Q2 2018 Earnings Call

Company Participants

- Yukinori Kuroda, Head of Investor Relations

Other Participants

- Futoshi Sasaki, Analyst
- Kazuki Watanabe, Analyst
- Koichi Niwa, Analyst
- Koki Sato, Analyst
- Masao Muraki, Analyst
- Natsumu Tsujino, Analyst

MANAGEMENT DISCUSSION SECTION

Yukinori Kuroda {BIO 19776286 <GO>}

I'm Kuroda with Sompo Holdings. Thank you very much for joining us despite a tight schedule to this conference call. I would like to talk about the numbers of FY 2018 first half results and full year forecast which was disclosed today and management will explain at next week's Analyst Meeting regarding the aspects of our management strategy.

Please turn to page 2. In first half of FY 2018 although losses incurred from large domestic natural disasters such as Typhoon Number 21 expanded helped by rebound from the impact of hurricanes in North America in FY 2017, resulting ordinary profit was ¥27.8 billion, up by ¥24 billion and the net income was ¥22.1 billion, up by ¥21.2 billion.

In light of the recent situations, we revised the full year forecast, which is indicated, with ordinary profit of ¥237 billion and the net income of ¥170 billion. As will be explained later, this is mostly reflecting the impact of domestic disasters, and also the adjustment of the landing (00:01:21) for Sompo International. Although not shown on the slide, as was disclosed today separately, cancellation of all treasury shares was approved today which amounts to 10% of total outstanding shares that we have been acquiring for shareholder return.

Please turn to page 4. This is the first half overview, positive and negative factors shown on the following pages.

Page 5, underwriting profit for Sompo Japan Nipponkoa was minus ¥58.4 billion, down by ¥86 billion mainly due to the increase of ¥121 billion in incurred loss from domestic natural disasters such as Typhoon Number 21. Excluding the domestic natural disasters, profit was positive at ¥13.4 billion, due to large losses staying at around ¥1.6 billion for this first half, improving ¥13.1 billion on a year-on-year basis.

The payment in progress for Typhoon Number 21 and others was about 15% at the end of September but we believe that up to 90% can be paid for the full year. And the full year performance will benefit from the gain on reversal of catastrophic loss reserve.

Please turn to page 6. Investment profit was ¥65.3 billion, up by ¥35 billion. Main factors include interest and dividend income being pushed up by cancellation of funds and absence of impairment loss from consolidated subsidiaries stock from the previous year.

Please turn to page 7. Ordinary profit was ¥27.8 billion, up by ¥24 billion year-on-year. And the main factors include underwriting profit, investment profit and also rebound from the impact of a hurricane in North America, which amounted to ¥74.5 billion in the previous year.

Overseas subsidiaries posted negative profit. But this is a technical issue. Inclusion of amortization of intangibles from this term in the local accounting process at Sompo International. Excluding such noise, the profit was actually up.

Net income is shown on page 8 for your later reference, please move on to page 9. Full year forecast numbers, as I mentioned in the outset, this number was revised from the beginning of the term, key points explained on the following pages. Please turn to page 10.

Net income was down by ¥40 billion from the initial forecast. There are two main factors involved. The first factor is impact of domestic natural disasters such as Typhoon Number 21. Considering the expected losses, reversal of cat loss reserve, reinstatement of premium for reinsurance, we reduced the number by ¥19.1 billion from the beginning of the term forecast.

The second factor is revision of the performance at Sompo International. The biggest difference between then and now is a degree of hardening of the market. Adjustment was made to the premium written at - in light of the current situation. And also although it doesn't impact the revised profit, there was an impact of changes in the fair value of securities. And the bottom line was adjusted by just above ¥13 billion.

On page 11, you can see the breakdown of original profit at the time of the forecast, you can see the progress on page 12 and also numerical targets for the management on page 13 for your later reference.

