PREMIUM GROUP (7199 JP)

FY21 (YEAR ENDING MAR-21) 1H EARNINGS RESULT

Premium Group reported FY21 (ending March 2021) 1H results with pre-tax profit of ¥2,001mil (-34.4% YoY) on operating income of ¥8,386mil (+26.0% YoY). Pre-tax profit without one-off factors, which shows profit earned from operations, was ¥1,457mil (+29.3% YoY) versus ¥1,127mil during the same period last year. Future expected earnings (deferred revenue reported on the BS from which the firm will realise as revenue at some point in the future) increased 16.5% YoY to ¥28,000mil – comprising Automobile Credit ¥23,090mil, Automobile Warranty ¥4,710mil and Others ¥200mil).

Premium Groups has three business segments:

1. Finance Business which includes Automobile Credit Business, Servicer, and Lease.
2. Automobile Warranty
3. Auto Mobility Services which includes Repair, Parts Reuse & Recycle and Software Sales to garages.

Premium Group established its "stock based business model" in the Finance and the Warranty businesses. Here, it builds business assets (stock) from the financial guarantee fees that it receives upfront when a loan is agreed. The loan is recognised as a cost to the firm as the guarantee must be honoured. Receivables – monthly payments – from the loans, generates a stable recurring revenue stream. Revenue from those two businesses are, therefore, usually the least sensitive to the external environment.

In FY21 1H, the operating revenue of the Finance Business, which includes the firm's core business, Automobile Credit Finance, grew 27.4% YoY to ¥5,843mil and rose 9.1% YoY in the Automobile Warranty Business to ¥1,945mil.

Meanwhile, Auto Mobility – a new business which made a kick start last fiscal year – is purely a fee-based business. The business earned operating revenue of ¥598mil (+108.3% YoY).

FY21 1H operating expenses rose 20.9% YoY to ¥6,944mil due to the added costs (ca. ¥430mil) associated with the consolidation of three new subsidiaries since Jan 2020. Without these costs, operating expenses would have risen 13.4% YoY.

EXECUTIVE SUMMARY

- FY21 1H operating income hit ¥8,386mil (+26.0% YoY), while pre-tax profit fell 34.4% YoY to ¥2,001mil. Without one-off factors, pre-tax profit was ¥1,457mil (+29.3% YoY).Future expected earnings increased 16.5% YoY to ¥28,000mil.

- Finance business, which includes the firm's core business, Automobile Credit, saw operating revenue rose by 27.4% YoY to ¥5,843mil thanks to recurring revenue despite the weak used car market. Gross profit rate of the segment saw a good improvement (+22% in Q2 alone).

- Out of the 3 KPIs for the segment, transaction of new loans was affected by the weakness of the used car retail market due to COVID. Other two KPIs, loan receivables balance and change in network store numbers both improved on the YoY basis.

- Automobile Warranty business saw revenue rose 9.1% YoY to ¥1,945mil. Thanks to the high market share the firm obtained in the third party warranty market, the business was least influenced by the weak used car market.

- The third growth pillar, Auto Mobility Services segment had a kick start this year. Revenue soared 108.3% YoY.

- Full-year company estimate remains unchanged from August. However, the used car market has been recovering since then. In October, used car registration number saw +12.5% YoY / +5.5% MoM increase.

- This year is the first year of the 3-year medium-term plan. Although the external environment has not been as expected, the firm's revenue has been stable thanks to recurring revenue earned from the 2 core businesses.

- FY21 dividend is ¥45/share, at pay-out ratio of 30%.

BUSINESS SEGMENTS

Finance Business

Finance Business segment includes Premium's core business Automobile Credit Finance business. In Finance Business, FY21 1H operating revenue reached ¥5,843mil (+27.4% YoY) vast majority of which was earned through Automobile Credit Finance. There are three key performance indicators (KPIs) for the Automobile Credit Finance business:

1. Transaction Volume of New Loans:
   FY21 1H new loans transactions fell 15.5% YoY to ¥77,800mil mainly due to the following three reasons.
   i. Weaker used car sales. Used car auction prices were impacted by weak new car sales in 1H. Fewer new car sales means a lower number of used cars going to auction. This led to higher used car prices which, in turn, affected the used car retail sales.

   ii. The delay in returning to normal level of marketing activities after operations were temporarily suspended due to the State of Emergency in Q1. The firm reckons that the delay in introducing digitalised marketing activities, such as paperless contracts was the fundamental reason behind this lost opportunity to boost its marketing.

   iii. In Q2 alone last year, new credit rose 53.2% YoY prior to the hike in the consumption tax introduced in October. Without the impact of the tax hike, new loan transactions might have been down just 0.9% YoY.

