Y 2021 Earnings Call

Company Participants

- Osamu Nose, Head of IR and Finance Department
- Unidentified Speaker, Unknown

Other Participants

- Kazuki Watanabe, Analyst
- Koichi Niwa, Analyst
- Masao Muraki, Analyst
- Naruhiko Sakamaki, Analyst
- Natsumu Tsujino, Analyst

Presentation

Osamu Nose {BIO 4205216 <GO>}

I am Nose, the Head of IR from Sompo Holdings. Thank you very much for joining us for our conference call today. We are going to mainly explain the numbers of the results of FY 2020 and the guidance for FY 2021 today. With regards to the new medium-term management plan, the management team, including CEO, is going to explain on the web meeting on May 26, next week. Let's get right into it. Please go to Page 2. This page shows the highlights. The key point for FY 2020 became the impact from COVID-19. On a consolidated basis, there was a positive impact at Sompo Japan from the decline in automobile accidents. Consolidated net income increased by JPY 19.9 billion to JPY 142.4 billion. Adjusted consolidated profit increased to the record high of JPY 202.1 billion, which was higher than the guidance we showed you in November last year.

In FY 2021, Sompo International is expecting the profit increase of JPY 39.9 billion, driven by increase in net premiums earned through rate improvements and absence of onetime impacts from COVID-19. However Sompo Japan is assuming the normalization of losses to some extent. As a result, we are projecting the consolidated net income to decline by JPY 17.4 billion to JPY 125 billion and adjusted consolidated profit to increase by JPY 2.8 billion to JPY 205 billion. With regards to the shareholders' return that we disclosed today as you can see in the public release, we decided JPY 40.4 billion buyback, making the total shareholders' return ratio to be 50% for 2020. On the financial disclosure statement, we have shown JPY 210 per share as an annual dividend forecast for 2021, which is JPY 40 up year-on-year. This will make the dividend increase for 8 consecutive years.

Please go to Page 4. This page shows the overview of FY 2020 results. Let me go through the highlights for the results for FY 2020 from the next page onwards. Please go to Page 5. This page shows the underwriting profit of Sompo Japan. Core underwriting profit increased by JPY 93 billion year-on-year versus 2019, mainly due to a decline in the loss ratio of automobile insurance.

Please go to Page 6. This page shows the investment profit. Investment profit declined in FY 2020 due to the impact from COVID-19. However investment profit, excluding the COVID-19 impacts trended steadily.

Please turn to Page 7. This shows the consolidated ordinary profit. Ordinary profit of Sompo International decreased due to natural catastrophes and the impact from COVID-19, which was offset by the increase of ordinary profit of Sompo Japan, which I have explained on the previous pages earlier. As a result, the consolidated ordinary profit increased by JPY 22.6 billion to JPY 215 billion.

On the next page, we are showing consolidated net income. However the trend is the same as the consolidated ordinary income. Please go to Page 9. Let me next go over the business forecast for FY 2021. Consolidated ordinary profit forecast is JPY 185 billion, down JPY 30 billion year-on-year. Consolidated net income forecast is JPY 125 billion, down JPY 17.4 billion year-on-year. Let me explain the key points for the forecast of FY 2021 on the next page.

Please turn to Page 10. Let me explain main points of the business forecast for FY 2021. Starting off with Sompo Japan, we are forecasting underwriting profit to increase assuming natural disasters will be normalized, although favorable loss ratio caused by COVID-19 will not repeat to a certain extent. With regards to Sompo International, we are forecasting profit to increase in the net premiums earned and the improvement of the loss ratio, driven by disciplined underwriting. In other businesses, we are forecasting steady profit growth, excluding onetime factors.

Please turn to Page 11. This page summarizes the impact of COVID-19. In the guidance we showed you in November last year, we have incorporated the impact of negative JPY 1 billion on the consolidated net income and positive JPY 10 billion on adjusted consolidated profit from COVID-19. However for the full year of FY 2020, the actual impact became positive JPY 2 billion on consolidated net income and a positive JPY 23 billion on adjusted consolidated profit. In the guidance for FY 2021, we are assuming certain normalization in Japan.

