

PREMIUM GROUP CO., LTD. (7199 JP)

FY20 (MAR 20) EARNINGS OVERSHOT COMPANY GUIDANCE. ADDED AN AUTO CREDIT SERVICER AS A SUBSIDIARY

FY20 (MARCH 20) EARNINGS

Premium Group reported FY20 (ending Mar 2020) pre-tax profit of ¥2,604mil (+24.2% YoY) on operating revenue of ¥14,016mil (+30.3% YoY). In 4Q alone, the firm earned pre-tax profit (excluding the impact of an impairment loss discussed below) of ¥232mil (-72.6% YoY / +22.1% QoQ) on quarterly revenue of ¥3,755mil (+30.6% YoY / +6.8% QoQ).

In FY20 4Q, Premium Group reported an impairment loss of ¥878mil on its holdings in ECL – Eastern Commercial Leasing – a Thai affiliate, due to the drop in share price led by COVID-19. There was a separate evaluation loss of ¥105mil on new shares issued by ECL in 3Q. Although Premium Group wrote off the impairment charge, the operation of ECL remained profitable. Premium Group took a cautious step to impair the temporary tumble in ECL's stock price because of uncertainty in the future stock performance due to the full lockdown in Thailand as of the end of March, which has since been lifted.

The firm did not have much impact of COVID-19 in FY20. However, the entire used car market remained almost flat, with the number of registered used cars totalling 3.3mil units (-0.9% YoY).

Business started slower in 4Q for the Automobile Credit Finance segment (to be discussed below), especially in February and March. Although all of its network stores remained open, the used car market-related activities fell quiet in late February as consumers, due to COVID-19, were understandably anxious and so were reluctant to buy large ticket items. Therefore, given the overall market weakness, demand for automobile credit also suffered.

BUSINESS SEGMENTS

Automobile Credit Finance Business

In its core business, Automobile Credit Finance, FY20 operating revenue reached ¥9,648mil (+19.2% YoY) thanks to the following 3 major key performance indicators (KPIs):

I. Transaction volume of new loans:

FY20 new loan transactions rose 29.2% YoY to ¥174,648mil, notching up its ninth consecutive year of constant growth. In FY20, Q1~Q3 led the annual transactions higher but in 4Q, due to slower activity in the used car market after the State of Emergency announcement on 28 Feb, transactions only grew by 14.4% YoY. However, Premium Group's 4Q loan growth (YoY basis) outperformed that of the three other listed automobile credit finance providers whose 4Q new loan transaction growth was between -2.2%~+4.5% YoY.

EXECUTIVE SUMMARY

- Premium Group reported FY20 (a year to March 2020) pre-tax profit of ¥2,604mil (+24.2% YoY) on operating revenue of ¥14,016mil (+30.3% YoY).
- Premium Group reported an impairment evaluation loss (¥878mil) on shares of its affiliated company in Thailand, ECL (Eastern Commercial Leasing) due to the drop in share price led by COVID-19.
- In the Automobile Credit segment, FY20 operating revenue hit ¥9,648 (+19.2% YoY) on the back of 1) a 29.2% YoY rise in new loan transactions to ¥174,650mil, 2) a rise in the loan receivables balance, 3) a higher number of network stores.
- Premium Group's second pillar of business, Automobile Warranty, generated FY20 operating revenue of ¥3,661mil (+52.8% YoY), thanks to a rise in transactions of new warranties, mainly contributed from EGS, a subsidiary acquired in April 2019.
- As of Mar 2020, the unrealised revenue (a source of the future operating revenue) on the balance sheet was ¥26,390mil (¥22,063mil from auto credit finance and ¥4,327mil from automobile warranty).
- Premium Group has refrained from providing FY20 guidance as it is impossible to foresee the impact of COVID-19.
- In the medium-term management plan, the firm is guiding for FY21 pre-tax profit of ¥2,400mil (-7.8% YoY). The figure does not include negative goodwill (ca. ¥600mil) from the acquisition of Central Servicer Corporation (CSC, unlisted, Japan), a specialist in debt collection and car repatriation. CSC became a 100% subsidiary from April 2020.

Premium Group assumes its continuous growth in loan volume attributed to:

- i. A +9.6% YoY improvement in per-head transactions/month to ¥182mil (as of FY20 4Q).
- ii. Development of varied services and cross selling for network stores (used car dealers)
- iii. An increase in transactions with large-scale network stores.

