Sompo Japan Nipponkoa Holdings Inc New Mid-Term Management Plan Presentation

Company Participants

- Kengo Sakurada, President, CEO
- Unidentified Speaker, Unknown

Other Participants

- Futoshi Sasaki, Analyst
- Kazuki Watanabe, Analyst
- Koichi Niwa, Analyst
- Masao Muraki, Analyst
- Natsumu Tsujino, Analyst
- Taichi Noda, Analyst
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Presentation

Kengo Sakurada {BIO 15149542 <GO>}

My name is Sakurada of SOMPO Holdings. I thank all of you for gathering here today for our IR meeting. Last year, in November, in the same meeting, I touched upon my thoughts on SOMPO Holdings' new medium-term management plan. I told you that we are drafting and creating and discussing over that plan and I did talk about my thoughts over that new mid-term plan back then. Today, I can finally talk about its details. This medium-term plan will have a significant meaning in shaping SOMPO Group's future. And therefore, I will focus on the topic of the new medium-term management plan for my presentation today.

I'd like to first talk about the brand. I will touch upon the SOMPO brand. As we have announced on March 25, we have decided to change the name of the company to SOMPO Holdings. This, of course, is on the assumption that revision of parts of the articles of incorporation will be approved at General Shareholders' Meeting to be held in June. Once it is approved, we will change the name to SOMPO Holdings starting from October. And that will be the gist of our branding strategy.

Since we have added two nursing care companies to the Group and we have become a Group boasting sales of JPY3.5 trillion in sales with employee headcount globally of 76,000.

To reflect the status quo, in order to emphasize the SOMPO brand of security, health and well-being, we decided that we should refresh our brand to strengthen the Group image and to the customers and stakeholders, we wanted to have something that is simple, easy to understand, with the sense of unity on Group-wide basis in terms of the company name.

Also, in the overseas markets, once we go globally, people call us SOMPO, not SOMPO Holdings. So we will still continue to use the name SOMPO, which will help us to construct a firm global brand as well.

Please turn to page 4. Let us briefly look back on the previous mid-term plan. In a word, we have cleared the targets that we set ourselves steadily. And so, we have executed as we committed and announced.

For the Group's numerical targets, adjusted consolidated profit reached JPY215.5 billion [ph], overshooting the original targeted range. Adjusted consolidated ROE achieved 7.8%, while the target was over 7%.

Please turn to page five. Let me now have some words for each business. In domestic P&C business, we had improved profitability of the auto business and realized merger synergy, which was a unique factor for us, which led us to a result far better than the original plan. For example, in terms of the adjusted combined ratio that we have been disclosing, we improved up to 91% mark, which is an improvement by 8 points.

In the domestic Life Insurance business, we launched new medical products that captured the needs of customers and successfully improved the corporate value. At the same time, we had started forward-looking initiatives, such as online sales and use of wearable terminals and use of big data to provide production services for the future.

In the Overseas Insurance business, successful acquisition of Canopius was the representative event under the plan. The fact that we gained tremendous knowledge and experience with PMI after the acquisition is a precious asset we had gained, contributing to our future. And there is more time that I spend with the overseas businesses and several times a week I speak to the CEOs from overseas and I talk to people in charge of M&A activities now.

Furthermore, for the future business, we are also in the nursing care business, including SOMPO Care Next and Message into the Group allowed us to have the robust business base in the nursing care business, which is the second biggest in the market. Without being constrained by the framework of insurance business, we have a taking the first step to develop business that will be attractive from the customer's point of view and we are finished with the preparation for that.

Next page, with the expansion of profit, we improved ROE. And together with that we have also fulfilled shareholder return.

Going on to page nine, this is our recognition of the external environment, you can see from Phase 1 to Phase III. What I often use these days and I have also use that word in the last meeting is VUCA. So we are responding to the VUCA world quickly. We don't really know what will happen and how shall we respond when we don't know what will happen is indeed difficult. I have discussions with the other Board members and I am learning a lot about this and after some thoughts, I believe that having a firm conviction in ourselves is important, because of the VUCA world.

So having a firm belief in conviction becomes ever more important. And to have this belief and to respond to the drastic changes quickly is very important. And to do so, needless to say, we have to cast out our antennas high with good sensitivity. So that not only myself. But we need to have the good antennas stretching out from all of the members of the Group, because we don't want to talk about the past in hindsight and say we should have done something. So in order to tap into people's wisdom, we need to have a diverse workforce. So this is not just diversity in terms of female-male. But in terms of nationality, age et cetera, in every sense we need to have a diverse workforce. And also, in this rapidly changing VUCA world, we should not be slow moving.

Therefore, without any hesitation we need to be able to make decisions quickly and to do that, we need highly capable people in different line of business, where changes will be happening first in who have contact with the customers. There will be devolution of authority to those people in different line of business. So that they can make decisions quickly. In order to respond to such environment better, I said that we are fully committed to it and this is going to be a new mid-term plan for the SOMPO groups to transform. So I would say that this mid-term plan is a plan to transform SOMPO Group.

