500.0bn in operating assets (4.1% average annual growth), 2.0% ROA* (return on assets) (+0.4ppt), and ¥50bn in ordinary profit (9.8% average annual growth). While the ordinary profit goal presents a tough hurdle, the Company hopes to reach this level through the combined impact of expanded operating assets and improved ROA.

In 1H FY3/19, the second year of the medium-term management plan, the Company posted a decline in revenues but an increase in profits. Total revenues were ¥295.7bn (-2.3% YoY), while the Company posted ¥18.2bn in operating profit (+3.9%) and ¥19.6bn in ordinary profit (+4.2%), which marked another record-high level (on a 1H basis). Total revenues declined due to the drop-off of large overseas projects, but profit before interest expenses, a measure of true business results grew healthily to ¥36.2bn (+3.8%, +¥1.3bn YoY). Operating assets temporarily declined due to completions and sales of large real estate leases, and gross margin on assets was flat YoY, but the increase in non-asset earnings contributed significantly to the growth in profit before interest expenses. Newly executed contract volume declined YoY due to the absence of large bridge projects and delays in aircraft deliveries, but the Company expects the volume of contracts executed to increase in 2H due to contracts executed on aircraft and other factors. In terms of strategy, the Company converted INVOICE INC., which provides integrated billing services, into a consolidated subsidiary, in a full-fledged effort to bolster the BPO business (a new domain), and made other moves targeting future business expansion.

The Company retained its FY3/19 forecast at initial levels of ¥600bn in total revenues (+1.6% YoY), ¥34bn in operating profit (+3.9%), and ¥37.5bn in ordinary profit (+6.5%). This outlook projects higher revenues and profits. While the growth rate was slower than in the previous fiscal year due to exhaustion of the consolidation effect for Accretive Co., Ltd. <8423>, the Company expects the accumulation of operating assets and growth in non-asset earnings to drive growth in overall operating results. Furthermore, the Company intends to pay an annual dividend of ¥156, an increase of ¥10 YoY, reflecting anticipated profit growth. We think the Company can achieve these forecasts due to: 1) the expected accumulation of operating assets in 2H; 2) improved ROA due to non-asset earnings; and 3) steady progress in strategic areas. We will keep our focus on progress in strategic areas and the path to improve ROA.

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Key Points

- In 1H FY3/19, total revenues declined while profit increased, and the Company once again posted record-high profit.
- Although operating assets temporarily declined, the increase in non-asset earnings drove the growth in operating results.
- Maintained FY3/19 forecast projecting higher revenues and profits (higher dividend).
- On the strategy front, the Company will make full-fledged efforts to strengthen the BPO business (a new domain) by making INVOICE a consolidated subsidiary.

Company profile

Comprehensive leasing company with strengths in real estate, aircraft, and other areas, aggressively pursuing expansion into new domains

1. Business overview

The Company has three business segments - lease and installment sales, financing, and other – and also provides disclosure of lease and installment sales separately. Mainstay lease business accounts for 88.3% of total revenues, 38.9% of newly executed contract volume, and 66.8% of operating assets (as of 1H FY3/19).
Company profile

Revenue composition by segment (1H FY3/19)

Source: Prepared by FISCO from the Company’s results briefing materials

Ratio of newly executed contract volume by segment (1H FY3/19)

Source: Prepared by FISCO from the Company’s financial results

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Below, we review the Company's business segments.

(1) Lease and installment sales
This segment handles leases of information and communications equipment, office equipment, industrial machine tools, and other equipment and installment sales of commercial facilities, production facilities, hospital facilities, and other facilities.

In lease business, the leasing company purchases and leases machinery, equipment, or other facilities selected by customers for a certain leasing fee over a relatively long period. In other words, leases constitute a funding method (financial transaction) that focuses on facility deployment. Benefits to customers, versus outright purchase (and ownership) of facilities, include efficient utilization of capital, reduction of administrative burden, avoidance of risk from outdated facilities, and cost control. Leasing companies, meanwhile, confront less collection risk than ordinary loan transactions because they possess ownership rights to the leased equipment. The Company conducts installment sales for equipment that does not qualify as leasing for tax purposes and cases in which the customer wants direct ownership.

When categorizing the volume of newly executed lease contract volume by type of equipment, buildings, etc. (real estate leases) and transportation equipment have been experiencing substantial growth in recent times. Key drivers in real estate leases are commercial properties (such as large shopping centers), an area of expertise, and business hotels, which have been growing recently thanks to rising inbound demand*. The Company leverages its experience of over 30 years and an extensive network in this business given the need for expertise and know-how with tough legal hurdles and complex rights relationships. Furthermore, aircraft leases are driving growth in transportation equipment and the Company holds advantages in this area as well with its lengthy track record and robust know-how.

* In 1H FY3/19, the absence of large bridge projects resulted in a temporary decline in real estate leases.
(2) Financing
This segment covers capital investment funding and other business loans, real estate financing, and securities-related management tasks. Its operating assets include corporate operating loans (such as syndicate loans) and retail funding through consolidated subsidiary Sharp Finance Corporation (SFC). The Company added factoring business* handled by Accretive, which became a consolidated subsidiary in January 2017.