Sompo Japan is assuming the increase in loss ratio of automobile insurance. And Himawari Life is assuming the increase in the claims as patients will resume going back to hospitals. Sompo Care is assuming the stagnation of growth in the number of new residents. As a result, we are projecting the impact of negative JPY 6 billion on consolidated net income and a positive around JPY 9 billion on adjusted consolidated profit.

We are showing the breakdown of the consolidated ordinary income on Page 12 and the historical progress rates of quarterly results over the past five years on Page 13 and numerical management targets on adjusted profit basis on Page 14. Please take a look later on. This completes the explanation on the consolidated business results and the forecast. I will now move on to the domestic P&C business. Please turn to Page 16. This page shows the overview of FY 2020 results of Sompo Japan. Let me explain each item on the next page.

Please turn to Page 17. Net premiums written. Net premiums written, excluding CALI and household earthquake remained almost unchanged from last year, even though COVID-19 negatively impacted the top line, which was offset by the increase of the top line driven by optimizing rates in fire and automobile insurance lines.

Please turn to Page 18. This is the earned incurred loss ratio. Loss ratio improved by 3.5 points mostly due to decrease in the accident rate for automobile insurance and personal accident insurance as a result of COVID-19. Loss ratio, excluding natural disasters, also improved by 3.7 points. In FY '21, we factored in certain normalization of the impact of COVID-19 and natural disasters and expect the earned and incurred base loss ratio, excluding CALI and household earthquake to be the same level as last year. The following page shows written paid loss ratio. Please refer to them later. Page 20. This page shows our net expense ratio. Due to consumption tax increase and other factors, net expense ratio rose year-on-year. However thanks to the appropriate control of company expenses, company expense ratio was almost flat year-on-year. In FY '21, we factored in the impact of transitioning into a new system. But if we exclude this impact, both net expense ratio and company expense ratio will be roughly flat.

Page 21 shows the combined ratio, which is the sum of net expense ratio and company expense ratio. Please turn to Page 22. This page shows the investment gains and losses. The results of FY '20 was explained on Page 6. The base net interest and dividend income, excluding the COVID-19 impact progressed steadily. In FY '21, we expect to generate JPY 120.7 billion in investment profit, factoring in the reduction of the gains on the sale of securities. Please refer to the next page for the details of the interest and dividend income and gains and losses on sales and securities -- of securities.

Please turn to Page 24. This is the business forecast for Sompo Japan. The following page shows the data on automobile insurance, so please refer to the page later. Please turn to Page 26. I would like to add some explanation on the situation of domestic natural disasters. In FY '20 compared to FY '19, we did not have large-scale natural disasters, but there were multiple medium-sized disasters. As a result, net incurred loss amounted to JPY 99.3 billion, slightly higher than previous year.

For FY '21, considering the recent trend of natural disasters, our forecast is JPY 84 billion. The next page shows the fund and reserve for your reference. Please review them later. This is all for domestic P&C. I would like to move on to overseas insurance. Please turn to Page 29. This is the overview of the overseas insurance business. In the first half, although we were impacted by COVID-19 and natural disasters, the negative impact of COVID-19 was smaller than initially anticipated. As a result, the adjusted profit for FY '20 was JPY 30 billion, which is JPY 20 billion down from the previous year. This is higher than the full year forecast presented in November last year. Our forecast for the adjusted profit for FY '21 is JPY 60 billion, which is year-on-year increase of JPY 29.9 billion. The factors include absence of COVID-19 negative impact at Sompo International and the increase of earned premium, thanks to rate improvements. By the way net premiums written includes the revenue increase from the crop insurance business of former Diversified, the company that we announced to merge with in December last year. We indicated the business highlights of group companies on Page 30.

Please turn to Page 31. I would like to add some explanation on the business results of Sompo International. Please note that on this page, the figures are shown in U.S. dollars. The top line in FY '20 outperformed the full year forecast, thanks to the progress in rate improvements. Adjusted profit was down due to the impact of natural disasters. However it outperformed the forecast we presented in November last year, thanks to the fact that the negative impact of COVID-19 was smaller than initially anticipated. Adjusted profit for FY '21 is expected to increase, thanks to the absence of negative impact of COVID-19 top line increase coming from rate improvements and improved loss ratio through disciplined underwriting.

