IR Meeting Q&A (November 26, 2015)

Next Mid-Term Management Plan

Q: What kinds of strengths, including in-house experience and capabilities amassed over the years, will enable you to build a unique business model?

A: Management, including outside directors, has held in-depth discussions on the core competence of SOMPO HOLDINGS. We have arrived at the conclusion that the essence of our core competence lies in frontline execution. We define “frontline” broadly to mean all of our interfaces with customers, not just our sales offices. Whether it is our agencies, claim offices or other entities, every operation that directly listens to the voice of the customer is part of our frontline. If an initiative may be beneficial to customers, SOMPO HOLDINGS has a culture of making decisions on those initiatives and executing them on the frontline. Our delegation of authority is grounded on this core competence. By clearly separating Head Office’s sphere of control from what we delegate to the frontlines, we will foster the agility needed to succeed in a volatile, uncertain, complex and ambiguity (VUCA) world as we shape this agility into our competence.

Q: What numerical benchmarks will your business portfolio mix in FY2020 be based on? Could you please go over any prioritization of business segments?

A: We aim to be “a globally competitive group” in terms of profit level. We intend to structure our business portfolio mix based on profit.
Our basic approach is to allocate capital to businesses with a higher return on risk (ROR). At this time, we recognize that the overseas businesses and nursing care and healthcare businesses have a higher ROR.

Q: What are your policies for achieving a high capital efficiency, i.e. a return on equity (ROE) of 10% or more?

A: We seek to achieve a high capital efficiency primarily by allocating capital released by reducing strategic-holding stocks to growth investments. The nursing care business we recently acquired (renamed as Sompo Care Next) is a part of these efforts. We recognize that some companies among existing nursing care providers have a double-digit ROE. Accordingly, we aim to achieve a double-digit return on investment (ROI) in the nursing care business within a certain timeframe.
Through these and other initiatives, we will continue working to enhance our ROE.

Q: What are your main considerations for selecting targets for M&A investment deals?

A: We assess the appropriateness of investments based on the perspectives of whether the investee possesses a core competence, whether we sympathize with the investee’s business model, and whether the investee is already developing businesses in fields closely related to ours. When deciding on investees, a demand-driven approach that asks “Why do we need this company?” will be crucial. If we casually make investments and acquisitions, post merger integration (PMI) will become extremely difficult.

Q: What do you mean specifically by a game-changing opportunity driven by a digital-technology strategy?

A: One example is pricing. Although we will continue to retain the structure of advisory rating system, if big data and other technologies continue to advance, we might be able to offer real-time and even forward-looking pricing, not just pricing based on historical statistics only.

Moreover, new technologies could dramatically reshape our business model itself. For example, "digital agency" systems that understand and respond to the feelings of customers are now being completed. These systems are highly efficient and even more accurate than people in certain respects. Therefore, they offer prospects for deployment in future.

That said, we are not seeking to become the next Google or Amazon. We will conduct R&D activities to deepen our understanding as technology users, focusing on how to go about using the latest technologies effectively.

Domestic P&C Insurance Business

Q: You discussed plans to reform your mainstay system by establishing a joint venture with a system subsidiary of Hitachi. To what extent will you be able to reduce the net expense ratio through this initiative?

A: We aim to further increase operating efficiency by reforming our existing system. The new system is scheduled to become operational in phases from around FY2020. We expect the new system to help reduce operating expenses by, for example, dramatically reducing product development lead times, introducing paperless sales office and agencies operations, and reducing personnel. In terms of the net expense ratio level, we aim to reduce the net expense ratio to below 30% in future, in order to build a globally competitive organization and vie with the majors as a global player.

In order to achieve our ROE target of 10% or more, the combined ratio must be less than 95%. Therefore, besides the net expense ratio, we will also need to consider various factors to control the loss ratio.

Overseas Insurance Business

Q: If the overseas insurance business is expanded to account for 25% of the business portfolio mix as shown for FY2020, by how much will the amount of risk change?