* This business mainly handles FPS (early payment service for accounts receivable) for small businesses and FPS Medical (early payment service for medical and care fee credits) for medical institutions. It has a high turnover rate with execution and recovery in a short period, which the Company lacked up to now, and has been contributing substantially to the expansion of newly executed contract volume and improvement of gross margin on assets.

(3) Other
This segment includes megasolar operations (renewable energy business) handled directly by the Company, silent partnership originations for aircraft leases and other businesses, and the life insurance agency business. Also, in October 2018, the Company made integrated billing service*1 provider INVOICE a consolidated subsidiary. Going forward, the Company will make full-fledged efforts to strengthen the BPO business*2 centered on INVOICE.

*1 A service that handles making burdensome monthly payments to telecom carriers and other utilities on behalf of customers.

*2 Business Process Outsourcing: A service that contributes to operational improvements and increased efficiency by handling some of client companies’ business processes.

2. History
The Company was established in 1969 with six companies from the Fuyo Group as shareholders led by Fuji Bank (now, Mizuho Bank, Ltd.) and Marubeni-Iida Co., Ltd. (now, Marubeni).

It steadily broadened business scope thereafter and created a local entity in the US in 1988. It established a local entity in Ireland (Dublin), a major center for aircraft leases, in 1999. The Company was relatively early in its entry to aircraft business, which has recently attracted attention from many companies, and accumulated a track record and know-how with leveraged leases (aircraft leases with investor subscriptions) and other formats.
Company profile

The Company has also teamed up with other companies to establish joint ventures, such as Yokogawa Rental & Lease Corporation (holds a large share in measuring instruments) with Yokogawa Electric Corporation <6841> in 1987 and Nihon Credit Lease Co., Ltd. (holds a large share in medical equipment and welfare equipment) with NICHIGAKKAN CO., LTD. <9792> in 1999.

Major turning points were listing shares on the First Section of the Tokyo Stock Exchange in December 2004 and acquisition of SFC as a consolidated subsidiary (buying a 65% stake) in April 2008. SFC controls a strong share in the retail (vendor lease) area that is highly profitable and contributed substantially to broadening business scope and increasing scale.

In June 2014, the Company acquired ALM 2010 Limited (it changed the name to Fuyo Aviation Capital Europe Limited), a UK-based aircraft-related services companies, as a consolidated subsidiary (buying all shares) and thereby strengthened its ability to expand aircraft business.

In January 2017, it acquired Accretive, a subsidiary of Don Quijote Holdings Co., Ltd. <7532> that operates a factoring (purchase of accounts receivable) business mainly for small businesses, as a consolidated subsidiary via a tender offer (acquired 51% of voting rights)*. It hopes to realize synergies from cross-selling with Group companies in addition to strengthening initiatives in new domains and collaborating with overseas sites. In October 2018, the Company made INVOICE, an integrated billing service provider, a consolidated subsidiary (acquired 60% of voting rights), in a full-fledged effort to strengthen the BPO business.

* On September 21, 2018, the Company decided to carry out a tender offer of Accretive with the aim of delisting the company (the tender officer was completed on November 6, 2018).

Financial results

Profit before interest expenses, an indicator of true business performance, is increasing due to the accumulation of operating assets

1. Key points for assessing results

The Company’s sales consist of lease fee revenue, which is roughly 85% of overall sales, revenue from installment sales, and interest income on operating loans. Since revenues fundamentally fluctuate with operating assets, the Company needs to increase newly executed contract volume and accumulate more operating assets in order to expand revenues. However, it should be noted that accounting of mainstay lease fee revenue reflects the purchase transaction and includes the price of the leased item. We hence think profit excluding the acquisition cost of leased equipment from revenues (henceforth, profit before interest expenses) is the suitable indicator for assessing income growth as business. This value corresponds to the operating assets multiplied by gross margin on assets. Movement in both of these amounts has an impact. Moreover, there is a need to take note of movements in the Other segment as the Company has recently worked to increase in non-asset earnings.
Financial results

To ascertain profitability of the Company’s main business, meanwhile, we think the most rational approach is monitoring ordinary profit that deducts interest expenses (funding costs), personnel and equipment expenses, credit-related costs (including reversals)*, and other items from profit before interest expenses.

* This is the net value of provision of allowance for doubtful accounts (SG&A expenses) and reversal of allowance for doubtful accounts (non-operating income).

2. Past results trends

Looking at past results, revenues steadily trended upward thanks to the accumulation of operating assets (particularly lease operating assets). While profit before interest expenses temporarily slipped in FY3/13 to FY3/14, it restored an upward trend from FY3/15. The setback in profit before interest expenses mainly occurred due to a fall in advanced profit effect in accordance with changes to the lease accounting standard in 2008 and the decline in gross margin on assets accompanying reduction of lease fee rates due to tougher competition. The Company pursued income recovery through accumulation of operating assets and improvement in gross margin on assets. We think expansion of real estate leases and aircraft leases with relatively large yields contributed to improvement in gross margin on assets.