Please turn to page 10. While we go through transformation in the VUCA world, one of the important elements is digital technology, or there is a word digital disruption. This disruption is not necessarily a negative thing, rather, because of the disruptive world, if we are too late in riding the waves of the disruptive world that will be a problem. However, as long as we catch the waves and as long as we're riding the waves in the front line, I believe that will allow us to transform ourselves.

What we are showing here is an example of how this digital disruption is going to happen. I will refer to this in more details later. IMD, a company called IMD in Switzerland, they distributed a questionnaire to global CEOs and I saw the result. It is said that in the next five years, within the best 10 companies, four companies will be falling out of the top 10 ranking. And the reason that they will be thrown out is because of digital technologies. So what are the threats or the enemies who will push them out and where will they come from? 50% will come from outside of that industry and then half of that will come from outside. And the companies who will be most exposed to such threat is distribution.

In this insurance industry, we are part of the financial industry and we are one of the four top industries that will go through that fate. Therefore, SOMPO Holdings' competitors will of course be domestic insurers. But there will Allianz, AXA, AIG. And not necessarily just them. But there will be competitors coming from other industries. So to such a world, how can we be more creative and how can we compete against them and how can we change ourselves? So that is the kind of a discussion I'm having among senior management and it seems like we will be beaten so easily. So I'm quite worried.

Leaving the joke aside, we would like to go on to page 12. I'll just touch upon the important points of the new mid-term plan. So next five years, until 2020, which is the year of the Olympic Games, is the term under the mid-term plan. Because we live in the VUCA era, specific numerical targets will be set for fiscal 2018, which is three years in time and adjusted consolidated profit will expand from JPY164.3 billion in 2015 to at least JPY180 billion. That will be our target. And as for adjusted consolidated ROE, our target is over 8%, if not higher. As profit expands, we expect to enhance shareholder return.

In domestic life insurance business, internally we will use MCEV as an important KPI and we will keep monitoring it. From this fiscal year, the source of shareholder return for adjusted profit, we are changing its definition. And also IFRS, which is expected to be introduced to Japan soon, will also be used in the new definition of adjusted profit. So that the profit becomes closer to the IFRS-based profit.

For what we aim to be come by 2020, as you can see on the right hand side, we are targeting JPY300 billion level of profit and double-digit ROE, which is not really rare on the global scale. But we will be targeting double-digit ROE. And in terms of ranking, we would like to become an insurance group within the global top 10 ranking. We want to prepare ourselves towards that stage, at least by 2020. A specific numerical target for 2020 will be considered to be full fiscal 2018 and will be announced once it is decided. First, we have a tentative target towards 2018 and we would like to work towards those targets. So that we are committed to those 2018 targets.

Please turn to page 13. In order to achieve the management objective, which is easier said than done, changes are frequent and we don't know what to expect. And what are the important factors to achieve this goal? I believe there are three -- nothing special. But still important. First of all, our Group, in preparation for this mid-term plan, has to have clear vision that would support the whole plan. Numbers without vision doesn't mean anything. Secondly, in order to achieve the objective and in preparation and execution of mid-term plan, we need robust governance. And thirdly, in order to differentiate ourselves, we need to be able to take advantage of ICT. Vision, governance, ICT, these are the three key factors that will help us achieve the mid-term plan objectives. In other words, these are the engines and energy.

Now, the new mid-term plan is a growth strategy to embody our management philosophy. So let us take another look at our management philosophy once again. We will strive to contribute to the security, health and wellbeing of our customers and society by providing services of the highest possible quality. This is our meaning of existence as a Group. So it does not say anything about selling insurance and this is our vision.

In order to embody this management philosophy, first of all, we need to make sure that within SOMPO Holdings Group, each business has to work and function as an attraction. In other words, each business has to be attractive. And also, in each of the industries or segments that they belong to, they need to have core competence, some kind of value and uniqueness that we can be proud of and we can clearly present to our customers. For example, life insurance and reform and the extended coverage, nursing care. Each of these businesses, of course, should come together organically, that's ideal. But first of all, each business has to exert strong core competence within that particular industry or segment and that is of utmost importance.

And secondly, these businesses don't just exist together. But they need to continue to evolve autonomously and holdings -- SOMPO Holdings can encourage these businesses to evolve. So corporate culture and DNA throughout the whole Group has to be established. And I believe that this is the most important vision and the philosophy behind our vision.

Please look at page 14. Based on this basic assumption, we want to establish advantage in each business area and promote digital strategy. And we will continue to conduct rigorous investment, including the M&A opportunities. We want to be dynamic, not static. This is an important point. Environment is changing very fast. It is too late to look at what happened 12 months ago, we have to be looking back all the time, which means after SOMPO Holdings has to leave each business owner to its own device. They have to make their own decisions and continue to evolve. They have to have the energy and the culture that will enable them to deserve.