Please turn to page 15. This is the overview of Sompo Japan Nipponkoa results. Each line item will be explained in the following pages. Please turn to page 16. Net premiums written excluding CALI and household earthquake increased by 0.2%. Fire and allied lines was down due to partial transfer of products to Sompo International and personal accident was also down partly because of the transfer to other lines. Voluntary automobile was impacted by the rate reduction in January. Other lines maintained strong, compensating those products and SMEs products showed a double-digit growth.

Please turn to page 17. Written and paid loss ratio. First half was 60.8%, up 2.0% year-on-year, mainly due to domestic natural disasters in fire and allied lines. Excluding the natural disaster impact, it was down by 0.9%. For full year, as claims paid for domestic natural disasters progresses, we expect an increase of 6.2% year-on-year.

Please turn to page 18 for earned and incurred loss ratio. Same as written and paid loss ratio, it increased due to domestic natural disasters. It increased to 73.4%, up 12.1 points year-on-year. In the full year, we are projecting 68.5%, up 6.8% year-on-year. Main reason behind the higher loss ratio is due to the impact from domestic natural disasters. However, another reason if I may add is also because we have incorporated potential large losses quite conservatively.

Please turn to page 19, net expense ratio. Net expense ratio was 33.5%, down 0.3 point year-on-year. We have been able to control both personnel and the non-personnel cost well and is trending according to the plan. There is no significant change to the full year forecast either.

Please go to page 20. Combined ratio, which is the sum of loss ratio and net expense ratio I have just explained. We are showing the combined ratio excluding domestic natural disasters for your reference.

Please go to page 21. Investment profit. Investment profit in the first half is, as I have explained at the beginning of this meeting. Let me supplement the explanation on the reduction of strategic holding stocks. We sold actual stocks of ¥55.2 billion by the end of the first half, thus making a good progress on the sale against the annual plan of around ¥100 billion. We are negotiating with companies where we hold shares and got the agreement for the amount exceeding the planned amount for this fiscal year. So we are going to continue to watch the market and there may be a situation where we may end up achieving more than planned.

With the conservation of the current environment, we are assuming ¥147.5 billion in the full year guidance, which is advised up by ¥5.3 billion from the projection at the beginning of the year. For interest and dividend income, gains on sale of securities and impairment loss on securities, please take a look at the next page, page 23.

Business forecast for Sompo Japan Nipponkoa, assumptions behind the projection are on page 24. And the usual data indicators related to automobile insurance are on page 25. Please take a look at them later.

Please go to page 26. Domestic natural disasters which are the biggest noise of this fiscal year. Gross loss incurred in the first half was ¥302.8 billion and net incurred loss was ¥147.2 billion. As you can see from this page, more than half of the gross incurred loss was from the impact of Typhoon 21. In the full year forecast, assuming the loss from Typhoon 24 in and after October, loss from snow damage during the winter season and some buffer, net incurred loss is projected to be ¥175 billion from domestic natural disasters. This is higher by ¥127 billion from the initial forecast of ¥48 billion.

Next page is on fund and reserve for your reference. Please turn to page 29. Overseas insurance, adjusted profit in the first half was ¥27.1 billion, up ¥62.4 billion, main reason for the increase is rebound from the impact from hurricanes in FY 2017, which was ¥57.6 billion after tax. We revised full year forecast downward to ¥54 billion from the initial ¥63 billion. Main reasons are division of SI's business projection of ¥6.8 billion and the impact from Turkish lira which was ¥1.9 billion.

Page 30 shows the business result breakdown by region. Page 31 is the business result breakdown by company. Please take a look at them later on.

Let me make additional explanation as SI on page 32, the largest vehicle overseas. Numbers shown are all in U.S. dollars. Top line in the first half grew mainly driven by insurance business. Incurred loss increased on the back of policy expansion, but the expenses are well controlled against the top line growth. We are receiving questions on the market hardening frequently in the meetings and interviews. But hardening is limited to low-single-digit on average in the industry. However, SI achieved high-single-digit rate increase above the market. However, we assumed more than 10% rate increase at the beginning of the year, as I mentioned in the previous meeting. So based on the current situation, we adjusted top line growth projection. That's the main outline for the division.

