FY2018 Financial Results, Medium Term Strategies

Investors Meeting (Held on May 16)

Q&A Summary

Q: About yesterday's press release, I have one question and one request. First, this has not been explained but the business and partnership with Suruga Bank. As far as we read the press release, more information is expected to be provided. But, just grasping a rough idea-- for the unsecured loans and housing loans the business, and so on. So, the partnership in those areas. Specifically, what businesses are you considering? Partnerships means we include credit guaranteed business, or others. What specifically are you considering?

And my request is, another press release regarding the share buyback. The amount and percentage of the issued shares, that was disclosed. But issued shares, the percentage of issued shares. And actual, the disclosure or the market value would be different. Maybe the market value as of May 14. If you add such information as a footnote, that would be appreciated.

Kudo: Regarding your second point, we will take that into consideration.

And the first point, several days ago, as several media covered many stories. And, honestly speaking, was confused because they created their stories without confirming with us. The fact is, what we have released in this press release yesterday. Today's Nikkei was in very precise, honest, and manner they wrote in the article. That is close to the actual situation. So, we only concluded a basic agreement, and we considered several areas that we have potential. And that is why we agreed to conclude the business partnership. But we have not done any in-depth discussions yet.

There were a lot of things written in the news article. But when I read it, some of them were confusing, even to me. For example, offering credit guarantee in unsecured loan business, or the criteria was quite different in housing loans. So, the mutual referral, for example. For those, the customers who did not meet our criteria will refer such customers to them. So, exactly what's written in the press release will be considered going forward.

Q: I have two questions with regards to the mid-term management strategies. EPS growth and value co-creation, you showed a target of 2% or higher EPS. How do you define 2? Why isn't it 3, or 5, or 10, and 2? That's my first question. And when you say EPS growth, are you thinking of cash base? Or do you include acquisitions or not? That's my first question. Then, I will cut that off here at one. What does this 2% represent? This kind of financial target is being shown with a backdrop.

Kudo: This is extension or extrapolation from our existing business, and we have shown a number that we can commit to. So, it's not ungrounded. Specific to its nonorganic factors? No.

Q: Second question. On page 10, you mentioned the value co-creation business model. How can you implement this kind of model? My point is, as you've shown on page nine, if it's just a function being offered by a bank like retail function or you offer credit screening services to a telecom company, if it's just a function that the financial company offers, then there are ample examples. But you think that you participate and create value. You have a cycle in mind.

So, the bank understands the financial services well, and then upon that, co-creating value through doing business together, that's unprecedented. Because probably, you're looking for more than just offering settlement service or creative screening service. Shinsei used to be quite innovative in the past. But today, do you have the capability of applying both the blue model and orange model, circulating the value created into yet further business expansion? What is needed in today's Shinsei to do this?

Kudo: It must be difficult for you to obtain a clear image. The same applies to our partner, but some kind of form is necessary. So, one entry point is something we are preparing at the moment. Something like a wallet, a digital platform. Through API, you can load something or change something. That's the kind of platform we are trying to build. And that in itself could become a product to be offered by the financial group. But that's not the end objective. Rather than trying to sell that as a product, we want to use that more as a tool to offer to our partners. They might have customers they want to offer financial services. So, this is a block we can offer. But that's invisible. It's difficult to understand.

So, if we can form something like a wallet and a settlement service is included in the wallet, that could be presented and explained that this is something we can do. And then, they may say," Oh, that's something we want." That would begin a conversation. And, partners are mixed in terms of size. There are large ones and small ones. And, if it's a really large and mature platform, then all they need is certain loan or certain function or IT. But, in other examples, foreign workers-- there is no mature platform that offers those services. There are providers that offer piecemeal services, like guarantee when they rate housings.

But individual company does not have the ability to create the whole ecosystem. So, someone has to become the orchestra master in order to be the conductor to arrange all functions. Then, that's the role Shinsei can play. And of course, nonfinancial services will be included. Rather, nonfinancial services may become the main service and we may be able to do that through the establishment of a joint venture. That's the kind of idea we have in mind.