2. Loan receivables balance:

Loan receivables in FY20 rose 27.1% YoY to ¥318,658mil. The default rate remained low at 0.86%. Unrealised revenue for the segment, a source of the future operating revenue reported on the balance sheet, was ¥22,063mil (+31.5% YoY / +6.6% QoQ).

3. Number of network stores (network of used car dealers):

The number of network dealers reached 22,549 stores, up 10.4% YoY. Since its inception, Premium Group has steadily grown its store network. As well as continuing to increase the number of stores that become a part of Premium Group's network, the firm aims to boost transactions per store – effectively raising ARPU – by promoting cross-selling. Premium Group also focused to activate dormant stores by utilising its contact centre.

Automobile Warranty Business

Premium Group's second pillar of business, Automobile Warranty, generated FY20 operating revenue of ¥3,661mil (+52.8% YoY). The segment operating revenue growth was boosted by an increase in transactions of new warranties – mainly from EGS, a subsidiary acquired in April 2019. Total new warranty transactions rose +45.5% YoY to ¥4,363mil of which transactions of the Premium Group brand warranty (the firm's original warranty business) was ¥3,424mil (+14.2% YoY). Of the ¥1,365mil increase in transactions, ¥939mil was a net contribution by EGS. The firm's efforts to promote awareness of its used car warranty service through radio advertisements and the revisions made to its original Premium Group warranty products, both supported the growth in transactions. In 4Q alone, the segment earned operating revenue of ¥945mil (+49.8% YoY) with an increase in transaction of ¥1,106mil (+34.8% YoY). In FY20, unrealised revenue for Automobile Warranty business was ¥4,327mil (+25.1% YoY / +3.4% QoQ).

Quarterly Revenue Trend										
¥mil	FY3/19 (FY19)				FY3/20 (FY20)					
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	YoY (%)	QoQ (%)
Automobile Credit	1,939	2,014	1,994	2,135	2,158	2,416	2,458	2,528	18.4	2.8
Automobile Warranty	566	589	610	631	877	907	933	945	49.8	1.3
Other revenues	37	39	97	109	131	187	123	283	159.6	130.1

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

PL Summary (Cumulative)									
(¥mil)	FY3/19 (FY19)				FY3/20 (FY20)				YoY (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	
Operating Revenue	2,542	5,183	7,885	10,759 ¹	3,166	6,659	10,173	14,016	30.3
Automobile Credit revenue	1,939	3,953	5,947	8,095	2,158	4,574	7,032	9,648	19.2
% Total revenue	76.3	76.3	75.4	75.2	68.2	68.7	69.1	68.8	-0.3pp
Guarantee Commission	289	594	913	1,247	383	853	1,351	1,854	48.7
GP - Automobile Credit	1,650	3,359	5,034	6,848	1,775	3,721	5,681	7,794	13.8
GPM - Automobile Credit (%)	85.1	85.0	84.6	84.6	82.3	81.4	80.8	80.8	0.0pp
Automobile warranty revenue	566	1,155	1,765	2,395	877	1,784	2,716	3,661	52.8
% Total revenue	22.3	22.3	22.4	22.3	27.7	26.8	26.7	26.1	-0.6pp
Warranty cost	392	806	1,211	1,590	589	1,222	1,826	2,421	52.3
GP- Automobile Warranty	174	349	554	805	288	562	890	1,240	54.0
GPM - Automobile Warranty (%)	30.7	30.2	31.4	33.6	32.8	31.5	32.8	33.9	+1.1pp
Impairment cost	335	777	1,092	1,581	34	23	56	79	-95.0
Personnel cost	568	1,239	1,916	2,602	744	1,561	2,404	3,307	27.1
Other overheads	635	1,326	2,131	2,972	1,030	2,083	3,319	4,797	61.4
Total operating cost	2,207	4,741	7,263	10,001	2,780	5,742	8,954	12,458	24.6
Operating profit	334	442	622	707	386	916	1,217	1,558	120.4
OPM (%)	13.1	8.5	7.9	6.6	12.2	13.8	12.0	11.1	+4.5pp

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

FY20 OUTLOOK

Premium Group has refrained from providing FY21 guidance for it is impossible to foresee impact of COVID-19.