And the ideal state that we're aiming for is that SOMPO Holdings Group as a whole will become a theme park, based on security, health and well-being. And as I mentioned in the outset that will embody our management quality. I will talk about this later, because this is very important. But existence of core competence is important, which means we need to clearly understand what is unique about that particular industry or segment. We are talking about diversification and conglomerate discount. I think that's probably what you are concerned about, our theme park idea leading to those things. But I would like to take this opportunity to say that it will not happen and it's the Holdings' responsibility to make sure that it does not happen.

Please look at the next page and this is the second factor, which is important, which is robust governance. In the area of VUCA, of uncertainty and the changing environment, in order to achieve resilience, this is what we thought. Group businesses should be separated into domestic P&C and Overseas Insurance, mostly P&C. And domestic Life Insurance, as well as nursing and healthcare. So in these four different business areas, we have identified business owners, not executives but business owners. And we have given them strong authority to make their own decisions, which means that each business can speedily make decision close to the customers. This is maximum level of a delegation to each business owner. So at the Nomination and the Remuneration Committee as well, we will try to further delegate that power.

On the other hand, the Group is very big. So we need to be able to look at the whole Group. And also assess the whole Group based on certain standards. So CxOs, Chief Officers will be introduced. Mr. Tsuji, for example, is the Group's CFO looking at the whole Group, across different businesses. And the Chief Risk Officer will be responsible for risks. Chief Information Officer will be responsible for information. And very recently, we have welcomed Chief Digital Officer. And Chief Digital Officer has a completely different role from Chief Information Officer. And again, he will be responsible for digital aspect of the company.

And what I'll do as Group CEO is to overview the Group-wide strategy. Specifically, capital allocation and cash management will be consolidated or aggregated at the holding company level. But in the Nomination and Remuneration Committee, the proposals will be made from the Holdings -- at the Holdings level. In other words, it will be concentrated then. When it comes to new businesses, or new business development and equity for that, as well as M&A will be taken care of by the Holdings company.

So this is how we have structured our new governance.

Please look at page 17. I would like to talk about the digital technology once again. In April, digital strategy -- with a digital strategy research in mind, not just research. But also introduction of new ideas, we have established SOMPO Digital Lab in Silicon Valley in April. We now have locations both in Tokyo and Silicon Valley. And the new CDO will be visiting both Tokyo and Silicon Valley, one after the other. We have already assigned several staff members at Silicon Valley. So under the leadership of CDO, I believe that we have assigned very strong team. And going forward, of course, the CDO will take the leadership. But also on top of that, within the market we need to obtain new information and build new connections.

Big data and computer science, in this area, Professor Thomas Davenport is a global authority. And we have asked him to advise us and also we have sent somebody from Japan, who is an expert on computer science. So our digital strategy will be implemented based on the best possible knowledge and insight.

When I say digital, people tend to think about IT and IT usually is translated into increased efficiency of existing business. Of course, that is the important part of a CIO's strategy. But when it comes to digital strategy, efficiency and the ease of use is not the only thing. We have to go well beyond that and think about the products and services themselves. So digital means product. Digital means service. Digital should become our main business, which means that we will be actively investing into our digital strategy.

Page 18 shows the overview of our management strategy. Each business and the Holdings will continue to execute the management strategy. We feel that the ESG strategy is going to increase in importance, as you can see from this slide. This is not limited to Japanese companies. But if you look at mid-term plan of any company, I think there is clear transformation or transition from B to C, to B to B, especially in manufacturing. But we have B to C, or B to B to C [ph], that's what we do. So B to B to C [ph] has to be supported by digital, vision and governance. And the B to C may become a red ocean, indeed. And it may be challenging for us. But I believe that there is always a path to find blue ocean within the red ocean.

Within the next five years, through digital disruption, four companies out of the top 10 companies will be out of the top 10. So if we continue to be defensive, we will just die in the red ocean. If we are more active and take the offense, I'm sure that we can find blue oceans and in due time I would like to present to you the details in the future.

Page 19, this is more like a textbook, a story about ERM and I don't need to preach it. So I would like to skip the details. We need to make management decisions, based on the ERM perspective. In any scenario, compared to several years ago as a CEO, I really feel that the corporate culture has changed. Measurement, followed by assessment, that's one culture. Measurement. And then discovery. And based on that, taking risks, that is a completely different way of looking at that. We need management to be able to take advantage of the measurement. So during this period things will be changing. So we will measure and of course we have the culture to make management decisions based on these measurements and indices. I think the culture is ready. So the question is what do we do next? We need to convince the Board with more outside members. And also, based on that results, we need to present this to you, investors. And convince you. So we will continue to improve step by step.

As I mentioned before, this new governance structure is extremely important for us. There will be strong empowerment, delegation. And the Chief Officers will be supervising across different businesses. And in the end, if the decision cannot be made at that level, the business owner and CEO, in other words, myself, will discuss this face-to-face and decide how to take the risk and present it to the Board for their decision.