Q: So, generally speaking, from a retail or telecom company perspective, I don't think they are expecting banks to offer them platforms. They probably think that they are more advanced than the financial institution. If there could be a clue, maybe the foreign worker example may be viable, or niche areas, where there is no well-established business model, and you want to bring in platforms in those areas. Is that the image?

Kudo: Yes. There could be both. Of course, super large giants in retail or telecom carriers, if they try, then they can do everything by themselves. And there are companies that are actually doing that. On the other hand, from their business model perspective, to what level should they internalize? What's the threshold of internalization? That's a challenge, like ourselves. There are things they shouldn't be internalizing. Then, that could lead to the possibility of alliance for those functions.

And, going to a different page, the page before, at the center is a function that DOCOMO may want as a single service line. Each function has its strengths. Many people neglect collection, which is our strength. Fintech companies cannot do that. If you have data, you may be able to come up with a credit screening model. But after credit screening, offering the credit and then collecting the debt is something that cannot be done. So ourselves, Acom, or Promise would be the players that can do that. So, that's the center circle. And then, ecosystem on the left-hand side. This is about the creation of markets and doing that without a clear market leader. Who will take the leadership? Someone appropriate to play the role can become the leader. And I think there are areas where we can play that role.

Q: In regard to shareholders' returns, I have two questions. First, once again, the recent shareholders' return, the policy on it, it appears it's 30% to 50%. So, this is going to be the maximum return? Once again, could you please give us your policy regarding the dividend? Current PER, I understand it's the buyback. But by receiving dividend, the customer investor base will be increased. So, what's going to be your future dividend policy? That's my first question.

And the second question is the share buyback. The amount is expanded. What is the background of such decision making? For example, what discussions made at the Board of Directors meeting? Did you decide based on the relative price? But because there was Dalton's proposal, you had such pressure? Or did you negotiate with the FSA, and this was the time that you obtained their approval. So, as far as it's available, could you please give us the process for the decision making?

Kudo Well, the dividend policy, basically it's based on the share price level. First, the total payout ratio, after deciding the ratio, the share buyback, and dividend, the allocation of two. So, that's how it is decided. But, based on the current share price level, rather than increasing the dividend, the share buyback is better in terms of shareholders' return. But that is what the background of that kind of structure. But if the PBR increases, as you pointed out, there are a lot of investors who prefer larger dividends and we hear in the market. So, as PBR increases, focusing more on dividends, that is the general idea we consider.

We do not have any interesting information regarding how this was decided this time. We have a reasonable different position or different model. Regardless of the fact, the evaluation is the same with others. We are not satisfied with it. This can be said as the total financial industry. Our PBR is extremely low. But in the industry, such a low evaluation is questionable. Although this is within the revitalization plan, we wanted to do the maximum we can do. So, that's the intention of the business execution of the management and the Board of Directors meeting.

The process for realizing this, as you imagine, of course we have discussions with the various parties. But we believe that our argument was accepted properly. As a voice of the market, for example, Dalton made various proposals. And including such proposals, we carefully listened to various voices, including the investors we meet in IR activities. It's not all the voices or increasing the share buyback. But, improving shareholders' return is the majority of such voices. Based on such voices, we have made our decision.

Q: I have two questions: First of all, profit growth, and second, value co-creation. You showed financial targets and you came up the value co-creation concept. And you said nonorganic isn't included. The bottom line, 2% from 52 to 55 billion yen, if you calculate that, that would give you moderate growth. What is the assumed tax rate or Kabarai reserve? Those are some of the technicalities. So, after the credit cost moderates, what would be the OBP after net credit costs, in order for you to achieve the organic growth? And, in the next three years, for example, the guidance is 13 billion yen OBP growth. And 4 billion yen is probably inorganic. So, 9 billion yen is not just through unsecured loans, because that's not enough. I cannot see how you can bring your growth to that level just through unsecured loans. Which area are you expecting as source of profit growth? That's first question.