A: The amount of risk will depend on not only the amount of investment, but also the business portfolio of investees. Therefore, we cannot give a generalized estimate of how the amount of risk will change at this time.

Q: What is the maximum amount of investment you could make while retaining your current credit rating, assuming the use of hybrid bonds and continuous reduction of strategic-holding stocks, and without increasing capital by issuing common shares?

A: Although this is just a trial calculation based on assumptions such as the issuance of hybrid bonds and continuous reduction of strategic-holding stocks over the medium term, we believe we would be able to retain our current A+ credit rating even if we were to make investments totaling around ¥1 trillion.

However, given that we will need to formulate specific capital policies and verify the feasibility of execution, we cannot execute this investment immediately at this time.

Capital Policy and Shareholder Returns

Q: To what level do you think you should reduce the proportion of strategic-holding stocks to assets under management on a consolidated basis? Do you intend to include the realized gains on the sale of strategic-holding stocks in funds available for shareholder returns?

A: We aim to achieve to have reduced strategic-holding stocks by approximately ¥750.0 billion or more in total by the end of FY2015, since our business integration in 2010. As of September 30, 2015, the balance of strategic-holding stocks stood at ¥1.6 trillion. Although the balance has increased slightly at present due to rising stock prices, we intend to reduce this balance to the level of around 60-70% of the adjusted net assets of the P&C insurance business over the medium term.

The purpose of reducing strategic-holding stocks is to increase our surplus capital. The surplus capital that is generated can then be used for growth investments in overseas businesses and elsewhere. Rather than directly allocating the realized gains on the sale of strategic-holding stocks to funds available for shareholder returns, our intention is to appropriately return the profits generated by investments to our shareholders.

Q: I would like to confirm the amount of funds available for shareholder returns and the amount that will be returned under the next mid-term management plan. Assuming an ROE of 10% and adjusted consolidated net assets of ¥3 trillion, adjusted consolidated profit would be approximately ¥300 billion. Am I correct in assuming that the monetary amount equivalent to adjusted consolidated profit excluding life insurance profit will constitute the funds available for shareholder returns?

A: Although we are currently discussing how we should approach the funds available for shareholder returns, we don’t expect to pull back from our current approach to shareholder returns. We will consider shareholder returns based a range of factors besides the level of adjusted profit, including cash flow and capital condition.

Additionally, we are considering new profit indicators for life insurance profit, with plans to return life insurance profit to shareholders using a method based on the new indicators. Although the introduction of IFRS has been delayed, we are now eyeing FY2020 for the adoption and introduction of IFRS. We have to be aware of IFRS as we consider our approach to profit indicators in the next mid-term management plan. In May 2016, we plan to disclose our method of reflecting life insurance profit in the funds available for shareholder returns in conjunction with profit indicators.

Q: I would like to confirm your shareholder returns for the current fiscal year. In FY2015, adjusted consolidated profit, excluding domestic life, is forecast at ¥133.0 billion, and cash dividends are projected at ¥32.6 billion. However, assuming a total payout ratio of 50%, you will need to conduct a considerable amount of share buybacks. What is your policy?

A: Looking at shareholder returns in FY2015, assuming dividends per share of ¥80 and a total payout ratio of 50%, share buybacks can be estimated at ¥34.2 billion. Meanwhile, looking at the past six years on a cumulative basis, excluding the adjusted consolidated loss of ¥98.7 billion posted in FY2011 and assuming that the dividend for FY2015 is paid as planned, the total payout ratio would be 80%, surpassing our mid-term target of 50%. With the typhoon season now behind us, we have decided to keep our forecasts unchanged. While confirming whether snow damage and financial market trends realize as expected, we intend to discuss shareholder returns next May, including share buybacks, in the context of our FY2015 results. We will consider shareholder returns for FY2015 based on factors such as our total shareholder returns of ¥45.5 billion for FY2014, while we remain aware of our capital policy for the next mid-term management plan. To date, we have provided shareholder returns so as to meet investors' expectations, including continuing stable dividends even when we posted a loss. We will continue to adhere to this principle as part of our shareholder return policy for the next mid-term management plan.