On the next page, we are showing numerical data of SI, so please take a look later. Page 35. Himawari Life. There was a net positive impact from provisioning and the reversal of policy reserve, but all in all, the business is trending in accordance with their plan. Ordinary profit was ¥15.4 billion, up ¥6.4 billion. Net income was ¥9.4 billion, which was up ¥5.1 billion. We have not changed our full year forecast, considering some costs are second half heavy.

On the next page, we are showing changing factors of net income of Himawari Life and on page 37, we are showing additional information on the adjusted profit. Please take a look at them later on.

Please go to page 39. Nursing Care & Healthcare, main KPI in this business is occupancy ratio which is continuously improving. Net income in the first half was ¥2.2 billion, up ¥1.2 billion. Trend of occupancy ratio is shown on the next page, page 40.

Please turn to page 42, ESR. There is no extraordinary change and there is no issue with the soundness of financials. Next page is on the breakdown of adjusted capital and risk. Please take a look at them later on.

Lastly, page 44. This page is on the group-wide asset portfolio. On the next page onwards, we included asset portfolio of Sompo Japan Nipponkoa, SI and Himawari Life. I would appreciate if you could take a look at them later on but there is no noteworthy change.

This completes my explanation.

Q&A

Operator

Thank you. We'll move on to Q&A. Mr. Muraki with Deutsche Securities.

Q - Masao Muraki {BIO 3318668 <GO>}

Thank you. My first question is about domestic P&C excluding natural disasters. On page 18 on the left-hand side, excluding natural disasters, the E&I loss rate was supposed to improve by 0.4% year-on-year. That was the initial plan. But you mentioned that the large losses will be included conservatively. Have you included the ones that have become more visible? Would you say that the new plan is more conservative than the first plan in the beginning of the term?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you very much for your question, Mr. Muraki. I would like to answer the question about the E&I loss ratio excluding natural disasters. As you could tell, slight increase is expected. And as you mentioned, major factor is large losses. As was explained earlier, up until the first half, we had a large loss of ¥1.6 billion. And as I explained last year, usually on average, we see approximately ¥10 billion to ¥12 billion large losses. So that's how much we should assume, but in the previous year, we had a lot of life losses ¥25 billion, which means that this year's forecast is closer to what we had in the previous term.

We have already recognized some of the larger losses at billions of yen. We believe that it will reach the level of the average here, so that is why we have added approximately ¥10 billion worth of large losses, which is more conservative than the initial plan.

By line, voluntary automotive sees automotive parts unit price increase and direct revision, so E&I loss ratio is expected to increase by 1% excluding natural disasters. And in the marine line, although the impact is small, we had some medium scale disasters such as Mexico flood and that is why the loss ratio is expected to increase. Thank you.

Q - Masao Muraki {BIO 3318668 <GO>}

Second question is about page 33. You have indicated the details of P&L and I have a question about this plan. The gross premiums written is lower by 7% compared to the initial plan and net premiums written is lower by about 12%. And the reason for this downward revision, can it be explained by hardening of the market not progressing as much as you had expected? I understand that you're hiring more underwriting employees to increase the volume. That was another direction. So, rate versus volume, how do you explain the 7% and the 12% downward revision from these aspects?

Now the loss ratio has remained basically the same from the initial forecast. You have the outlook about the natural disasters versus others. And how have these numbers changed from what you expected in the beginning of the year?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you. I would like to explain about SI. With regard to top line, the gross premium written rate can be affected by the reinsurance, but mostly this can be explained using the gross premium written, so that you can explain using this number of other downward revision. In the beginning of the term, you asked a similar question and I said that we expect 34% increase in gross premiums written, which breaks down to 13% due to integration of Sompo America, 10% organic growth and just above 10%, in fact 11% from market hardening. That's how I explained it.

Gross premium written is a plus 25% in this forecast, which breaks down to 13% from integration of Sompo America, which is the same as before. The remaining 2% increase can be broken down into organic growth 6% and market hardening 6%.