And secondly, you mentioned the highlights of the strategy for value co-creation. Your explanation was clear. I got your point. And from 52 to 55 billion yen, that's the financial target. You said nonorganic isn't included. But, what's the timeframe? 3 years, 10 years? And in the 3 years or 10 years, how much upside potential do you think there is? So, those are my two questions. Thank you.

Kudo: Well, the first question, I have to check the detailed numbers, so I will leave that to Hirano to respond to the first question later. So, let me take the second question first. Nonorganic elements that have not yet emerged, of course are not included in the plan. I've been talking about the business model, but we are not just drawing that picture groundlessly. There are seeds, ongoing conversations that have not yet realized in the pipeline. But what would be the estimated market size? It's often an area where there is much uncertainty. You call them foreign workers coming to Japan to work, but how much revenue can we generate from them for financial services? The estimates are extremely crude, and we are trying to prioritize sizable opportunities.

As a general trend, as I touched upon slightly, the growth potential of stand-alone financial sector doing service only on their own has its limits. Also, partners are asking for cooperation. And that's where we see potential. How long will it take to bloom? Is it three years? Five years? And how much percent can we grow our business? We really aren't sure when asked. If it's less than 10%, then we would not make that a big element of the mid-term strategy. So, our ambition is higher than that level.

Hirano: To respond to your first question, not the bottom, real bottom, but OBP, taking into consideration net credit cost, fiscal year 2018, in comparison to the year ended, as we already announced, two acquisitions have had an impact. That made a difference. And in terms of OBP, we are assuming that there will be growth. But on the other hand, expenses. As I said originally, system-related expenses, its expenses are designed so that the increase rate will mitigate. So, rather than the very, very bottom, OBP after net credit cost is going to be higher than net profit, because the amount of tax will increase. So, I think the slope will be higher at the OBP level than net profit.

Kudo: May I add to your second question? Two business models and value co-creation is also part of the nonorganic growth. But there could be organic growth through value co-creation. Rather than commercial banking, we are thinking of non-banking, but domestic business and in the Asian region, investment and acquisition opportunities are constantly being pursued. Most recently, SHINKO LEASE. We obtained 80% of their equity and there are other examples of financial services to individuals, and we've begun such initiatives in Vietnam, in Asia, and we are looking for opportunities in other countries. So, they could be tacked upon. And ROE 8% also takes those opportunities into consideration. Thank you.

Q: On page 12, financial targets, just briefly, I have one question. ROE is aiming to increase from 6% to 8%. It means even the capital does not increase. The profit will increase by 30%. In such a case, EPS target is 2%. So, if this is a simple profit increase, it would take more than 10 years, even if capital does not increase. How are you going to fill the gap? Meaning, you're going to increase or grow areas which hide ROE or to acquire such businesses? Or, do you have simulation? I'm not sure whether you have such simulation, but could you tell us your policy?

Kudo: Well, of course, consistency between the numbers-- we have consistency. But, it's not that we have a very detailed simulation. For example, what if the numbers will be if we buy this? The EPS growth without a share buyback, and nonorganic initiatives, they are not included. On the other hand, the 8% ROE, or the controlling CET1 ratio, the other nonorganic initiatives are included in the building of the ecosystem are included or simple acquisitions are also included. So, that is realistic. Even the ROE is not extremely high, we can be reasonably consistent.

Q: It's a bit an ambiguous question, but in the mid-term management strategy, you talk about redesigning finance. And, I think that's in response to transformation occurring in the financial sector. But, in creation of those strategies, what different requirements do you think that is emerging from your potential partners? And how do you think that your competitiveness can respond to those new requirements?