From a cost perspective, meanwhile, funding costs have been largely flat. This trend, despite growth in total funding value, is driven by decline in funding costs due to the impact of market rates. Additionally, the Company keeps personnel and equipment expenses at a certain level and has low credit-related costs. Low-cost operations, a strength, are paying off. Ordinary profit hence has risen for four straight fiscal years.

Interest-bearing debt has been growing due to the accumulation of operating assets, but the equity ratio remains steady at about 10%. The 10% range does not lag other companies in the leasing industry, which possesses large amounts of highly liquid operating assets, and should not spark concerns about stability of the Company’s financial base.

ROA* stayed at around 1.4% even with intensification of interest rate competition. ROE, which reflects capital efficiency, however, trended lower, though it has offered signs of improvement since FY3/16. * Ordinary profit / Total assets (average balance)

Operating cash flow remains negative and the size of this deficit has grown in the past three fiscal years. We think it is reasonable to interpret this as a reflection of the Company’s growth potential because the main cause is aggressive accumulation of operating assets, which are future income sources.
Financial results

**Trend in operating assets**

![Trend in operating assets chart](image)

Source: Prepared by FISCO from the Company’s results briefing materials

**Trend in gross margin on assets**

![Trend in gross margin on assets chart](image)

Source: Prepared by FISCO from the Company’s results briefing materials

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3. Summary of 1H FY3/19

In 1H FY3/19, the Company posted a decline in revenues but an increase in profits. Total revenues were ¥295.7bn (-2.3% YoY), while the Company posted ¥18.2bn in operating profit (+3.9%) and ¥19.6bn in ordinary profit (+4.2%), and profit attributable to owners of parent of ¥12.7 billion (+8.4%). In terms of profits, the Company once again posted record high profit (on a 1H basis).

Total revenues declined due to the drop-off of large overseas projects, but the Company secured the second highest level of total revenues (for 1H) behind the previous fiscal year. In addition, profit before interest expenses, a measure of true business results, grew a healthy 3.8% to ¥36.2bn (+¥1.3bn YoY). Operating assets temporarily declined due to completions and sales of large real estate leases, and gross margin on assets was flat YoY, but the increase in non-asset earnings* contributed significantly to the growth in profit before interest expenses. In terms of newly executed contract volume, although the factoring business performed well, centered on Accretive, newly executed contract volume declined YoY due to the absence of large bridge projects and delays in aircraft deliveries, along with other factors. Nonetheless, the Company expects the volume of contracts executed to increase in 2H due to multiple contracts executed on aircraft and other factors.

* Posting of gains on sales related to the asset turnover business (monetization transactions for the purpose of replacement of lease assets, etc.) and an increase in fee income.

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Financial results

Ordinary profit rose, as growth in profit before interest expenses and an increase in the equity-method investment gain* absorbed cost increases due to an increase in interest expenses and absence of reversal of allowance for doubtful accounts stemming from an increase in foreign currency borrowings (borrowings in conjunction with the expansion of the aircraft business).

* From a Canadian pick-up truck rental and leasing company (equity-method affiliate) acquired through M&A in March 2018.

As a result, ROA* improved slightly to 1.83% (versus 1.82% in 1H FY3/18). As discussed above, the increase in non-asset earnings resulted in the improved ROA.

* Ordinary profit (annualized) / operating assets (average balance).

In terms of financial condition, while operating assets temporarily declined due to completions and sales of large bridge projects, the increase in cash and deposits resulted in total assets moving roughly sideways, increasing 0.4% versus the end of FY3/18 to ¥2,440.2bn. Meanwhile, the Company’s equity ratio slightly improved to 10.5% (vs. 10.2% at the end of FY3/18) as shareholders’ equity grew 2.7% to ¥259.9bn due to accumulated retained profit and other factors. Interest-bearing debt rose 0.5% to ¥19,753mn, but we think the Company is maintaining a stable financial position with the long-term debt ratio of interest-bearing debt (excluding lease obligations) at a high level of 52.7% (vs. 51.1% at the end of FY3/18) and a high liquidity ratio of 144.2% (vs. 141.1% at the end of FY3/18).
Financial results