Now, which means that five point impact – negative impact for not reaching the expected hardening of the market and also, for organic growth, we underachieved by 4%. Hardening of the market was approximately 1% to 3% – 1 to 3 points. So we are providing underwriting with a strong awareness about the P&L, but the initial forecast was maybe too aggressive.

Organic growth, we have not really reached the target, but the P&L standard is very stringent at SI and we have not really achieved that. Last year, we had seen worsening of losses due to property insurance and we were trying to remove the low profit contract. But during the first half, we still have some of those contracts, that is why we could not achieve the target for organic growth.

Back to P&L and low profit contracts are controlled very tightly, which means that net losses and loss expenses can stay lower. With regard to loss ratio, the assumptions have not changed very much from the beginning of the term. Initial forecast was 60.4% and the new plan is at 60.6%. So the difference is only 0.2%.

Cat budget for SI is ¥26 billion, up to the first half there was basically no impact. But during the second half, more recently we had Hurricane Michael, which may exceed ¥10 billion in terms of losses and there are some smaller things that would be accumulated. So the total number will be below ¥26 billion but some of that will be consumed. So we decided to maintain the same number for cat ¥26 billion. And the loss rate and rate reduction, these were some of the impacts that resulted in the worsening of 0.2%. Thank you.

Operator

Thank you so much. Next questions are from Ms. Tsujino from Mitsubishi UFJ Morgan Stanley Securities. Ms. Tsujino, please go ahead.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Thank you so much. I have two questions. First with regards to the reversal of natural catastrophe loss reserve associated with natural disasters, this time you are assuming net reversal of net cat loss reserve of ¥125.5 billion for Sompo Japan Nipponkoa and your net reversal assumption at the beginning of the year was ¥13 billion. That means our loss assumed for natural catastrophes at the beginning of the year was around ¥50 billion.

So are you not assuming extraordinary provisioning to the net cat loss reserve? Have you calculated on a regular basis and as a result you are projecting the reversal of ¥125.5 billion on the regular calculation basis without extraordinary provisioning.

A - Yukinori Kuroda {BIO 19776286 <GO>}

Let me address your first question first. Yes. In this projection, we are not assuming any extraordinary provisioning to the net cat loss reserve. This is on the regular calculation basis. As you know, when we top up the net cat loss reserve, there is 5% tax free additional provisioning capacity, but we made an additional provisioning already of 14%, way above 5% tax free additional provisioning capacity. Is it enough? We are going to decide whether that's enough considering various factors, but at the moment, we think we can achieve the targeted balance of the net cat loss reserve within few years. So we are not assuming any extraordinary provisioning to the reserve, but temporary, the balance of the net cat loss reserve will go down that's the fact. So if necessary, there's a possibility that we are going to study the additional extraordinary provisioning to the reserve. But when we do that, there is also a possibility that we may offset that by capital gains and other factors.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Secondly, with regards to the adjusted underwriting profit, net provisioning to the natural catastrophe loss reserve incurred natural disasters and foreign exchange fluctuation reserve. In the first half, there was negative ¥4.2 billion. You left the full year number unchanged. So from the beginning of the fiscal year, it's negative for that portion. With that, adjusted underwriting profit is down by ¥18.3 billion I don't think you can explain this amount only by large losses that you explained earlier. I don't think that's the only reason. Are there anything else?

A - Yukinori Kuroda {BIO 19776286 <GO>}

The biggest factor is over ¥10 billion large loss or large losses, that's the biggest factor. But also for each product line, we have changed our base views a little bit. So that we don't get further down side at the end of the year. We've made assumptions more conservative. For example, for automobile line, for the premium assumption, for the claims assumption, we made them a little bit more conservative, and also compared to the beginning of the year, E/I loss ratio is now higher by 0.6% compared to the initial projection. So it's a combination of those factors. Thank you.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Thank you so much.

Operator

Thank you very much. Next, we have Mr. Watanabe with Daiwa Securities.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Thank you. I have two questions. First question is about page 26, domestic natural disasters. First half gross incurred losses ¥302.8 billion. Out of that, how much was the impact by the corporate? And next year, I understand that you're going to increase the rate for fire and allied in retail. What is your policy for the corporate? That's my first question.

