IR Meeting Q&A (May 26, 2016)

– New Mid-Term Management Plan (FY2016 to FY2020) –

Management Strategy and Management Targets

Q: What is your rationale for setting a range of ¥180 to ¥220 billion for your adjusted consolidated profit target for FY2018?

A: The projected ¥180 billion floor of the adjusted consolidated profit target is based on a conservative outlook for the organic growth of each business, and is thus one that we must achieve. The ceiling takes into consideration the potential M&A and the synergies generated among businesses as a result of executing our theme park business model. Considering that we are also targeting an adjusted consolidated profit level of ¥300 billion in future, we have set the ceiling at ¥220 billion to define the final stretch toward our ¥300 billion target.

Q: You said that you aim to become one of the top 10 global publicly listed insurance companies in FY2020. Do you think other Japanese insurance companies will also make the global top 10?

A: Our true intention behind the goal of joining the global top 10 is to enable us to operate in an environment where we are able to compete on a par with major global insurers such as Allianz and AXA. This will be achieved by developing distinctive businesses through the realization of a theme park for the security, health, and wellbeing of customers, in addition to expanding our business scale. We are not in a position to comment on how other companies will be placed in the future. However, in the course of seeking to join the global top 10, there is no need for us to become overly optimistic or pessimistic about our prospects based on our ranking relative to other companies in Japan.

Q: In regard to your digital strategy, are you considering entering into tie-ups and other arrangements with other businesses and experts besides those in the insurance and finance sectors?

A: As an example, we may consider tie-ups and other arrangements with automakers or the auto industry. Cutting-edge automotive technology has been advancing considerably on the technical front. However, we believe that social acceptance of this technology will become the focal point for discussion going forward. We think the main theme will be to ask, “To what extent is society willing and able to accept the collection and disclosure of automotive data?” This is also a field in which the Japanese government is making a national effort to examine the issues. We have taken steps such as developing and selling the “Smiling Road”, and we will continue working to ensure that we do not fall behind on this front. In addition, we could find promising partners from among the startup companies we invest in by searching for technologies that could spark digital disruption going forward. In the process, we will need to make certain that we obtain groundbreaking technologies by building relationships with those companies. Rather than search for the advanced technologies we seek within the boundaries of an insurance company, we will need to first conduct research into what kinds of innovative technologies are actually out there, and then explore how we will be able to make use of those technologies. This type of approach will be essential in the future.

Domestic P&C Insurance Business

Q: What factors will pressure earnings in the domestic P&C insurance business?

A: Factors pressuring earnings include Japan’s next consumption tax hike (scheduled for April 2017) and a drop in demand following a rush to purchase ahead of revisions to fire insurance premium rates in October 2015. The consumption tax hike is expected to push up the loss ratio by around 0.5 points and the net expense ratio by around 0.4 points. Earnings will also come under pressure from higher expenses due to upfront investments.

Q: In recent years, you have often exceeded your annual natural disaster budget of ¥43.0 billion. How have you factored this into your business plan?

A: We are assuming an annual natural disaster budget of ¥43.0 billion.

Natural disasters are reported to have become increasingly frequent in recent years, and our risk management and other divisions are currently analyzing these trends. The average amount of the net incurred loss for the past 10 years is around ¥47.0 billion. Considering the expansion of reinsurance coverage and other factors in recent years, we believe that the projected amount of ¥43.0 billion for the net incurred loss is largely in line with actual results.

Q: Could you please go over your outlook for the number of non-fleet vehicles and net premiums written in automobile insurance?

A: We expect the growth rate for the number of owned vehicles to remain mostly flat over the next few years. The number of non-fleet vehicles in domestic automobile insurance is also expected to follow a similar trend. From FY2016, we will have a well-developed sales framework in place as the impact of the merger of Sompo Japan and Nipponkoa subsides. Accordingly, we expect to improve our market share by around 1-2 percentage points, taking into account factors including the benefits of stronger sales capabilities and the positive impact of other systems and product development.

Q: Could you please go over the amount of investment and the related investment benefits with respect to systems investments for the Future Innovation Project and other initiatives?