Although new loan transactions fell YoY, Premium maintained its level of the credit screening. As a result, the gross profit of Auto Credit improved. For example, in Q1, gross profit margin improved 0.51pptYoY and in Q2, it rose 1.21pptYoY. Interest rate on credit differs from one used car dealer to another but in general, interest rate charged at smaller dealers is higher because of smaller transaction volume hence less volume discount on credit interest.

Premium launched a fee-paying membership service, PFS *Premium Club,* for used car dealers to further monetise transaction opportunities.

2. Loan Receivables Balance:
   The total loan receivables balance in FY21 1H increased 14.5% YoY to ¥333,606mil, though was lower than the 28.5% YoY growth reported a year ago. The default rate slightly rose to 0.92% from 0.83% a year ago due to delays in collection activities on the back of the temporary closure of the courts under the COVID. The slower growth of the loan receivables balance, on the back of the fall in new loans transactions, also led to a higher default rate.

   Premium aims to reduce late payments by proactively contacting the borrowers at an early stage (less than one-month after the planned payment date). Ca. 12% of the borrowers miss payments simply because they forget to pay, or their bank account balance does not cover the loan payment because they did not check their account balance in time. By checking on the status of the borrowers at an early stage, Premium reckons that it will likely reduce defaults at a later stage, which will subsequently improve the quality of its loan book.

3. Number of credit network stores:
   The number of credit network stores rose 9.5% YoY to 23,322 as of 1H. Despite marketing activities being voluntarily suspended during Q1, the firm managed to increase the number of new network stores in the Q2 by 42.7% YoY. However, the number fell 22.8% YoY in the 1H.

   There are 50,000~60,000 used car dealers in Japan, therefore, the firm hopes to continue to increase the number of new network stores. However, it will also promote the cross selling of other products and services, such as automobile warranty, to the active network stores. It launched a portal site, *P-Gate,* on which all network stores will have access and will be able to find all available services. Concurrently, it aims to activate dormant network stores.

Automobile Warranty Business

Premium's second pillar of business, Automobile Warranty, generated FY21 1H operating revenue of ¥1,945mil (+9.1% YoY). Thanks to its high market share, the impact of the weak used car retail market was small. This segment is formed with two brands. Transaction volumes of Premium warranties fell 1.7% YoY while those of EGS, an acquired subsidiary, saw a 5.7% rise.

In Japan, 90% of used cars are given warranty by dealers, while the remaining 10% is provided by third parties, where Premium has a dominant market share of ca. 70%. It aims to penetrate the third-party warranty market by offering its products through smaller dealers who do not have the capability to offer such products in-house.

In October, the firm newly established a company that oversees the warranty business, *Premium Warranty Service,* to consolidate the business expertise between the two brands and enhance its market share.

Auto Mobility Services Business

The third and newest pillar of the Premium's business, Auto Mobility Services, comprises garage services, software sales and parts sales including recycling used parts. In FY20 1H, the segment surged 108.3% YoY to generate operating revenue of ¥598mil. Premium aims to provide multiple services required to run the entire used car value chain, which the firm identifies as the 3Rs – recycle, reuse and repair. Although earnings from Auto Mobility Services are not factored in the current medium-term plan which started this year, the company aims to achieve 3-year CAGR of 30% in segment revenue. The medium-term segment revenue growth only takes into account contributions from repair services at its network garages, including its own FITMAN garages, and from the SaaS-based software (GATCH) provider subsidiary, Soft Planner.

Segment Revenue & GP Illustration (Cumulative)

(¥mil)	FY3/20 (FY20)				FY3/21 (FY21)		
	Q1	Q2	Q3	Q4	Q1	Q2	YoY (%)
Operating Revenue	3,149	6,659	10,173	14,016	4,022	8,386	25.9
Finance Business Revenue (Automobile Credit, Servicer, Lease)	2,162	4,588	7,032	9,648	2,848	5,843	27.4
% Total revenue	68.7	68.9	69.1	68.8	70.8	69.7	+0.8pp
Guarantee Commission	383	853	1,351	1,854	486	981	15.0
Financial cost	28	47	74	102	36	68	44.7
GP – Finance	1,751	3,688	5,607	7,692	2,325	4,794	30.0
GPM - Automobile Credit (%)	81.0	80.4	79.7	79.7	81.6	82.0	+1.6pp
Automobile Warranty Revenue	877	1,784	2,716	3,661	957	1,945	9.1
% Total revenue	27.9	26.8	26.7	26.1	23.8	23.2	-3.6pp
Warranty cost	589	1,222	1,826	2,421	644	1,359	11.2
GP- Automobile Warranty	288	562	890	1,240	314	586	4.3
GPM - Automobile Warranty (%)	32.8	31.5	32.8	33.9	32.8	30.1	-1.4pp
Auto Mobility Service Revenue	110	287	425	707	217	598	108.4
% Total revenue	3.5	4.3	4.2	5.0	5.4	7.1	+2.8pp