A - Yukinori Kuroda {BIO 19776286 <GO>}

First half gross incurred losses was approximately ¥300 billion and very roughly speaking, 20% is from corporate. As far as rate increase is concerned, in 2019 January, two months from now, we plan to revise the rate for fire and allied base increase of 1% to 2% will be implemented. And as you may know, advisory rate went up in May 2018 which usually is applied to the actual rates within 12 to 18 months. So, as was reported, the rate may be revised around autumn 2019 timeframe. Do we do it to the advisory rate level or are we going to do more, we have not decided yet. But at any rate, our policy is to achieve profitability in fire and allied. If the retail model changes then the corporate model will have to be reconsidered, which means that reasonably speaking, we should conclude that the base rate for corporate should be increased. We don't know when but general direction is for the increase of the rates.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Thank you. Second question about shareholder returns. So, the revised profit plan is ¥105 billion and 50% of that is ¥52.5 billion, which is probably the pool for the shareholder return. If ¥50 billion is used for dividends, the budget for share buyback is very small. Do you have any plan to change this policy for this year?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you for your question. Regarding shareholder return, we are trying to achieve 50% of the adjusted consolidated profit for the mid-term and for the last four terms, we have been achieving 50%. So, the shareholders can really see strong commitment by the management to this number. Having said that, in 2013 for example, we had snow damage, and the adjusted profit was lowered. And the total return payout ratio was 220%. And for this year, we have experienced a lot of temporary damages, which means that the total return ratio, simply speaking, would be likely exceeding 50%.

Now from the management's perspective, we don't want to be seen as if we have regressed or stepped back our shareholder return. And the next week, you'll have an opportunity to hear directly from our management about the strategy and the policy.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

I see. Just to clarify, the total return amount from the previous term can be used as a benchmark?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Well, we don't plan to step back on our shareholder return, so that may be one of the factors considered.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Thank you. That's very clear.

Operator

Next questions are from Mr. Otsuka from JPMorgan (00:30:27).

Q - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you so much. My name is Otsuka from JPMorgan (00:30:33). I have two questions. First question is about SI. You have revised your projection of SI business result. You have also changed your forecast for the hardening a little bit. Is it a timing difference? Meaning in this fiscal year, it's difficult for you to increase rates, but in the next fiscal year, you think you can increase the rates or simply was the forecast at the beginning of the year too bullish. Would you please give me more color on that? That's my first question.

Thank you, Mr. Otsuka (00:31:14). First about the timing difference, in the negotiations with policyholders, there may be some cases. But in principle, there are not so many such cases. When this year is closed, then price is set to the – that will reflect in the next year, next year situation. So, answer is, our projection at the beginning of the year was too aggressive, that's mostly only reason.

Understood. My second question is about page 9. When I look at consolidated net income of overseas subsidiaries, also I'm looking at adjusted profit for overseas insurance. Net consolidated income of overseas subsidiaries is ¥21.1 billion and adjusted profit for overseas insurance is ¥54 billion. There is a quite significant gap between the two numbers from the beginning of the year. You have changed your projection for SI, so would you tell me the factors contributing to the adjusted profit which is higher than the consolidated net income for overseas subsidiaries.

Thank you, Mr. Otsuka (00:32:23). There is a technical reason, so let me go through. Last year, there was a profit from the reorganization, as you recall. So because of that, local (00:32:36) accounting was changed a little bit. Up until then, intangible asset such as goodwill was accounted for on the consolidated basis in Japan. But from this fiscal year, first SI recognizes such intangible assets first and then holdings in Japan eliminates once and then recalculate the amount that Japan needs to recognize and recognize that amount once again. So that's the technical reason.

And the amount of that is on page 11 at the very bottom on page 11, the section that no one looks at, this amount which is ¥20 billion. So deducted that amount and added back that amount. If that's the case, although the amount is slightly different from the past, but basic thinking has not changed at all, exactly, basic thinking has not changed.

Thank you.