Page 21, this is a path for further ROE improvement. And again, this is again a story from textbook, I will not explain too much details. It's easy to draw this picture. But the question, or the change really is, how can we execute, implement, based on the picture on this slide. Of course, we just have to put our minds and efforts together. Now, insurance companies weighting is and will continue to be high. So capital intensive business is what we're doing. And more recently, we started nursing care business, which is light on capital. But still labor intensive. So business model is different between these different businesses.

In terms of capital weighting, of course, the insurance companies weighting will be higher. So it's not just a simple question of increasing ROE. I have exchanged opinions with the Western insurance companies' CEOs, in terms of weight of capital. 10% ROE is actually quite tough. And that is the recognition by many CEOs these days, especially because the P&C market is tough and also the reinsurance market is quite soft.

Page 22, going into the future. This is a picture showing how we plan to expand the overall profit level of the Group and also the breakdown of the business as a portfolio. Obviously, we plan to grow all of the business in the portfolio. However, as for the weight of each business, domestic P&C is going to reduce its weight in a relative manner. And we would see increase in the weight of overseas, domestic life and nursing care and healthcare business. The overall target figure and percentages are written. So if you do the multiplication, you can see the target figure for each business. So why don't we put those down. Well this is the overall picture of what we plan to achieve.

What I would like to touch upon here is that by 2018, for the nursing care & healthcare business, on profit level, it is only 3%. And so there would only be JPY9 billion if you multiply that with JPY180 billion. However, in 2020, which is the last year of the plan, it is likely to become about JPY15 billion. And the meaning of this business, of course ROE is higher. But having this business in the portfolio itself is that it will have some impact to the -- all of the markets. And so as I said in the theme park story, I said it's important to have the significance of each business within the industry they belong. And at last exercise synergy across other businesses.

So we are right now number two in the nursing care business. And that is because of the companies we added. However, using the position of the number two company in the industry, what kind of leadership can we exercise in that industry. And also, how will that create the customer experience. And how will that lead to high evaluation of the customers. And that leads to our businesses in the P&C and Life business. And so, the evaluation returns to us in a different way. So making profit itself within each business is not so interesting. But because it is a theme park, I believe this nursing care, healthcare business is an indispensable part of the theme park and having the number two position in the industry will probably have an impact to various parts of the society, such as the government. We do need to be speaking to the government about the nursing care and we will be an influential presence in that the market. Then we have to have a good business model. So that we can claim for such an important position in the industry.

Going on to page 24, I have touched upon this already, this is the strategy of each business. You can refer to this page later. If I may just to say one word, in the P&C business, going forward, even after 10 years, this will still going to become our biggest cash generator. And what we expect of the P&C business, therefore, is efficiency and cost reduction. In other words, having a high profitability and cash flow on the global scale. And Mr. Nishizawa, who is the head of this business, has strategies is his field of business and I'm sure he is fully prepared to do so.

For the domestic life business, we will simply not be chasing after the large life insurers. But from 2016, we position this as the second founding year and conceptually, we want to become a health support enterprise, simply from a life insurance company. And that is the thinking within the precedent of the life insurance business. In terms of product channel and services, we will have this tripartite type of business model that will become a new model to grow the business. For nursing care and healthcare business, we don't want to become too relaxed just by having the number two position in the market. But I want to show to the world that this is the nursing care model that we have in Japan and we want to realize the motto of contributing Japan as the affluent country with long and quality life. So under this justification, we would put our best effort into the nursing care and healthcare business and at the same time claim for high ROE, which is expected towards our Group. So hopefully, if we can develop a SOMPO Holdings model in the nursing care, healthcare business, we can bring that to the global market. Already in this business, we are receiving various inquiries from overseas and also in Japan. Various manufacturers, sensor manufacturers and other manufacturers, IT companies and SIRs are coming to us to collaborate.

Another important business is the overseas insurance market. In the existing markets where we are already doing the business theme, we want to achieve organic growth, outperforming the average growth rate of the market in each region. And M&A, which is going to be centrally at the Holdings company as the next opportunity for growth. We would like to actively seek for the opportunity for such business investment. For details, if you have questions, I'd like to answer them later.

And underpinning these four businesses and our differentiating factor is digital and also human resources. Right now, at the HR department of Holdings, there is a global HR policy, which they are trying to create. And there is a job grading that that they are creating and we will be executing. Once that is done, there is the level of the wage or HR by each region. But we would like to have a unified job grading system within SOMPO Group and we would like to have the leaders come out from each market.

On page 25, the focus is on the domestic P&C business. Until 2018, which is the year of our next numerical target, we expected to grow by CAGR of 1%. But beyond that to still continue to achieve growth, we want to achieve a global level of business efficiency and we will be making some advanced investment for the future growth. So the profit growth is rather conservative. But eventually we would like to achieve expense ratio of below 30%.