In the month of April, Auto Credit Finance transaction growth rose at a slower pace (+0.9% YoY vs +14.4% in the previous quarter) due to delay in finalising credit agreements in March. Due to COVID, Premium Group remained cautious on the outlook for automobile loans, particularly during such periods of low volumes. However, after the Golden Week holiday, from the beginning of May, Premium Group observed increases in applications for credit from subprime borrowers because dealers were eager to start selling again. After the middle of May, the borrower profile was back to normal as customer traffic to dealers started recovering. Currently, the used car market is attractive to price sensitive consumers because they can find luxurious used cars such as the Toyota Alphard, a model which is usually exported, are sold at a reasonable price in Japan. Premium Group reckons that after 1Q, visibility to full-year earnings will likely improve.

Premium Group announced the medium-term earnings target in its medium-term management plan released in February. In the plan, the firm is guiding for FY21 pre-tax profit of ¥2,400mil (-7.8% YoY). The figure does not include negative goodwill of ca. ¥600mil from the acquisition of Central Servicer Corporation (CSC, unlisted, Japan) – a debt collection and car repatriation specialist – and made it a 100% subsidiary from April 2020. This acquisition will further develop Premium Group's third business pillar – Auto Mobility Services. Cars repatriated through CSC can be 1) redistributed to Premium Group's network stores and garages or 2) scrapped while extracting reusable components which can then be distributed through the firm's used auto parts distribution network. Premium Group plans to start the Auto Mobility Services business later this year.

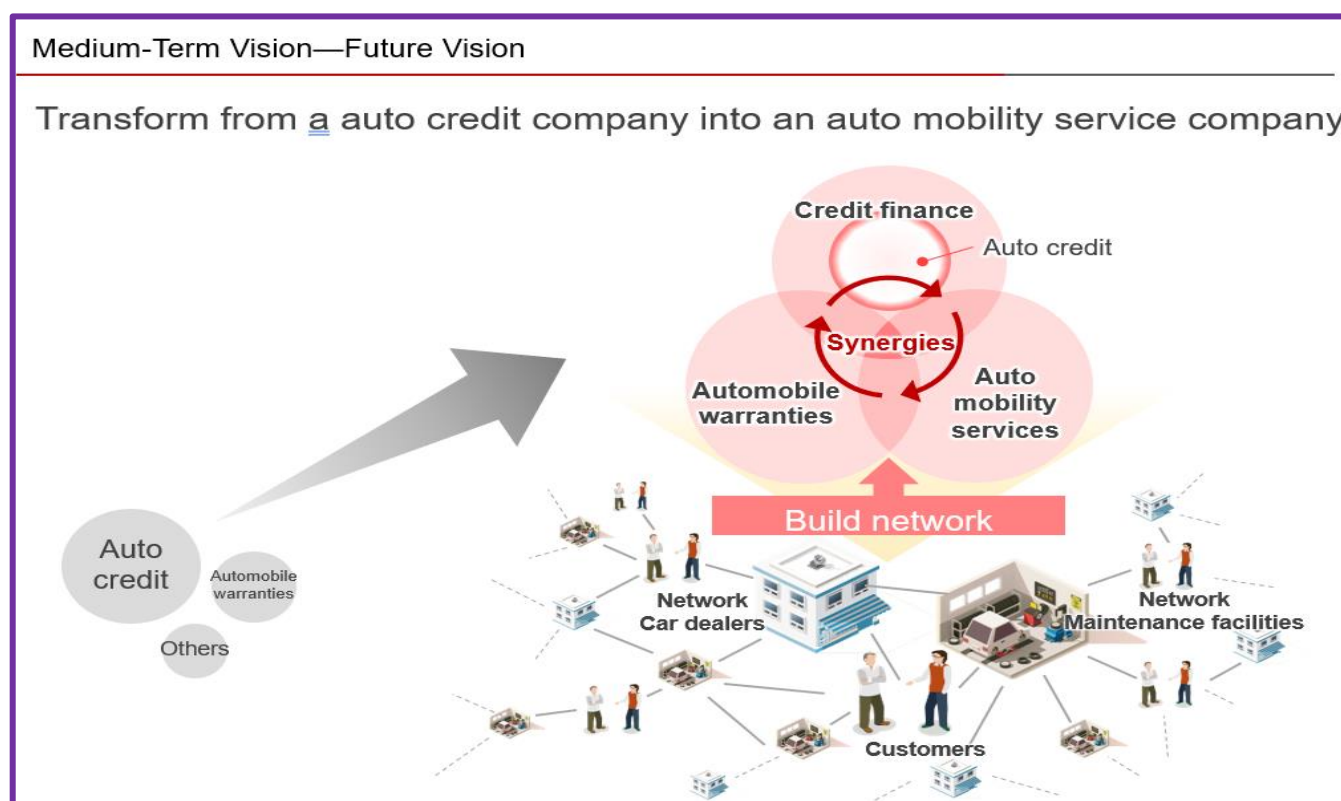
¹ FY18 operating revenue was retrospectively adjusted due to more accurate evaluation of a consolidated subsidiary.