Summary of 1H FY3/19

<table>
<thead>
<tr>
<th></th>
<th>1H FY3/18</th>
<th>1H FY3/19</th>
<th>Change</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Results</td>
<td>Ratio</td>
<td>Results</td>
<td>Ratio</td>
</tr>
<tr>
<td>Total revenues</td>
<td>302.6</td>
<td>86.7%</td>
<td>295.7</td>
<td>88.3%</td>
</tr>
<tr>
<td>Lease</td>
<td>262.4</td>
<td>92.0%</td>
<td>261.1</td>
<td>91.1%</td>
</tr>
<tr>
<td>Installment sales</td>
<td>27.9</td>
<td>9.2%</td>
<td>19.2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Financing</td>
<td>6.4</td>
<td>2.1%</td>
<td>7.0</td>
<td>2.4%</td>
</tr>
<tr>
<td>Other</td>
<td>6.0</td>
<td>2.0%</td>
<td>8.4</td>
<td>2.8%</td>
</tr>
<tr>
<td>Profit before interest expenses</td>
<td>34.8</td>
<td>11.5%</td>
<td>36.2</td>
<td>12.2%</td>
</tr>
<tr>
<td>Lease</td>
<td>23.6</td>
<td>9.0%</td>
<td>23.0</td>
<td>8.8%</td>
</tr>
<tr>
<td>Installment sales</td>
<td>1.1</td>
<td>3.9%</td>
<td>0.9</td>
<td>4.7%</td>
</tr>
<tr>
<td>Financing</td>
<td>6.4</td>
<td>100.0%</td>
<td>6.9</td>
<td>98.6%</td>
</tr>
<tr>
<td>Other</td>
<td>3.8</td>
<td>63.3%</td>
<td>5.3</td>
<td>63.1%</td>
</tr>
<tr>
<td>Interest expenses</td>
<td>3.6</td>
<td>1.2%</td>
<td>4.1</td>
<td>1.4%</td>
</tr>
<tr>
<td>Gross profit</td>
<td>31.2</td>
<td>10.3%</td>
<td>32.1</td>
<td>10.9%</td>
</tr>
<tr>
<td>SG&amp;A expenses</td>
<td>13.7</td>
<td>4.5%</td>
<td>13.9</td>
<td>4.7%</td>
</tr>
<tr>
<td>Operating profit</td>
<td>17.5</td>
<td>5.8%</td>
<td>18.2</td>
<td>6.2%</td>
</tr>
<tr>
<td>Ordinary profit</td>
<td>18.8</td>
<td>6.2%</td>
<td>19.6</td>
<td>6.6%</td>
</tr>
<tr>
<td>Profit attributable to owners of parent</td>
<td>11.7</td>
<td>3.9%</td>
<td>12.7</td>
<td>4.3%</td>
</tr>
<tr>
<td>Newely executed contract volume</td>
<td>523.5</td>
<td>53.6%</td>
<td>484.5</td>
<td>48.9%</td>
</tr>
<tr>
<td>Lease</td>
<td>280.7</td>
<td>53.6%</td>
<td>188.4</td>
<td>38.9%</td>
</tr>
<tr>
<td>Installment sales</td>
<td>28.5</td>
<td>5.5%</td>
<td>16.3</td>
<td>3.3%</td>
</tr>
<tr>
<td>Financing &amp; Other</td>
<td>214.3</td>
<td>40.9%</td>
<td>279.9</td>
<td>57.8%</td>
</tr>
</tbody>
</table>

Newly executed lease contract volume by type of equipment

<table>
<thead>
<tr>
<th>Type of Equipment</th>
<th>March 31, 2018</th>
<th>September 30, 2018</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>280.7</td>
<td>188.4</td>
<td>-92.3</td>
</tr>
<tr>
<td>IT &amp; office equipment</td>
<td>97.6</td>
<td>97.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>Industrial machinery</td>
<td>12.2</td>
<td>13.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Civil engineering and construction machinery</td>
<td>4.7</td>
<td>4.2</td>
<td>-0.5</td>
</tr>
<tr>
<td>Transportation equipment</td>
<td>35.9</td>
<td>14.5</td>
<td>-21.4</td>
</tr>
<tr>
<td>Medical devices</td>
<td>12.0</td>
<td>13.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Commercial/services equipment</td>
<td>22.3</td>
<td>14.1</td>
<td>-8.3</td>
</tr>
<tr>
<td>Buildings, etc.</td>
<td>81.9</td>
<td>22.6</td>
<td>-59.3</td>
</tr>
<tr>
<td>Other</td>
<td>14.1</td>
<td>9.0</td>
<td>-5.1</td>
</tr>
</tbody>
</table>

Source: Prepared by FISCO from the Company’s financial results and results briefing materials.

We encourage readers to review our complete legal statement on “Disclaimer” page.
Below we review results and activities in the Company’s strategic business areas.

(1) Real estate
Operating assets as of September 30, 2018, temporarily declined 9.1%, or ¥33.0bn, compared to the end of FY3/18, to ¥329.0bn, due to completions and sales of bridge projects, including large projects, but this was as expected. Newly executed contract volume declined significantly by 72.4% YoY to ¥22.6bn, due to the fact that the Company carefully selected bridge projects for which profitability has declined amid the increasingly fierce competition. Consequently, the bridge ratio declined to 37% (vs. 42% at the end of FY3/18). ROA, however, was flat at 1.8%, and improving ROA remains an issue for the Company to address going forward. The Company will continue to steadily accumulate assets, pursuing appropriate levels of risk/return even in overheated markets. In particular, as the CRE* strategy by companies that own real estate become increasingly important, the Company is advancing its strategy to increase the added value (profitability) of deals by further strengthening its proposal sales in which it provides land information, which is one of the Company’s areas of strength. One of the key projects implemented in 1H FY3/19 was the Kawasaki King Sky Front Tokyu REI Hotel (a hotel that uses hydrogen energy).