Now we go to page 28. Within what we call digital strategy, this is related to IT. So this is IT rather than digital. And this is a project to refresh the business system -- IT system infrastructure. So this is what we call future innovation project at SOMPO Holdings. Due to the aging of the system infrastructure, more steps are required than expected to develop products, which leads to worsening efficiency. So in other words, where we are less efficient, we have huge opportunity to improve efficiency in the future and there is much more room for improving efficiency. So by investing in this area, we can reduce the number of steps we have to go through. We can show then the period required for product development and we can achieve no administrative work in sales office. So that will be what will be done in the project and this should significantly improve business efficiency and making us achieve top level of company expense along with global peers. Specific numbers are also indicated on the chart in the slide.

On the next page, this is about the direct business. This is another thing that we will be doing. Thankfully, this direct business is doing well and finally we are turning the business profitable, at least we have a visibility to profit making business and further use of ICT will be done. But we will also be doing our branding strategy to help the direct business. With the business owner system, there is one thing that I need to add and that is that for the domestic business owners, Sompo Japan Nipponkoa's President is one business owner in the Domestic business. But at SJNK, he is not only the President of SJNK. But also the leader of all domestic P&C business. So for the distribution of the capital etcetera and also direct insurer, which is the sales on auto and fire and also Sompo 24 will also be under his scope of work and he will be responsible for allocating capital to all the domestic businesses. So it sounds like he has a multiple role or ambivalent role. But I think that's the good thing to achieve comprehensive optimization. If we simply focus on each business or each entity in Japan, we will be caught up by the outside competitors easily. So we want people to look at us as a fun company, most innovative company, always trying something new. And so in order for people to have such a brand image, we will be starting new things. We have over 3,000 wearable terminals in collaboration with a Silicon Valley company called Fitbit and we are distributing this to the employees first. So that we can gather a big data and see what we can do with such big data. So please have high expectations for where this is going to end up. And at least we want to be growing by 2% per annum.

As you can see on the next page, we are not big. However, we are very agile and we have very little to lose with the Himawari Life. So that in the existing business model in the market and with our customer base and customer awareness, we want to be changing those existing elements with our life entity, Himawari Life. And Mr. Takahashi, who is the business owner of this business also shares the same vision.

If you go to page 32, my explanation perhaps was not so good. But I said that I have changed the definition of the adjusted profit of Domestic Life, or we are giving a new definition to the adjusted profit of Domestic Life and that we'll be applying to the new mid-term plan as a numerical target. So it is not going to be EV-based target. But it's going to become a profit, a source of shareholder return and I believe it is easier for people to understand it that way. And also, we are preparing ourselves for the potential introduction of IFRS in the near future.

Please go to page 33 to talk about the Nursing Care and Healthcare Business. I have already talked about the overall story. So let me just talk about the numbers. Adjusted profit for 2018 is targeted at 70% annual growth. And we need to start with a structure. Our know-how will be used and ICT will be leveraged to improve productivity. And surprisingly, maybe not surprisingly. But in terms of our claims payment know-how from P&C, this can actually be useful for nursing and healthcare, how to respond to customers' complaints and residents' complaints. There is very strong affinity between these two elements and this is something that you would not find, unless you do the operation yourself. And this is the true meaning of synergy. We will take advantage of the synergy. So that we can further reinforce our position.

Moving on to the overseas market, page 35, for 2018, adjusted profit, based on organic growth alone, in other words a conservative estimate, is targeted at 6% growth, or slightly above. And as I mentioned before, we believe that it's possible for us to grow organically above the market average, considering the current structure and the capability of the leaders. But we are also ready to consider M&A opportunities as well.

Page 36, this is the non-organic portion of the growth. As I mentioned before, we want to increase the retail business and continue to grow beyond the market average. In terms of capital injection and also in terms of M&A, we now have a British Executive Officer heading a very unique and agile organization. In addition to that, we are listening to the opinions of advisors who are experts in overseas insurance business. And our appetite is not weakening at all. People think that we are stingy also. So we need to strike the right balance. But from the investor's perspective, I think you want us to be aggressive. But also invest at a reasonable price. And this is something that we can only assess after it's done.

Skipping few slides, going to page 40. In terms of investments, we have not made any major changes to the plan. In other words, our approach so far has been correct. So we will continue to use the same approach. Diversified investment into foreign currency denominated assets will be done and also investment into growth areas, close to business investment will be done and we will try to minimize the impact of the low interest rate environment.

Please look at page 41, reduction of our strategically-held stocks. I'm sure that you have many questions about this. But you can see the overview on the slide. Risk reduction is of course one of the factors. But more than anything else, we want to improve capital efficiency at this stage. We want to release the risk and increase the capital efficiency. And this extra capacity can be used for next investment.

In terms of market value, the plan is approximately JPY100 billion per year. We believe that this is necessary for us to sell JPY500 billion over five years. And we also believe this is possible. And this is not going to be done in a blind manner, in other words, we calculate ROR each name and use that number as a reference and plan sales carefully.