FY21 forecast under the medium-term plan should be considered as a target not a guidance for the figure does not reflect the impact of either COVID-19 or negative goodwill of ¥600mil from CSC.

MEDIUM-TERM MANAGEMENT PLAN TO MAR 23 (FY21~FY23)

Premium Group released its first 3-year management plan together with its FY20 3Q results release on 14 February 2020. The foundation for the medium-term plan is to demonstrate management's risk awareness of the potential decline in the auto credit finance market. Growth in the used car market is somewhat linked to that of new car markets, but with some time lag. For the past 3 years, annual used car sales volumes have been stable at around 3mil units, with the market size estimated at around ¥3.5trn. For the next 3 years, it is assumed that the growth will remain flattish, or to decline gradually, as the new car market shrinks [NB: Japan's new car sales fell 1.5% YoY in CY19].

With Japan's ageing and declining population, demand for self-purchased cars is expected to slow eventually, though the demand for mobility services is likely to become the new norm. Premium Group's current business model is mainly associated with the domestic used car sales. The firm's focus is to transform the current business model and create a platform formed with various mobility services during the medium-term management plan.



Source: Premium Group "Medium-Term Management Plan Value Up 2023"

The plan has two phases: Phase I – named "Value up 2023" – covers the 3 years to FY23 (to Mar 2023).

Under Phase I, the firm has two missions, each of which can be further divided to three goals:

I. Providing the best finance by:

- Growing its existing businesses – i.e. auto credit and auto lease: Premium Group aims to achieve the past 3-year CAGR of 22% or more in Automobile Credit over the next 3-year period through increasing sales staff and sales offices. The firm has not revised its plan to add 10 new locations, bringing the total to 25, however, new openings have been temporarily suspended due to COVID. Contributions from the Automobile Lease business – aimed at consumers – is not included in the medium-term growth projections.
- Sourcing used cars through a subsidiary that specialises in collecting collateralised second-hand cars and making them fit for purpose again. Premium Group plans to wholesale such second-hand cars to its network dealers.

- Expanding its existing businesses to include shopping credit (shinpan) on higher-value items, such as solar power installation and other housing equipment. The firm is also considering entering into other credit businesses, for example, rent guarantee.
2. Providing quality service to the used car platform value chain by:
- Continuing to grow the existing Automobile Warranty business: Premium Group is looking for service revenue CAGR to grow in line with what it has achieved over the past few years (3-year CAGR to FY18 was ca. 14%). However, with auto warranty revenues growing at a rate of ca. 50% in FY20, thanks to contribution from a newly added subsidiary EGS, it is likely that this business will be the main growth driver. The 4-year CAGR to FY20 was an impressive 22.1%.

Premium Group reckons that used cars' life expectancy can be extended by providing services / products that can be guaranteed by a warranty. Improved quality maintenance and servicing is likely to reduce the scrappage of used cars, which the firm identifies as an ESG-related business opportunity.