Also, you touched upon several of the salient points, but what is the special area where only you can be competitive? And page 17 talks about ecosystem, but sorry, it's really similar to what others are saying with regard to next-generation financial services. There seems to be much overlap. And even when I compare this with your conventional and existing strategy, it doesn't really give me the feel of a complete redesign. And it doesn't give me the image that it's going to be a great leap forward. So, can you elaborate on this? Thank you.

Kudo: Then, let me use page 16 to respond to that question. You said, what is our motivation and ambition? Yes, some of this has factored in. Ambition, and we disclosed the strategies expecting that feedback that you really don't feel that this is a complete redesign. But, what kind of customer change are we witnessing? Financial sector had been fragmented: bank, securities, consumer finance, credit cards. But that was not in line with what the customers were asking for. There had been division because partly of regulatory environment, and there used to be reasonable factors that supported or justified that fragmentation. But, it's not like that anymore. Then, do we have everything on the platform so that the customers can use all of those services at ease? No. There aren't players as such.

There are interesting fintech companies emerging. But, most of them are focused on single function. In the case of Alibaba and Tencent in China, they try to offer everything on the platform. But so far, we've not seen anything like that in Japan. We don't expect that they would emerge in the short run. But at least we need to make an effort to offer a platform that doesn't offer just a single function. We are not an entity with a long customer list. There are potential partners who are trying to do something similar, who already have a gigantic platform. And I think there is room for striking alliance with those potential partners. I'm not really sure whether I've been able to respond to your questions. But I've tried.

Q: In other words, it's not focusing on individual products or instruments, but where are the customer needs when you buy something? Do you want one-year finance, or do you want us to wait for two weeks?

Kudo: There's not a clear line in between those two options. In fact, there is no service offered seamlessly. Shinpan company, or a credit card company, or a banking company individually may offer different products. So, to what extent can the service be customized or personalized depending on the customer needs? That could be the key to competitiveness. And in order to offer that, we have to have extensive coverage to be able to accommodate all requirements. We have a group that can accommodate. So, we want to tap that. Also, there could be nonfinancial requirements. Then, how could we offer even nonfinancial elements in a seamless manner? That would require a robust digital platform. It would probably be like building an enterprise with a partner.

Q: I have two questions. First, to create this new business model, are you okay with the current framework? Don't you need to change anything? For example, to create the API that's usable, then in order to do it, you need a different type of human resources, which you have hired. So then, don't you have a gap between your current people? And I think you have the constraint as a bank. Based on this, you have established a virtual headquarters. Half of the economic value you will lose if you do this through joint ventures. Regarding your organization, do you have any challenges? That's my first question.

Kudo: I think that is a good point. And for the human resources, our answer is yes and no. For example, the AI area we are really in a shortage of humans. It's very difficult to hire people. But for other areas, there are many areas that we can outsource. For example, if we use AWS, instead of using just cloud, there are a lot of different tools. So, in that sense, somehow, we can complement, and we should be able to manage.

And regarding our organization, yes, we have the restriction problem. Although we are aiming to have unified operations, we can consider our strategies as one entity. Therefore, the serving customers, we also have the sharing information problem, and the businesses will be divided by entity. That is in reality. And we talked about the ecosystem to create the joint venture, for example with different sectors. Of course, that will lead to the issue of the share of the total profit. But we don't mind if we can make the success. And overall, it's not that we can-- will not do this, because we can just take a part of the share. So, it's not that we are going to implement such initiatives. So, based on the value, if we can create the framework for the profit sharing, we should do that. So, that will not be an obstacle for implementing initiatives.

Q: And my second question is regarding capital policy, or the financial targets. You set the targets for CET1 ratio and ROE, which are reasonable. So normally, if you cannot increase risk assets, then the E of the ROE should be controlled. And I think this is consistent. And in your case, you have public funds injected. So, through share buybacks, the controlled capital in such a scenario, if you have implemented such a scenario, the ratio of the government in shareholders will continue to increase. Don't you have any constraint?