Page 42 shows the internal solvency ratio and it's very straightforward. Target range for internal solvency ratio is 120% to 170%. If it's below 120%, we need to, of course, strengthen the capital base. And if it's above 170%. And at that time if we cannot find effective way of investing, maybe we will invest into ourselves.

Last. But not least, please look at page 43. This is about the shareholder return. The basic policy has not really changed. We want to increase the shareholder return as the Group's profit continues to expand. What makes our policy quite unique is that we have introduced adjusted profit, which is close to IFRS for domestic life insurance. So adjusted consolidated profit and shareholder return fund are now clearly linked.

Total payout ratio over the mid-term will be targeted at 50%. For each year, we will look at the status of capital and M&A execution. And depending on the situation we may increase or decrease this number in an agile manner. But even if we wanted to reduce this, we will try to make sure that it will not go less than 30%.

That's all from me. Thank you very much for your kind attention.

Questions And Answers

Operator

(Operator Instructions).

Q - Kazuki Watanabe {BIO 15948747 <GO>}

My name is Watanabe from Daiwa. I have two questions, one is about the shareholder return. The total payout ratio over the medium term, you said that it is 50% [ph] over the medium term, your lower range will be 30%. So on the lower threshold of 30% is used, buyback and dividend together, the total shareholder return amount I believe is going to be reduced. However, in this slide you are showing the arrow going up. So what is the nuance of this 30% versus 50%? Is it closer to 30% or is it more like 50%, where a bounce, will that be this year? And also, if you do a large scale M&A, the profit contribution coming from the company that you have acquired, would you be adding back the amortization of the goodwill that you will have to do? And as for the timing of M&A, you said that you will like to do M&A with a rational pricing. However, considering the stock level -- stock price level, are we in an environment where you can buy companies with such rational pricing?

A - Unidentified Speaker

Thank you for your question. I'd like to answer your first part of the question. So about the shareholder return, first is stable dividend payment; that is the basic rule that we like to abide by. And taking the adjusted profit, the total dividend payment will be about JPY32 billion, based on JPY80 per share. And how we use this JPY32 billion, we can increase dividend or we can do share buyback. So we have to make the choice between the two. Once we close our books and know the figures for the financial year, we have a discussion in the Board level and depending on the economic environment and looking at our share price, if we believe that we are undervalued, then we would like to use that fund completely for share buyback purpose. However, looking at the share price, if the share price is trending high, then we can use that funding to increase the dividend. And this payout ratio of 30% to 50%, basically it is okay for you to understand this to be 50%. As we have discussed, if we do a large scale M&A or if there is a large natural catastrophe that has occurred, which is impairing our financial condition. So in such cases we may not be able to return 50%. But even so we would at least like to keep 30% of the total payout. So that is our philosophy. I hope that answers your first question. Thank you.

So if we do M&A, the amortization amount per year, of course, is there to some amount. And I believe what you're asking is for dividend or whatever, a source of shareholder return, is amortization going to be included or excluded? It's going to be based on the adjusted consolidated profit. So it will not be excluded from the source of shareholder return payment.

And your final question is rather very difficult, how do we view the current environment? We have look at FX, we have to look at interest rate, we have to look at the local currency basis, corporate value, future prospects. All of the factors included, I would say that the current environment, compared to one or [ph] two years ago, I think the markets are settling down. However, what I mean by settling down is that in the insurance market's future, compared to one year ago, there are more people who are rather pessimistic about the insurance market and not pessimistic forever. But maybe for the next five years, maybe for the next two to three years, they think it's going to be a pessimistic market. And based on that, the M&A market and the market cap tends to be coming down, based on that view. But will that trigger us to do something, I cannot really say. In general terms, such company may not necessarily be a good company. That's all I can say in today's meeting.

Operator

Tsujino, JPMorgan.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Net profit for the term for 2018, page 45. Number for Japan will be flat. But you talked about the future innovation project, IT investment. How much is the investment estimated at and also what kind of systems will be operational at which time and where and how much depreciation do we expect? That's my question.

During the teleconference at the other day, we talked about the impact starting from this year, JPY17 billion on a consolidated basis, there is an increase. And the burden will be maybe twice of that in the next two or three years. I think that you touched upon it very, very quickly. But can you please elaborate on this point? That's my first question.

My second question is about life insurance, page 44. I think there were some other slides as well. For 2018 plan, JPY32 billion. And on the adjusted basis, based on US GAAP and current IFRS, this is the number. And it goes down once, because of the increase of the system expenses, I guess. But after that there is a recovery in this number. And is this based on the increase in new policy sales? For 2016, I think you accounted for JPY5 billion of a system investment, consolidated and standalone just for life insurance. And this is before the tax number. So the way the number declines is quite steep. So can you please talk about the specific factors behind the number going down. And then up?