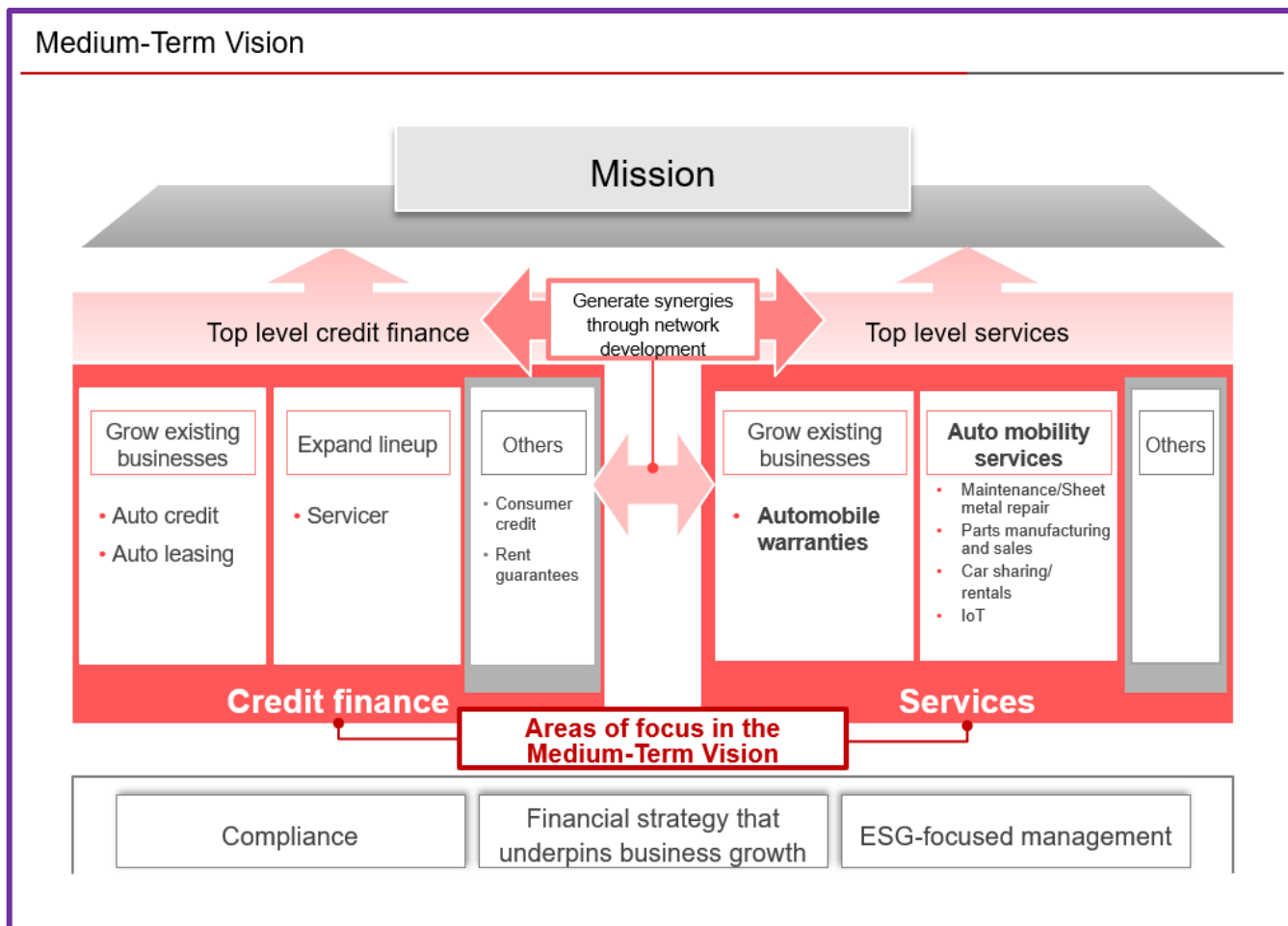
Existing warranty products are all BtoC-based products. Premium Group aims to launch the new-type warranty products that also targets CtoC second-hand car transactions. Although it has not yet become a sizeable market, Premium Group's interest lies in providing warranties for those direct CtoC trades.

- Auto Mobility Services – providing multiple services required to run the entire second-hand car value chain: Premium Group identifies those businesses as 3Rs – recycle, reuse and repair. The next 3 years are considered as a seed phase to build those businesses. No earnings contribution is included in the current medium-term earnings estimates. Premium Group plans to start an auto parts recycling business through an acquired subsidiary that specialises in rebuilding and making fit for purpose used automobile components. Those recycled parts can then be wholesaled to Premium Group's network dealers and garages to service used cars. After establishing the second-hand parts market in Japan, Premium Group plans to expand its recycled parts business overseas. Cities like Dubai, Nairobi and Sao Paulo are known for their active recycled auto parts markets.