On the next page, we have shown the business results of Sompo International for your reference. This is all for overseas insurance business. Next, I would like to cover domestic life insurance. Please turn to Page 34. This is the overview of Himawari Life. The balance of protection-type products is increasing, and the adjusted profit increased by JPY 1.7 billion. In FY '21, through the promotion of Insurhealth products, we expect the new business to expand. Next page shows the factors affecting the net income, and Page 36 provides supplementary information. For MCEV, which was separately disclosed in detail, you can find the outline on Page 37. So please refer to them later as well. This is all for domestic life insurance.

Next, I would like to cover nursing care and healthcare business. Please turn to Page 39. This is the overview of nursing care and health care. Sompo Care in FY '20 incurred some expenses for the COVID-19 countermeasures, but there were positive onetime tax effect and closed with JPY 7.3 billion of adjusted profit, increase of JPY 1 billion. In FY '21, we expect the increase of new residents to slow down due to COVID-19. The trend of occupancy rate is shown on Page 40 for your reference. Please refer to them later. This is all for nursing care and health care.

Finally, I would like to cover ERM and asset management. Please turn to Page 42. This page shows the situation of ESR impacted by the improvement of financial environment, such as high stock prices and rising interest rates. The ESR as of the end of FY '20 rose from the end of FY '19 to 238%. Our soundness continues to be intact. You can find the breakdown of adjusted capital and risk amount on Page 43. Please turn to Page 44. Finally, this is our group's consolidated asset portfolio. On the following pages, you can also find asset portfolios of Sompo Japan, Sompo International and Himawari Life. Please refer to them later. All of our portfolios are conservative with focus on safety. This concludes my presentation. Thank you for your kind attention.

Questions And Answers

Operator

(Operator Instructions) The first question is from SMBC Nikko Securities, Mr. Muraki.

Q - Masao Muraki {BIO 3318668 <GO>}

My name is Muraki from SMBC Nikko Securities. My first question is on the capital policy. Specifically, ESR declined versus December. Would you please give us the reason? I think it's related to the division of your capital model. But would you please explain the reason why ESR has declined? And secondly, which is related to the total return ratio, exactly 50%, would you please give us the logic. Is it partially due to the decline of ESR? Or are you assuming large investments, large pipeline for the potential investment in the medium-term management plan? Is that the reason of the return ratio being exactly 50% in total?

A - Unidentified Speaker

Mr. Muraki, thank you so much for your questions. Relating to your first question, which is about ESR level. From December to March, what is the reason for the change and then our policy towards the total shareholders' return. First, from December to March, ESR declined from 244% to 238%. So ESR has declined a little bit. There are several reasons. First, market factor. The stock market and FX market changed, which were increasing impact by 3 points. On the other hand, the interest rate change gave an impact of minus 1%. In total, plus 2%.

The big element for the change of the ESR this time is related to the shareholders' return. Specifically speaking, when we calculate the ESR at the end of March, we look at the dividend at the end of the fiscal year and then buyback, which are included, reflected in advance. That impact is minus 5%, which is quite a large impact. And division of the model had almost no impact on ESR and other changes or factors for the change. International operation has taken more risks, and then we have included profit in the Fourth Quarter. But the big elements related to the shareholders' return policy, as I mentioned earlier. That's the big component for the reason for the change. With regards to your second question, which is related to the 50% total shareholders' return ratio. Mr. Muraki, as you pointed out correctly, in the new medium-term management plan, we have plans for investments for the future. So we'd like to accumulate capital for future investment for growth. In the new medium-term management plan period, we have investments for growth, and we'd like to explain the capital policy in the next meeting to be held next week by the management team. I hope I answered your questions.

Q - Masao Muraki {BIO 3318668 <GO>}

My second question is on the international operation. I'm on Page 31. The top line has been increasing steadily. So the question is how confident you are with this level of profits. I think the potential risk is a potential rise of the loss ratio again. Looking at January through March in the United States, probably the impact from cold wave in the United States. Was it large or not so large? Are there any risks for the potential rise of the loss ratio in the United States?