Kudo: I see. That is also another good question. But we have not faced that constraint yet. But, it's not realistic that they will continue to increase. But as you pointed out rightly, in order to achieve ROE, again, the E is a major factor. So, we decided to do the maximum shareholder return. But we are considering the E in that sense.

FY2018 Financial Results, Medium Term Strategies

Teleconference for Overseas Investors (Held on May 16)

Q&A Summary

Q: I have a couple of questions. The first one is on reserve write-back. I wanted to confirm. It seems that you did not do an additional write-back in Q4 despite the fact that Kabarai positively trended down. I was wondering if there was a particular reason for that. If so, and I guess the approval rate for Q4 for the consumer finance business, Lake ALSA, has come back down.

Can you comment a little bit on that, as well as the slowdown in the growth rate for the consumer finance industry that have in your slides, down to basically 1%? If you could comment on the environment. And my second question would be, on the mid-term plan, you do mention 8% ROE target for the medium-term. You just referred to, Mr. Gupta, whether it’s a three- to-five-year plan. But I would like to confirm whether it’s three years or five years, because it does make a bit of a difference when you work out the numbers backwards. Thank you.

Gupta: Your first question is about the gray zone reserve write-back in the fourth quarter, or the gray zone reserve write-back, in general, in fiscal year 2018?

Q: So, just for the fourth quarter, please. It seems to me you did not do any additional in Q4. Is that correct?

Gupta: No. Basically, what we did in Q4 is that we did release some more reserves in Shinsei Financial legal entity. But we were able to use that reserve because we needed more reserve in our entity APLUS. But the company as a whole, I think we were largely flat.

With regards to the approval rate of the Lake ALSA business, yes, the approval rate has been hovering around 30%, which is lower than what we were seeing in the previous fiscal year, i.e., 36%. One point to note here is that finally, in the fourth quarter, we are able to bring back the overall customer application number to the level that we were seeing in the third and fourth quarter of fiscal year 2017. Typically, in each quarter we get 110,000 applications. So, we got 30,500 customers in the fourth quarter of fiscal year 2018, with 30% approval rate. That would translate into 110,000 applications.

Yes, you are absolutely right at the approval rate is still lagging, and we have taken various measures to improve the overall loan approval rate. For example, we have further diversified our marketing activity, and we are focusing on a lot of smartphone-related advertisements.

Also, because more and more customers, more than 70% of our customers apply for new loan, or become a new customer, and they come through smartphone, we are looking into how we can improve and expedite the overall approval process. So, there are numerous initiatives we have underway to improve the approval rate. I fully agree that the 30% is not at the desired level. But we are hoping that we would be able to improve it to somewhere in between where we are today versus where we used to be. As we speak, we are working on it.

Finally, on your first question, the growth rate of 1% of the industry as a whole-- yes, so the overall industry has slowed down meaningfully. The bank lending has actually become negative. Whatever growth that we see in the fourth quarter or the third quarter of last fiscal year, it is coming in its entirety from the non-bank sector. So, keeping that in mind, if you look at our target, a growth target of loan growth target from growth areas in fiscal year 2019, we have kept it at 3%. So, we hope that we are able to grow our unsecured loan balance between 1 to 3%, you know, 4%, where the market is headed right now. That's what we believe the growth rate is going to be, practically speaking.

Now, your second question is about our medium-term strategies. The separate document that we have on slide 12; we have various numbers or percentages written there. With regards to the ROE going from 6% to 8%, that is our aspiration over the medium-term. Let's say three to five years. But, for example, in the first number, which is the EPS target of 2% or more, that pertains to the current medium-term strategy covering the next three years.

We have received a question via email from one of our esteemed investors. This question pertains to the goodwill amortization going forward. As you know that we acquired Shinsei Financial legal entity 10 years ago. We expect our goodwill amortization to decline to somewhere between 2 billion to 2.5 billion yen. I hope that answers the question.

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