A: Expenses related to upfront investments in domestic P&C business are forecast at around ¥10.0 billion in FY2016-FY2018 and around ¥20.0 billion in FY2019-FY2020. The anticipated investment benefits include reduced company expenses through improved business efficiency. We plan to start reaping the benefits of these investments between around FY2018 and FY2019. For example, in FY2018, we expect to reduce business expenses by around ¥13.0 billion, mainly through investment benefits, against investment of ¥10.0 billion in a single year.

Q: What is your approach to the sales agency channel? Do you plan to reduce sales agency commissions?

A: We do not plan to reduce commissions across the board in the short term, partly out of consideration for the intensified competition for market share. We will continue to emphasize strengthening communication with customers through the use of digital technologies, the Internet and other channels. In the process, our expectations in terms of what we look for in sales agencies will change. Our priorities will include bolstering the insurance sales capabilities of sales agencies through the use of digital technologies and other means.

As a Group, we also support direct sales channels primarily through Saison Automobile & Fire and Sonpo 24. Therefore, we do not see a problem with customers shifting from the sales agency to direct sales channel. In this case, the Group's commission rate will decline in step with an increase in the share of the direct sales channel.

Domestic Life Insurance

Q: Adjusted profit in the domestic life insurance business is forecast to decline in FY2016, and then recover to ¥32.0 billion in FY2018. What are the main factors supporting this outlook?

A: Himawari Life is pushing ahead with a growth strategy based on a business model focused on seamless integration of product, service and channel. Given that Himawari Life is forecasting upfront investment of around ¥5.0 billion a year, adjusted profit is projected to temporarily decline in FY2016. Thereafter, the number of policies in force and profit is expected to expand steadily based on an increase in new policies due to the execution of new growth strategies, along with steady increases in business in force.

Capital Policy and M&A

Q: Could you please share your outlook for the total payout ratio for shareholders over the medium term?

A: In regard to shareholder returns, we are committed to paying steady dividends, in principle. When there are funds available for shareholder returns in excess of this commitment, we will consider whether either to increase dividends or conduct share buybacks, in light of our stock price, economic conditions and other factors prevailing at the time. Our policy is to basically maintain a total payout ratio of around 50% over the medium term. It is possible that we may adjust the payout ratio up or down from 50%. However, the floor of 30% shall only apply when we require additional capital for large M&As and other initiatives.

Q: Could you please discuss the role of the holding company and the domestic P&C insurance business with respect to the sale of strategic-holding stocks?

A: Strategic-holding stocks will serve as the source of funds for executing future M&As, in addition to providing a means of reducing the risk amount. Accordingly, the holding company will examine strategic-holding stocks as part of the Group's capital policy in close coordination with the operating companies. The holding company has approved a basic policy including formulating plans to sell strategic-holding stocks of around ¥100.0 billion a year. The role of the domestic P&C insurance business will be to undertake the execution of these sales, including selecting specific stocks and deciding on the timing of the sales.

Q: Could you please comment on the ratio of capital allocation to each segment?

A: Roughly speaking, we will allocate around 50% of capital to the domestic P&C insurance business, 20% to the domestic life insurance business, 10% to the overseas insurance business and around 20% to other businesses and reserves to fund investments in future M&As and other initiatives. In future, we envision that around 20% of the reserves will be allocated to the overseas insurance business and new businesses through the execution of M&As and other initiatives.

Q: In terms of your capacity to invest in M&As, what is the extent of your capital buffer? Can I assume that the capital released from the sale of strategic-holding stocks will be used for M&A investments and so forth?

A: Considering that we have not executed any large M&As, we believe that we have ample investment capacity. In cases where additional capital is necessary, such as when executing large M&As, we have options for increasing capital without dilution, including the issuance of hybrid bonds. This is in addition to funds provided by the release of capital through the reduction of strategic-holding stocks.

Q: Looking at the timing for making M&A investments, do you believe that the current environment presents favorable conditions for investment?

A: We believe that the M&A market is showing signs of settling down compared to 1 or 2 years ago, as seen in the decline in the market capitalization of the insurance industry as a whole. However, that alone is not the trigger for executing investments. We will make investment decisions only after taking steps such as appropriately examining the details of each investment candidate.