A - Unidentified Speaker

Mr. Muraki, your second point was related to the business performance of Sompo International. Large cold wave in Texas in February. Then throughout the whole year, are there any risks that may push up the loss ratio for the full year? So those were the 2 questions. First, about the cold wave in Texas. From January to March, in the March quarter, this cold wave happened in Texas. The impact of that will be in the June quarter, which is Q1, from April to June. So for the details, when we announced our Q1 results, we are going to go through. But at the moment, looking at Sompo International's performance for the March quarter, the impact of Texas cold wave did exist, unfortunately. But including that even, looking at their First Quarter performance against the target, they are generating profit level that is in line with the targets for the Fourth Quarter. So at the moment, there is no anticipated that impact from Texas cold wave.

With regards to your second question, potential risks that may push up the loss ratio, the biggest uncertainty is natural catastrophe. Fortunately, if the frequency of natural catastrophe is low, that's pleasing. But as we all know, in 2020, that was a year when we had the fourth largest frequency of natural catastrophes. So for this fiscal year for 2021, we have to be cautious for the frequency of natural disasters. But as of now, Sompo International nat cat budget does not assume extraordinary factors. But because of the top line increase, the impact of natural catastrophes is assumed to go up due to the top line increase. In 2020, in Sompo International, nat cat assumption was JPY 26 billion in 2020. But in 2021, we have increased that to JPY 45 billion estimation. Driven by the top line increase, we are assuming the frequency increase of the natural catastrophes. I hope I answered your questions.

Operator

Next, from Mitsubishi UFJ Morgan Stanley Securities, Tsujino, please ask your question.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

First of all, this time, the expected dividend will be increased by JPY 30. What is the basis of the calculation of the increase of the dividend?Another question. This time, in the new fiscal year, the reinsurance cost of the natural catastrophe. Last year, you commented that you will change the method and the method of reinsurance, have you actually changed the method? Those are my two questions.

A - Unidentified Speaker

Thank you for your questions, Tsujino. This time due to the system trouble, I'm sorry to have created inconvenience to you. Your first question, regarding the dividend. To date, we started FY '21's dividend forecast, and it is JPY 210 per share, which is increased by JPY 40. The details of the capital policy will be explained next week in the explanation session. And gradually, well, originally, our trend of dividend is on the increasing trend that has been presented.

In starting the new midterm management plan, for the dividend, we have changed our concept. Please wait until next week for the details. Your second question, in the new fiscal year, will there be changes in the cost of reinsurance? I believe that was the point of your question. The reinsurance cost related to the natural catastrophe is my understanding of your question. The -- we reviewed the reinsurance scheme. In terms of the cost after tax, it will be a decline by JPY 3 billion. So those were my replies to your question.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

The concept, the complicated concept was explained previously. And for those matters, should I be asking next week?

A - Unidentified Speaker

You're talking about capital policy?

A - Osamu Nose {BIO 4205216 <GO>}

The policy of reinsurance.

A - Unidentified Speaker

The scheme, the details of the reinsurance scheme is not disclosed. In negotiating the reinsurance at this time, depending on the layer, there are some unreasonable layers in terms of the risk return under our understanding. So we made judgment so as not push reinsurance in such areas.

Operator

Next question is from Daiwa Securities. Watanabe, please go ahead.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

My name is Watanabe from Daiwa Securities. I have 2 questions. My first question is on the initial budget for natural catastrophes in Japan. At the beginning of the last fiscal year, you assumed JPY 60 billion, but you raised that to JPY 84 billion in this fiscal year. Probably, that's related to the reinsurance scheme, but would you please give us the reason? Second question, Page 10, the strategic shareholdings. For 2021, you are assuming a reduction of JPY 50 billion. Every year, the reduction has been declining. So what is your stance towards the reduction of strategic holdings?

A - Unidentified Speaker

Mr. Watanabe, regarding your question or questions, the first question was about natural catastrophe budget for Japan. Second question was about policy towards reduction of strategic stocks. To your first question about the initial natural catastrophe budget for Japan, we are budgeting JPY 84 billion this time, which is an increase from JPY 60 billion at the beginning of the last fiscal year. The reason, one, is because of the change of the reinsurance scheme.