* Effective utilization of corporate-owned real estate

(2) Aircraft
Operating assets as of September 30, 2018, declined slightly by 1.2% to ¥96.4bn, partly due to the impact of exchange rates (there was a slight increase excluding exchange rates). The Company increased the number of aircrafts it owns to 31 (up by 7 from the end of FY3/18), as the Company took in the planes for which deliveries were delayed in the prior fiscal year and by accumulating deals with new overseas airlines. ROA also increased to 2.1% (vs. 1.9% in FY3/18). Amid the downward trend in yields due to intensifying competition, it seems that the Company successfully leveraged its excellent judgment capabilities, and carefully selected deals on an individual basis and made purchases. Going forward the Company plans to continue to increase the number of airlines and companies with which it does business, including further leveraging ALM in the U.K.

(3) Overseas
Operating assets (including investment in affiliates in the overseas business) as of September 30, 2018 grew 1.7% from the end of FY3/18 to ¥95.0bn. ROA increased slightly to 0.7% (vs. 0.6% in FY3/18). Overseas, the Company is pursuing a two-pronged strategy of organic growth and inorganic growth (M&A and alliances, etc.), and the pick-up truck rental and leasing company (Canada) that became an equity-method affiliate in March 2018 contributed to earnings. Also in 1H FY3/19, there were achievements in the organic growth strategy, including the decision to employ people full-time in Singapore and the execution of a lease transaction denominated in Japanese yen within China (a first for the Company). With respect to the former, Singapore is an excellent location as a hub for cross-border business in the ASEAN region, and the Company will focus sales efforts on the markets in Singapore and India for the foreseeable future. However, the Company also views inorganic growth as being necessary in order to achieve future business growth and improved ROA, and it plans to proactively pursue M&A.
Financial results

(4) Energy/environment
Operating assets in the solar power generation business as of September 30, 2018 grew 12.7% from the end of FY3/18 to ¥22.2bn. With the launch of operations at two new sites in the Fukushima area (total power output of 38MW), the Company currently operates megasolar operations in 32 locations nationwide (for a total of 140MWdc). As a result, the Company has achieved its interim target of total output (135MWdc at the end of FY3/20) ahead of schedule. Furthermore, construction is underway on an ultra-large-scale project which will have output of 60MW in the Fukushima area*. ROA increased significantly to 8.3% (vs. 5.1% in the year-earlier period), but this was due to seasonal factors (solar power generation increases in the summer months), and ROA for the full fiscal year is expected to end up around 6.0%. In terms of notable activities, the Company became the first Japanese general leasing company to join RE100**. By 2050, the Company will procure 100% of the energy it uses from renewable energy sources (reaching at least 50% by 2030). At the same time, the Company will contribute to regional areas by further expanding the solar power generation business, provide solutions and services related to renewable energy and energy-saving, enter into alliances with start-ups possessing new technologies that contribute to the proliferation of renewable energy, and otherwise aim to contribute to a sustainable society and achieve continuous growth as a company.

*1 The first project in Japan in an area designated as a “Difficult-to-return zone.”
*2 An international consortium of companies that aim to procure 100% of the energy used in their operations from sustainable sources.

(5) Medical/social welfare
While the Company has not provided detailed numerical targets, a key action was the establishment of the Healthcare Advisory Office and the launch of a management support advisory business targeting healthcare companies. Until now, the Company has been expanding its business domains by buying and selling secondhand medical equipment, factoring service for medical fees, and making investments in medical start-ups and other companies. Going forward, the Company will implement various solutions with its wide-ranging product lineups and service capabilities, with the aim of strengthening its consulting business to solve problems faced by hospital executives. In particular, the Company will pursue improved profitability by switching from an approach based on sales of leases on a unit basis, for which competition is intense, to a model based on proposing solutions. By doing so, the Company will aim to expand its business by working with regional financial institutions and distinctive partner companies.

(6) New domains
Flex Payment Service (FPS; faster payment of accounts receivables) and FPS medical (faster payment of medical treatment and care receivables) provided by Accretive helped to buoy operating performance, and FPS medical grew significantly due to Group partnerships (collaboration with partnering regional financial institutions). In addition, in October 2018, the Company made INVOICE, which provides integrated billing service, a consolidated subsidiary*, as the Company started to bolster the BPO business. Positioning INVOICE as the core company, the Company plans to proactively invest management resources in this area. The strategy appears to be to promote immediately effective sales to the Group’s customer base (contacts with people in finance and accounting divisions of companies). Also, by combining this with existing services (payments of property tax for leased equipment, insuring, asset management services, vehicle maintenance, etc.), the Company will roll out a service to handle cumbersome administrative tasks peripheral to accounting, and help improve productivity at client companies (such as resolving personnel shortages and addressing work style reforms).

* Joint acquisition with the Development Bank of Japan Inc. (the Company holds a 60% stake). The acquisition cost was approximately ¥10.0bn (goodwill undetermined). INVOICE has been performing stably. In its most recent fiscal year (FY3/18), INVOICE posted total revenues of ¥136.9bn and ordinary profit of ¥4.65bn.
Financial results

In summary, based on the above, the results for 1H FY3/19 were strong, and the Company is generally making steady progress in each strategic area. In particular, the establishment of the Healthcare Advisory Office in the medical/social welfare area as well as the acquisition of INVOICE in the new domains area indicate the future path towards business expansion, and are significant, praiseworthy achievements.