Source: Nippon-IBR based on Premium Group's presentation materials

FY21 GUIDANCE

Premium is guiding for FY21 (ending March 2021) pre-tax profit of ¥2,865mil (+10.0% YoY) on operating revenue of ¥17,140mil (+22.3% YoY). Excluding one-off profits and losses in both FY20 and FY21, FY21 pre-tax profit solely from operations will likely be ¥2,300mil (-6.0% YoY). The company estimate for the full year from its guidance in August, when its view over the used car market was still conservative and pre-COVID and assumes that the growth in used car registrations in the 2H would remain in the negative. In October, however, number of used car registration rose by 14.8% YoY / +5.5% MoM after September's -3.2% YoY / +7.5% MoM. The negative YoY growth in Sept 2020 was due to tougher YoY comps from frontloading of buying ahead of the Oct 2019consumption tax hike.

Trend of used-car registration (YoY %)

(YoY, %)	Apr-20	May-20	Jun-20	Q1	Jul-20	Aug-20	Sep-20	Q2	1H	Oct-20
Standard-size car	-9.4	-20.1	7.6	-7.2	6.7	6.6	-2.1	3.6	-1.7	14.8
Small-size car	-10.4	-21.7	3.5	-9.5	0.0	2.2	-4.5	-0.9	-5.1	9.5
Total passenger vehicle	-9.8	-20.8	5.8	-8.2	3.8	4.7	-3.2	1.6	-3.2	12.5

Source: Japan Automobile Dealers Association

This year is the first year of the firm's 3-year medium-term management plan. The basic assumption of the plan is that the used car sales volumes remain flattish or see a slight YoY decline over the 3-year period. Growth in the used car market is lagging that of the new car market, which saw 1.5% YoY decline in CY19 in Japan and will likely see a further dip in CY20 because of COVID.

Although Premium has not identified any significant risk to its FY21 earnings guidance as more than 90% of its operating revenue will be generated from recurring revenue, a possible dip in the used car market remains a concern for the firm's growth in new credit transactions and subsequently the loan balance. It is estimated ca. 3~4% of the previous year's loan balance will likely be the operating revenue of the core Automobile Credit Finance business, therefore any slow-down in the loan balance growth will likely lead to slower revenue growth. The firm aims to achieve at least flat YoY growth in 2H new credit transactions.

Premium plans to pay a cash dividend of ¥45/share (pay-out ratio of 30%), +¥1 YoY.

Balance Sheet

(¥mil)	Mar-19	Mar-20	Sep-20
	FY	FY	1H
Cash and cash equivalent	6,186	6,286	9,468
Financial receivables (Finance Business)	14,746	20,011	21,554
Other financial assets	3,293	6,408	7,905
Tangible fixed asset	481	3,092	3,464
Intangible Asset	5,913	5,950	5,950
Goodwill	2,693	3,958	3,958
Equity method investment	2,195	1,224	1,262
Deferred tax asset	609	0	22
Insurance asset	0	2,965	3,334
Other asset	7,424	8,309	6,624
Total asset	**43,540**	**58,203**	**63,541**
Financial warranty contracts (Warranty Business)	17,086	22,063	23,088
Bank loans	10,637	16,421	19,618
Other financial liability	3,140	6,340	5,488
Allowance	70	327	293
Accrued corporate income tax	643	386	561
Deferred tax liability	1,599	1,355	1,505
Other liability	4,836	5,999	6,591
Total liability	**38,011**	**52,891**	**57,144**
Capital	227	1,534	1,569
Capital reserve	2,412	1,260	1,267
Treasury shares	-1	-1,201	-1,201
Retained earnings	2,693	3,587	4,620
Other capital components	133	62	65
Total equity attributable to the parent's shareholders	5,464	5,242	6,320
Minority interest	65	70	77
Total shareholder's equity	**5,529**	**5,312**	**6,397**
Total liability & equity	**43,540**	**58,203**	**63,541**

Source: Premium Group's financial statements

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