The auto parts rebuilding subsidiary is just about break-even. Therefore, Premium Group has not yet included any contribution to the medium-term management plan. Over the next 3 years, the firm's focus is to build a platform for the distribution of recycled auto parts. In the Reuse business, it plans to wholesale used cars that the aforementioned CSC has collected from defaulted debtors to Premium Group's network dealers and garages.

- Continuing to grow the existing Repair business by expanding a network of member garages: The Repair business will operate Premium Group's network garages, including its own FIXMAN garage in Hokkaido, providing environmentally friendly support, such as using water-based paint, and human resources. Premium Group also aims to give support to other garages with expertise in improving service quality. The firm also plans to start its own road services. Out of the 3Rs, the Repair business is the only service that is estimated to contribute to mid-term plan.

Premium Group reckons that the Auto Mobility Service has a potential to achieve 3-year CAGR of above 30% in revenue. However, almost all the growth will come from Repair services at its garages and from its SaaS-based software provider (for garages) subsidiary, Soft Planner. Soft Planner's software, such as GATCH, provides back office functions for garages such as MOT test bookings, service bookings, quoting / invoicing and controlling parts inventories. It is yet unknown when the Recycle and Reuse services will commence during this medium-term plan, therefore no contributions have been included in the figures. The CSC business, which was consolidated from Apr 2020, is also not included in the plan.



Source: Premium Group "Medium-Term Management Plan Value Up 2023

In FY23, the final year of Phase 1, Premium Group estimates pre-tax profit of ¥5,600mil (3-year CAGR +21.6%) on operating revenue of ¥26,000mil (CAGR +23.9%). In FY21, pre-tax profit of ¥2,400mil is estimated, a drop of 7.8% from FY20 pre-tax profit of ¥2,604mil was bolstered by accounting changes related to estimates for insurance cost (in FY20 1Q).

Details of Phase 2 have not yet been disclosed.

SHAREHOLDER RETURN POLICY

Premium Group is not guiding for a FY21 dividend at this point. The firm’s shareholder return policy, in principle, is to provide a stable and steady dividend while securing sufficient funds for growth investment which will likely resume after the impact of COVID tapered off.

Due to liquidity issues (trading less than \$3mil/day), as well as numbers of shareholders, Premium Group’s shareholder return policy appears more geared towards dividend payments rather than share buy-backs. The shares it repurchased in January 2020 in total of 525,711 shares (at ca. ¥1,200mil in total) are on BS as treasury shares which can potentially be used for M&A and other growth potentials.

Medium-Term Plan "Value Up 2023" Illustration										
(¥mil)	Pre-Medium-term Management Plan						Value Up 2023			
	FY3/18 (FY18)	FY3/19 (FY19)	FY3/20 (FY20)				FY3/21 (FY21)	FY3/22 (FY22)	FY3/23 (FY23)	CAGR (%)
<IFRS>	Result	Result	CE & N-IBR Est	Result	YoY (%)	vs. Est (%)	Nippon-IBR Estimate			
Operating Revenue	9,065	10,759	13,668	14,016	30.3	2.5	17,500	21,500	26,000	23.9
Automobile Credit	6,885	8,095	9,700	9,648	19.2	-0.5	12,600	15,480	18,720	24.5
% total revenue	76.0	75.2	71.0	68.8			72.0	72.0	72.0	
Automobile Warranty	2,068	2,395	3,650	3,661	52.9	0.3	4,375	5,375	6,500	21.2
% total revenue	22.8	22.3	26.7	26.1			25.0	25.0	25.0	
Others (incl. Garage, Overseas & Software)	112	269	318	707	162.8	122.3	525	645	780	34.9
% total revenue	1.2	2.5	2.3	5.0			3.0	3.0	3.0	
Pre-tax profit	1,979	2,097	3,141	2,604	24.2	-17.1	2,400	3,600	5,600	21.3
Net profit attributed to the parent's shareholders	1,293	1,388	2,052	1,466	5.6	-28.6	1,500	2,300	3,600	20.6
Source: Nippon-IBR										
FY3/20 estimate for Automobile Credit is illustrated based on ca. 3.5~4% of previous year's loan balance										
FY3/20 estimate for Automobile Warranty is illustrated based on assumption that 4Q revenue is flat QoQ										
For all 3 segments, FY3/21-FY3/23 estimates are based on assumption that 1) target growth rate is similar to the past 3 years or more in each segment, 2) there is no major change in revenue breakdown.										

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