Business outlook

The Company has left its full-year forecasts for FY3/19 unchanged, and continues to expect an increase in both revenues and profit. The Company will grow operating assets and increase non-asset earnings

The Company retained its FY3/19 forecast at initial levels of ¥600bn in total revenues (+1.7% YoY), ¥34bn in operating profit (+4.3%), ¥37.5bn in ordinary profit (+6.5%), and ¥23.0bn in profit attributable to owners of parent (+4.8%). This outlook projects higher revenues and profits.

The rate of growth will slow compared to the previous fiscal year due to the exhaustion of the Accretive consolidation effect, but the Company expects operating results to be driven by the accumulation of operating assets and an increase in non-asset earnings.

Although operating assets at September 30, 2018 temporarily declined due to the absence of large bridge projects, we think the Company can achieve these forecasts due to: 1) the expected accumulation in operating assets in 2H; 2) improved ROA due to non-asset earnings; and 3) steady progress in strategic areas. Also, we feel that the effect of the INVOICE acquisition (which was not included in the forecast at the beginning of the fiscal year) will have limited contribution to full-year operating results due to the initial costs associated with the acquisition.

<table>
<thead>
<tr>
<th>FY3/19 outlook</th>
<th>(¥bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY3/18</td>
</tr>
<tr>
<td></td>
<td>Results</td>
</tr>
<tr>
<td>Total revenues</td>
<td>590.2</td>
</tr>
<tr>
<td>Operating profit</td>
<td>32.6</td>
</tr>
<tr>
<td>Ordinary profit</td>
<td>35.2</td>
</tr>
<tr>
<td>Profit attributable to owners of parent</td>
<td>21.9</td>
</tr>
</tbody>
</table>

Source: Prepared by FISCO from the Company’s financial results

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Industry environment

Facing tougher competition, including direct entry by banks, amid modest softening of the domestic lease market

A survey conducted by the Japan Leasing Association reported a 2.9% YoY decline in lease handling volume in FY3/18 to ¥4,875.8bn, continuing a downward trend for two years. Looking at trends in the business environment in past years, the domestic lease market steadily contracted due to cutbacks in capital investments after the economic downturn precipitated by the Lehman Brothers bankruptcy, then achieved a moderate recovery on improved economic activity and higher capital investments, including help from the government’s capital investment promotion measures, and has been softening recently because of uncertainty and lackluster interest in leases.

Competition is fierce with 10 listed companies, mainly independent companies, bank-affiliated companies, and manufacturer-affiliated companies. Leading participants in terms of operating assets are ORIX Corporation <8591>, Mitsubishi UFJ Lease & Finance Company Limited <8593>, Sumitomo Mitsui Finance and Leasing Company, Limited, Tokyo Century Corporation <8439>, and Hitachi Capital Corporation <8586>. The Company ranks sixth in the industry but posts strong growth rates among major companies. Bank affiliates expanded their scale through mergers as part of bank reorganizations. The top group has not changed much recently. Additionally, competition is likely to become even tougher with direct entry by banks in response to the impact of the negative interest rate policy.

Main leasing companies (ranking by operating assets as of the end of March 2018) (¥bn)

<table>
<thead>
<tr>
<th>Code</th>
<th>Operating assets</th>
<th>Change from the end of the previous fiscal year</th>
</tr>
</thead>
<tbody>
<tr>
<td>ORIX</td>
<td>8591</td>
<td>9,017.2</td>
</tr>
<tr>
<td>Mitsubishi UFJ Lease &amp; Finance</td>
<td>8593</td>
<td>4,909.2</td>
</tr>
<tr>
<td>Sumitomo Mitsui Finance and Leasing Company, Limited</td>
<td>-</td>
<td>4,795.9</td>
</tr>
<tr>
<td>Tokyo Century</td>
<td>8439</td>
<td>3,230.6</td>
</tr>
<tr>
<td>Hitachi Capital</td>
<td>8586</td>
<td>3,179.1</td>
</tr>
<tr>
<td>Fuyo General Lease</td>
<td>8424</td>
<td>2,168.7</td>
</tr>
<tr>
<td>IBJ Leasing</td>
<td>8425</td>
<td>1,683.0</td>
</tr>
</tbody>
</table>

Source: Prepared by FISCO from the Company’s materials
Growth strategy

Aims to increase operating assets and raise ROA through expansion of businesses with high profitability and frontier (new domains) initiatives

1. Medium-term management plan

The Company is promoting its medium-term management plan Frontier Expansion 2021, which covers FY3/18 through FY3/22. With a slogan of “Going where no one has gone before,” it aims to become a corporate group with sustainable growth, despite major changes in the environment for domestic leasing business, through expansion of the business portfolio’s “frontier” by pursuing new business areas and business models. The plan is a five-year long-term outlook for expansion of the frontier.

Its business goals for five years from now are ¥2,500.0bn in operating assets (+¥456.4bn), 2.0% ROA (+0.4ppt), and ¥50.0bn in ordinary profit (+¥18.6bn). Average annual growth rates for the five years are 4.1% in operating assets and 9.8% in ordinary profit. While the ordinary profit goal presents a tough hurdle, the Company hopes to reach this level through the combined impact of expanded operating assets and improved ROA.