A - Unidentified Speaker

Regarding the first question, the future innovation project was explained earlier. In addition to that we have already started some other upfront investments, flood in Thailand and M&A costs, we have already moved away from that. So we want to make more upfront investments. As we explained during the teleconference the other day, between 2016 and 2018, we are estimating about JPY10 billion. And then another JPY20 billion in 2019 and 2020.

In the case of P&C, the impact is of course growth. But also decrease in the expense ratio. And the impact will continue to expand starting from 2017. This future innovation project is quite big. And within the five year plan, release of the system will be concentrated towards the latter half of this period. So the impact will gradually start and the major impact will be seen in 2019 and 2020, or even beyond that. So for the 2018 target, investment is JPY10 billion and the impact is maybe JPY12 billion or JPY13 billion. In other words, it's more or less flat at the time being.

In terms of life insurance, for 2016, as was explained earlier already, we have this trinity or tripartite growth strategy, which will be implemented. And after September time frame, we will be talking about specific products and services. We will be releasing some information. So that requires system cost and promotion cost, which is about JPY5 billion. That is why in 2016 profit level seems to be lower. But up until 2018, the inforce is building up nicely according to plan. And also we have new strategy that will be implemented. So we expect the policy continue to go up. On a J-GAAP basis, by 2020, we believe that we can double the number. And as was mentioned before, number of policyholders will be double by 2025. That is our current plan.

So Tsujino san [ph] is correct in giving his explanation. That's how we want to grow.

Q - Taichi Noda {BIO 16478436 <GO>}

From Goldman Sachs, my name is Noda. I have two questions. First is on page 12, towards 2018, JPY180 billion to JPY220 billion. So what is the meaning of this range that you're giving to the adjusted consolidated profit? Is it the optimistic scenario, JPY220 million? Was M&A included JPY220 million or is it the buffer that you have for NatCat. So it's JPY220 million without NatCat. But with NatCat it's going to be on the lower range, what is it?

And the second question is about 42, the internal solvency ratio and the reduction of the strategic holding stocks. You said that you will be quite active with M&A. And how much of capital buffer do you have. And if you reduce the equities by JPY500 billion, how much of capital would you be releasing and how much more buffer would you be adding to M&A due to this? So what is the volume of the M&A that you are willing to do, based on your capital availability?

A - Unidentified Speaker

On the first question, the range that we are giving for the profit target -- by the way, in the previous mid-term plan, we always had a target range giving and this JPY180 billion, this is for the organic growth of each business that will achieve the lower range, which is JPY180 billion, because our loss ratio is always being very conservative in our plan. So with the conservative loss ratio, this is the must meet target. However, we will also be doing M&A and also as Mr. Sakurada mentioned, in order to pursue this theme park strategy, there will be various chemical reactions and new businesses and new events to occur, which are unforeseeable at this point in time. And so, the upside is incorporated in terms of the range and ultimately we want to achieve JPY300 billion and as the mid-landing point, we are giving a range that you see here.

And the M&A and the volume of M&A in the capital, giving -- at least compared to the peers, we have not really done any large M&As, unlike others. So we still have some cushion with our capital. And on top of that that we will be reducing the equities by about JPY500 billion. So that should allow us to do several tens of billion yens [ph] of M&A. And when we require bigger funding, because of the low interest rate, we might think about working on the leverage. And so using hybrid capital et cetera as source of funding. So I cannot really give you a number. But within this industry, we will be able to do M&A equivalent to the size of the M&A done by the peers.

Q - Taichi Noda {BIO 16478436 <GO>}

One additional question. For NatCat, for the five years, out of the five, in four years, your NatCat loss was bigger than the NatCat budget. But will that become a differentiating factor due to this target?

A - Unidentified Speaker

This is a very popular question. Our risk management department is doing various analysis and there is increase in the NatCat occurrence in general. In the past three, four, or five years, it has been quite volatile. But generally increasing trend in NatCat. And for the past 10 years, I believe it was JPY47.6 billion, which is the average NatCat loss. And compared to the past 10 years, because of the utilization of reinsurance schemes, our NatCat budget this year is JPY43 billion and I believe that is an appropriate NatCat budget. It's not going -- some years might have like JPY80 billion, like last year. Other years, it's only JPY10 billion or JPY20 billion and it's really difficult to read off. But I don't think we have a constrained target based on the NatCat assumption.

Q - Wataru Otsuka {BIO 16340098 <GO>}

I'm Otsuka, Nomura Securities. I have two questions. First of all, for domestic P&C, especially for Sompo Japan Nipponkoa, the adjusted profit and also net profit, page 45, that's the question. And the second question is expense, especially for agency, Page 45, Sompo Japan Nipponkoa, combined ratio is just under -- well the plan says that it will go down by about 3%. But the adjusted profit and net income do not improve based on this reduction. So do you have any special allowances to be included? So adjusted profit, actual 2015 and growth in 2018 is not in parallel with the net income. That's my first question.