Operator

Thank you very much. Next, we have Mr. Niwa from Citi Securities (sic) [Citigroup] (00:33:49).

Q - Koichi Niwa {BIO 5032649 <GO>}

I have a question about your guidance. I'm looking at page 10 and I may be a little bit critical. I do understand the details and I also understand the big impact of natural disasters, but we have seen the same situation this year and last year, meaning that the beginning of the guidance tends to be quite aggressive. So, as you formulate your next mid-term plan, how do you deal with the gap between the plan and the actual, looking back at what happened in the last two years, how do you see this and also how do you plan to communicate the numbers for the new mid-term plan?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you for your question. The forecast that we're presenting this time is quite conservative as you can see, because we are learning from this experience. Basically in the beginning of the term, we try to find the most reasonable set of numbers. So, it may be slightly aggressive or conservative, but our basic stance is always the same. We try to provide the most appropriate numbers at that time. Last year and this year, the biggest gap came from natural disasters. So, we really need to look at year end and really consider where the right level should be and reflect those numbers in our plan. But our responsibility is to indicate the numbers that we believe are reasonable at that time.

Q - Koichi Niwa {BIO 5032649 <GO>}

Very clear. Thank you.

Operator

Next questions are from Mr. Sasaki from Merrill Lynch Japan Securities.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

I have two questions. My name is Sasaki from Merrill Lynch Japan Securities. My first question is about the guidance for this fiscal year. As I recall, you gave me the number or the assumption for the natural disasters overseas which was ¥28 billion, as I remember. And you left the number unchanged. So, is ¥28 billion still a good number? That's my first question.

Second question. This time, there was higher frequency of natural disasters in Japan. But in the next fiscal onwards, are there any impacts to continue in the next fiscal year onward, for example, potential rise of the reinsurance cost? Are there any lingering impacts from the higher frequency of natural disasters in Japan in the next fiscal year onward, if any? So that's my second question.

A - Yukinori Kuroda {BIO 19776286 <GO>}

Mr. Sasaki, thank you so much. First about overseas natural catastrophe budget, you're right. ¥28 billion, that's the total amount of overseas natural catastrophes budget including the amount underwritten by Sompo Japan Nipponkoa. It's on the group basis. So, basically Sompo Japan Nipponkoa and SI altogether, specifically ¥2 billion underwritten by Sompo Japan Nipponkoa, ¥26 billion underwritten by SI, that's the budget for overseas natural catastrophes at the beginning of this fiscal year. And for that, yes, ¥28 billion still a good number. We have not changed.

Your second question, are there any factors to continue in terms of impact on the higher natural catastrophe this fiscal year in the future. As we mentioned about the insurance cost, we cannot assume softening of the insurance premiums.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

But how much will that impact be?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Currently, we are studying the potential impact. But reinsurance programs are quite complex. It's a combination of various complex reinsurance structures and it depends on where we assume the judgment point (00:37:58). So there's no straightforward way of calculating how much percent increase of the reinsurance cost because our loss is increased by how much percent.

Our policy is to contain the impact on the natural catastrophes so that it does not become the capital event. At the same time, our policy is also to control the profit volatility impact on income statement. So based upon those policies at the reasonable reinsurance premium, we are trying to structure the scheme of reinsurance towards the renewal timing on April 1. But when our reinsurance cost is increased, we may offset by pricing increase of fire and allied (00:38:41) and so forth. So at the moment, we are not assuming any significant factor that may continue in the next fiscal year onward.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

If that's the case, is your company trying to reduce the retention going forward? Does the management think that retention should be lower in the future or there's nothing to do with the higher frequency in this fiscal year and you are not going to change the retention amount?

A - Yukinori Kuroda {BIO 19776286 <GO>}

At the moment, it's difficult to say, it's hard to say at the moment. For the same – simply for the same risk amount, of course cost gets cheaper if we do the retention. So depending upon the cost control, there is a possibility that we may change the retention amount. But as I mentioned earlier, basically we control the reinsurance program, so that it does not become the capital event. At the same time, we'd like to control the volatility because large shareholders and the long-term shareholders request us to control the volatility as much as we can, so that's how we are trying to structure the reinsurance programs.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

Understood. Thank you so much.