The second reason in the calculation of the natural catastrophe budget, there was this issue, whether we should include IBNR or not. So from the new fiscal year, we decided to include IBNR in the natural catastrophe bucket for Japan. We are budgeting JPY 84 billion. Of that, JPY 74 billion is the natural catastrophe budget, but we have a JPY 10 billion IBNR, in total, JPY 84 billion. In the last fiscal year, our initial budget was JPY 60 billion, which did not include IBNR. So on the apples-to-apples comparison basis, JPY 67 billion is the number for this fiscal year. So on the apples-to-apples comparison, the increase from last year to this year is JPY 60 billion to JPY 67 billion. Relating to your second question on the strategic shareholders -- holdings, since the beginning of the holdings, we have sold JPY 1.2 trillion on the market value basis. On the book value basis, over the past 10 years, we have reduced by roughly 60%. So our policy is to continue the sale of strategic shares, although the value amount has become less. There's no change to our plan to keep reducing strategic shares. But we have reduced so much of strategic shares over the past years. That's why the level of the reduction is at this level, but would like to free up capital by selling strategic shares and use proceeds to invest for future growth. So I hope I answered your questions.

Operator

Next from Citigroup, Niwa. Please ask your question.

Q - Koichi Niwa {BIO 5032649 <GO>}

I have two questions regarding the domestic P&C. One is the property and another is catastrophe reserve. And looking at Page 20, the property fee will rise. The expense -- company expense is likely to increase. What will be the trend next fiscal year and onward? Will this be on an increasing trend? That is my first question. My second question, this is related to the previous question. In the special measure related to catastrophe reserve is being scheduled in my understanding. And how will that be reflected to the shareholder return? The strategy of the reinsurance, well, I will not ask about that. But in relation to the shareholder return, how should we understand that point?

A - Unidentified Speaker

Thank you, Niwa, and same for you as well. I apologize for the inconvenience caused. There are 2 questions raised from Niwa. One is domestic P&C at Sompo Japan, what is the property cost and another is the concept of the catastrophe reserve. First is about the company expense ratio. As you know, as shown on this line graph, along with the system cutover, the cost is increasing. FY '21 incorporates that increase in the system cost. Regarding the future, actual amount will continue to rise. But in terms of the ratio, company expense ratio, it will slowly go down. That will be the forecast. Your second point regarding the catastrophe reserve and the relationship of that and the shareholder return. The -- according to the calculation of adjusted profit, we have eliminated the fluctuation of the catastrophe reserve. And even if there's any changes -- there's some changes in that area, they will -- that will not impact our shareholder return.

Operator

Next questions are from Nomura Securities, Sakamaki.

Q - Naruhiko Sakamaki {BIO 19968981 <GO>}

My name is Sakamaki from Nomura Securities. Time is limited. So I'm going to ask you just one question. Relating to the impact from COVID-19 for this fiscal year for Japan, what are the assumptions that you have incorporated? EI loss ratio. When I look at your plan in the automobile line, EI loss assumption is going down. But are you assuming some impact from COVID-19 to remain? Or is that due to the impact from the rate divisions?

A - Unidentified Speaker

Sakamaki, thank you so much for your questions. For 2021, the guidance assumptions for the impacts from COVID-19. Mr. Sakamaki, you referred to EI loss ratio in the automobile product line. For 2020, EI loss ratio was 54.9% and we are assuming that to go up to 57.6% in 2021. That is assuming some normalization of the impact from COVID-19. EI loss ratio, that will be about 3.5%. Some normalization of the impact of COVID-19 on EI loss ratio. So here's what we are thinking as an assumption. Versus 2020, in 2021, the loss is assumed to go up. In other words, the impact from COVID-19 will taper off in 2021. But versus 2019, which is pre-COVID-19, still fundamental loss or downward trend will continue, especially at the beginning of the year. Towards the end of the year, in 2021, that will paid out gradually. That's our assumption. So versus pre-COVID, loss ratio is still improving a little bit. But versus 2020, we are assuming some deterioration of the loss ratio. I hope I answered your questions.