### Numerical targets of the medium-term management plan

<table>
<thead>
<tr>
<th>FY3/17 results</th>
<th>FY3/18 results</th>
<th>FY3/20 interim target</th>
<th>FY3/22 target</th>
<th>Five-year increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset balance</td>
<td>¥2,043.5bn</td>
<td>¥2,168.7bn</td>
<td>¥2,300-2,400bn</td>
<td>¥2,500bn</td>
</tr>
<tr>
<td>ROA</td>
<td>1.6%</td>
<td>1.6%</td>
<td>1.7%-1.8%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Ordinary profit</td>
<td>¥31.3bn</td>
<td>¥35.2bn</td>
<td>¥38.0-42.0bn</td>
<td>¥50.0bn</td>
</tr>
</tbody>
</table>

Source: Prepared by FISCO from the Company’s materials

Core strategies include 1) selection and concentration in strategic areas, 2) challenge the frontier, and 3) pursue Group synergies.

1. **Selection and concentration in strategic areas**

The Company intends to concentrate business resources in strategic areas as growth drivers – 1) real estate, 2) energy/environment, 3) medical and social welfare, 4) aircraft, 5) overseas, and 6) new domains. It also positions the following areas as core areas where it aims to maintain and expand the market (customer base) via group collaboration and other improvements in efficiency – 7) auto leases, 8) vendor leases, 9) domestic corporate, and 10) finance.

2. **Challenge the frontier**

The Company plans to shift emphasis to added value, services, and business areas that banks cannot offer in order to clarify differentiation with rivals (bank-affiliated leasing companies and banks themselves). It aims to expand into areas that place value (business value) on goods. In new domain expansion, it is mainly considering utilization of M&A and capital and business alliances and seeking non-asset businesses that contribute to higher asset efficiency (ROA), such as through fee income.

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(3) Pursue Group synergies
It aims to maximize Group synergies by rolling out products (services) from Group companies to the markets (customer bases) of other Group companies. It hopes to dramatically enhance sales performance by effectively connecting the Group’s “functions” and “customer bases,” including its main operations with strength in large corporate transactions, SFC’s retail-oriented business, Accretive’s factoring platform that links large companies and small businesses, and INVOICE’s integrated billing service with a customer base of 16,000 companies.

2. Direction in strategic areas

(1) Real estate
The Company set goals of ¥480.0bn in operating assets in five years (roughly doubling value over five years) and 2.2% in ROA (+0.3ppt) that it intends to achieve by maintaining and expanding upbeat newly executed contract volume. It plans to continue recruitment of customer needs by offering land information, expansion of risk-taking activities, such as finding tenants on its own, and broadening the frontier with real estate financing, investments in REITs, and real estate investments. It is also promoting Group initiatives, such as real estate lease proposals at SFC.

(2) Energy/environment
In the mainstay solar power business, the Company seeks to expand scale by multiple times, while reducing the number of projects, as phase two that emphasizes mega-solar power sites unfolds. Over the next five years, it plans to expand power output to 165MW (doubling electricity supply in five years) and operating assets to ¥34.0bn (roughly doubling in five years) and sustain ROA at a strong 6.0%. As already explained, the Company has started operations at two large-scale solar plants in 1H FY3/19 with combined electricity output of 140MWdc. The Company has also started construction on an ultra-large-scale project (60MW) that will be its biggest project ever.

(3) Medical/social welfare
While it has not presented specific goals, the Company expects growing demand, including wide adoption of community-based integrated care systems promoted by the government, and views this as an area where it can create synergies among Group companies. In medical business, it is taking steps to expand the frontier by offering consulting services for hospital revitalization, business management, and other areas, utilizing know-how in alliances with consolidated subsidiary FUJITA Co., Ltd., which sells used medical equipment, and promoting Accretive’s factoring service for medical and care fees, as well as work toward switching to a model based on proposing solutions through the establishment of the Healthcare Advisory Office and the launch of a management support advisory business targeting healthcare companies. In social welfare (care) business, it plans to further pursue building leases for senior homes and other care facilities, an area where it led the industry, through the partnership with NICHIGAKKAN, a major company in the care industry.

(4) Aircraft
The Company intends to accelerate arrangement of ownership to about 10 aircraft per year and expand the number of aircraft that it owns by fourfold to 70 (an increase of 51) in five years. With these additions, it is targeting expansion of operating assets to ¥280.0bn (+¥204.9bn) and ROA of 2.3% (+0.4ppt). While competition has heated up amid growth in global demand, the Company hopes to expand scale and improve asset efficiency through provision of added value that leverages its strengths, similar to real estate leases. In particular, as discussed above, it will seek expansion of transactions with airlines, arrange package deals (multiple aircraft), and realize inorganic growth (through investments, joint ventures, and other activities).
Growth strategy

(5) Overseas
The Company presented goals in five years of a roughly 1.5-fold expansion of operating assets to ¥120.0bn (+¥35.9bn) and ROA of 1.8% (+1.2ppt) driven by further promotion of non-Japanese business mainly in North America and Asia and inorganic growth (including investments, acquisitions, and alliances). Its inorganic strategy appears to be targeting non-Japanese lease companies located in North America and Asian emerging countries (with specialized businesses that focus on transportation equipment leases, medical equipment leases, auto loans, and other areas). In organic growth, it is aiming for expansion of overseas sites and utilization of Accretive’s overseas sites (offering small-sum financing services in Thailand and Cambodia).