Operator

Thank you very much. Next, we have Mr. Sato from Mizuho Securities.

Q - Koki Sato {BIO 19983862 <GO>}

I have a couple of questions. The first one has to do with catastrophic reserve. For fire and allied, you had ¥150 billion and there was reversal of ¥100 billion and you mentioned that you don't consider extraordinary provision and it doesn't make sense to me. You spoke about additional provisions even at 14% reversal exceeds the provision. Simply speaking, it seems that the balance is too low. And looking at the current circumstances, Sumitomo Mitsui (00:40:44) decided to go ahead with the extraordinary provisioning. How did you decide that it was not necessary?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Let me try to clarify. We have not decided that extraordinary provision is not necessary. We have already implemented additional provisioning and looking at the past several years, we have seen some reversals. So the balance is not very high that is the current situation. And if we land according to the plan for fire and allied, provision will be approximately ¥52.6 billion. Is it sufficient? If it turns out to be too small, then we will look at balance of different factors and still have the option of implementing extraordinary provision.

Q - Koki Sato {BIO 19983862 <GO>}

So currently, you have to consider many factors and cannot decide whether the balance is too low at this point.

A - Yukinori Kuroda {BIO 19776286 <GO>}

That is correct. The company looks at economic values and we do not see any issues with ESR, management decision making or shareholder return policy.

Q - Koki Sato {BIO 19983862 <GO>}

For catastrophic reserve and JGAAP profitability leveling, this provision is very useful. But how much balance do we need in order to enjoy this benefit?

A - Yukinori Kuroda {BIO 19776286 <GO>}

We have to look at this holistically.

Q - Koki Sato {BIO 19983862 <GO>}

I understand. My second question is about the cancellation of treasury shares. In previous meetings, you have explained that the cancellation would not be necessary. How did you decide to do this this time around?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you for your question. As far as cancellation of shares are concerned, we have indicated that there is no advantage or disadvantage for us as a group. And we had no intention of releasing these shares either. So we just kept them as they were. But the buyback decided in May would put the level beyond 10% of outstanding shares, which means that outside directors and shareholders began noticing this and we have more opportunities to exchange opinions and that led to this decision.

We have governance of course, so we cancelled these shares and if necessary we can do more programs. We don't have any specific threshold but we look at the share prices and we do the buyback and cancellation we have established a cycle to be able to do this.

Q - Koki Sato {BIO 19983862 <GO>}

Thank you.

Operator

Next question is from Ms. Tsujino from Mitsubishi UFJ Morgan Stanley Securities. Ms. Tsujino, please go ahead.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

I have one question, I'm on page 9 - slide 9. Without the consolidated net income line, there is a line of consolidated adjustment and others for FY 2018. The negative adjustment became larger by ¥9.5 billion from the beginning of the year, what is it?

A - Yukinori Kuroda {BIO 19776286 <GO>}

This is just as an example, as we talked about earlier, there are intangible assets, such as capital gains and losses that SI recognizes and Japan cancels or eliminates. When we do that, there's always a difference of the amount and also for other companies not written here, not a large amount but for example, a direct line company, nursing care company, we made small adjustments for those companies as well and other than that, the reasons are all technical.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Excuse me about the amortization of intangible assets. From this time, SI recognizes this amortization and the Japan cancels, isn't that the positive impact from that item?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Why is the negative adjustment becoming larger even though that particular item is positive adjustment?

A - Yukinori Kuroda {BIO 19776286 <GO>}

The amount that they recognize and the amount that Japan cancels are different and also, we recalculated amount that Japan needs to recognize on JGAAP. And for the cancellation, the cancellation is not for the whole amount, so there is always a difference. It's extremely technical, so if necessary, I can explain in more details offline to you later on. That's the main reason.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Understood. However for (00:45:59), the negative adjustment became bigger, am I right?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes, there are several few hundreds of million yen items for other (00:46:10).

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Understood.