(6) New domains
New domains generally refer to “business that involves new initiatives,” such as expansion of new businesses and business areas. The Company seeks to expand its frontier mainly in non-asset businesses and raise ordinary profit to about ¥4.0bn in five years. Its strategy targets improved profitability and asset efficiency through initiatives in Accretive’s factoring services; INVOICE’s integrated billing service; development of a lease scheme that incorporates used equipment sales and used values; lease asset monetization business; and accounting services, mainly using FLOW Cube+ which it developed jointly with SAP, and other related services. In particular, the Company will make full-fledged efforts to strengthen the BPO business with INVOICE as the core company and help improve productivity at client companies.

Numerical targets in strategic areas

<table>
<thead>
<tr>
<th></th>
<th>FY3/17 results</th>
<th>FY3/18 results</th>
<th>FY3/20 interim target</th>
<th>FY3/22 target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating assets</td>
<td>¥240.2bn</td>
<td>¥362.0bn</td>
<td>¥380.0bn</td>
<td>¥480.0bn</td>
</tr>
<tr>
<td>ROA</td>
<td>1.9%</td>
<td>1.8%</td>
<td>2.0%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Energy/environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating assets</td>
<td>¥17.2bn</td>
<td>¥19.7bn</td>
<td>¥29.0bn</td>
<td>¥34.0bn</td>
</tr>
<tr>
<td>ROA</td>
<td>6.1%</td>
<td>5.1%</td>
<td>6.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Output (MWdc)</td>
<td>77</td>
<td>102</td>
<td>135</td>
<td>165</td>
</tr>
<tr>
<td>Aircraft</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating assets</td>
<td>¥75.1bn</td>
<td>¥97.6bn</td>
<td>¥210.0bn</td>
<td>¥280.0bn</td>
</tr>
<tr>
<td>ROA</td>
<td>1.9%</td>
<td>1.9%</td>
<td>2.0%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Self-owned aircraft</td>
<td>19</td>
<td>24</td>
<td>49</td>
<td>70</td>
</tr>
<tr>
<td>Overseas</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating assets</td>
<td>¥84.1bn</td>
<td>¥87.1bn</td>
<td>¥110.0bn</td>
<td>¥120.0bn</td>
</tr>
<tr>
<td>ROA</td>
<td>0.6%</td>
<td>0.6%</td>
<td>1.5%</td>
<td>1.8%</td>
</tr>
<tr>
<td>New domains</td>
<td>¥1.7bn</td>
<td>-</td>
<td>Approx. ¥3.0bn</td>
<td>Approx. ¥4.0bn</td>
</tr>
<tr>
<td>Ordinary profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Prepared by FISCO from the Company’s materials

Given these efforts, we expect expansion of operating assets and profitability improvement led by real estate and aircraft areas to continue to play a major role in attainment of the Company’s goals in the medium-term management plan. We also think that the increase in new domains which have a high asset efficiency (including non-asset earnings) will contribute to an increase in ROA. In particular, it is very likely that the development of the BPO business will become a new earnings driver, due to the fact that potential demand is high and this is an area in which the Company can leverage its strengths.

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Growth strategy

We believe the Company is capable of reaching its goal for expansion of operating assets in light of the external conditions in strategic areas, its results up to now, and its advantages. Our main focus is how the Company increases ROA. Progress in lifting ROA should be assessed in terms of 1) expansion of business in areas with high ROA (change in mix), such as real estate, aircraft, and renewable energy, and 2) improvement of ROA in the real estate and aircraft businesses. We see healthy prospects for boosting ROA through change in mix by expanding businesses with high profitability and obtaining income in new domains with high asset efficiency. For the latter effort (finding ways to raise ROA in the real estate and aircraft businesses), we think it is important to pay close attention to the external environment and internal measures.

Shareholder returns

Steadily raising the dividend with support from strong performance and plans to increase it again in FY3/19 by ¥10 to ¥156

The Company follows a fundamental policy of striving to return profits to shareholders by reinforcing shareholders’ equity and continuing long-term, stable dividends to ensure a solid business foundation and robust financial conditions taking into account its profits and business goals. It appears to be aiming for a dividend payout ratio of about 20.0%.

The Company paid a ¥146 annual dividend in FY3/18 (¥68 interim dividend, ¥78 year-end dividend), an increase of ¥16 YoY. This put the dividend payout ratio at 20.1%. In FY3/19, the Company plans to raise the dividend again to ¥156 (¥78 interim, ¥78 year-end), an increase of ¥10 YoY that reflects anticipated profit growth.

The Company has been steadily increasing its annual dividend each year, and we see room for further increases accompanying growth in profits.

![Dividend per share and dividend payout ratio graph](image-url)

Source: Prepared by FISCO from the Company’s financial results

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