My second question has to do with the expense, especially agency fee. For the new mid-term plan, I know that you're talking about aggressive transformation. The domestic agency business, what is your plan for that in the future? I don't think reducing agency fees is necessarily a good thing. But how do you plan for this in the next three, five years, or beyond that? I don't know if you can give us a clear answer to the second question at this point. But I would like to ask anyway. Thank you.

A - Unidentified Speaker

With regard to the first question, from 2016 to 2018, Sompo Japan Nipponkoa, the profit level is impacted by several factors. One is consumption tax. April 2017, we'll see hike in consumption tax. So 0.5% for loss ratio and 0.4% for expense ratio, there is a positive impact. And the second thing is 2016, there was a revision for the fire insurance in October 2015 and there was revision in terms of limiting the term to 10 years, which is going to see a reduction in this number. And also, there was another revision for the rates and there was a last-minute demand as well, just before that. Sometimes the contract expires in July 2015 and then there was a long-term contract signed after that. So topline reduction expected for 2016 [ph], JPY30 billion or so, because of the fire and allied impact. In terms of loss ratio, we expect the loss ratio to stay flat.

So that means there has been some numbers -- adjustment made to the number that is used to devise the loss ratio and expense ratio. So it's not about allowance or reserves. And that is why we see the adjusted profit and net income in this way. And as I mentioned already, there will be upfront investments, which will be another factor.

As far as agency fees are concerned, I would like to give you a comment, first of all. Digital will transform the way we communicate with our customers and agency services are very human. We have to think about what the appropriate fee level is for human services. And as mentioned before, this area is extremely competitive. So I don't think we have accounts did for this, probably not planned yet.

And in terms of direct business, we expected a rapid growth within Japan. But looking at direct business market as a whole, the growth is quite slow. But going forward, digital will change the society and customers' behaviors. And therefore, it's difficult for us to predict how this will develop. Within our Group and also domestic P&C business, if we see an increase in the customers in direct business and see a decline in agency customers, of course, the agency fees will shrink over time. But at the global level, of course, we see this as a challenge and we have to reduce it. But there are many potential approaches, not just one.

Q - Wataru Otsuka {BIO 16340098 <GO>}

If we look far into the future, what would to happen. And I have to say that this is my personal perspective. But there are many factors. First of all, competition within the Japanese P&C market, among different players. And also there is certain dynamics going on between the agencies and the insurance company and also there is a comingled agency. And there is also a relationship between the insurance company and the customers and there is a complete mixture of these relationships. So looking into the future, what is the most influencing factor?

A - Unidentified Speaker

Well I would say it's a customer, anywhere in the world.

Q - Wataru Otsuka {BIO 16340098 <GO>}

And what is the definition of customer in this case?

A - Unidentified Speaker

For any insurance company, the biggest volume zone is people in their 30s and through their 50s. If we segment this even further, people in their 40s and 50s, definitely 50s, would prefer human intervention. But younger generation, they think it's okay to go through human. But if it's more convenient it's okay to use the machine. And if both the mother and father are working during the day and they can sign the contract at 1 AM in the morning, maybe direct sales is easier, for better convenience.

So depending on the age of the customer and also the shift in the volumes in terms of age group, the required function of the agency will continue to change over time. And I'm sure as a trend, digital will continue to grow. And agency fee, the fees paid to agencies, maybe there is a digital agency and we pay cost for that. In other words, digital investment will replace some of the agency fees, potentially.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Now, looking at our current business plan, what have we included or taken into account?

A - Unidentified Speaker

In the next three years, for the short term, we do not expect the agency fees to go down so much. But digital investment will definitely increase. So the business expense for each business will continue to increase, which means that we have to be more aggressive with the non-agency area in order to prepare ourselves for the next set of battles. So as far as the general direction is concerned, we focus on digital and convenience and agency run by humans. Providing more convenience will continue to exist. But if they cannot provide more convenience than digital, then they may disappear. So the total amount for agency fee may decline over time. If the question is, is it already reflected in the business plan, no. But we don't want to be passive. Thank you.

Q - Masao Muraki {BIO 3318668 <GO>}

My name is Muraki from Deutsche Securities. I have two questions; one has to do with the topline. You are serving your topline with a conservative plan. Looking at your auto situation, the non-fleet number of automobiles has improved and I believe there was an improvement coming from the rate deduction. But I don't think it has recovered back to the level that you're satisfied with. And during the course of the new mid-term plan for the domestic P&C business, topline expansion and expansion of the market share with improved topline is not really part of your plan. That's my first question.

And the second question has to do with the future innovation project. So reduction of the expense, looking at the systems of global peers and also administrative systems, I believe you said that you will be studying those. And as you have done those studies of the global peers, what are the activities that you're paying attention to? What do you want to emulate and you know that to kick off this project in Japan how much of those learnings have you been able to factor into your project plan?

A - Unidentified Speaker

So first to answer your first question about your topline growth expectations, as you said, in the past two years, we are lowering our market share in the mid-term plan. Of course, we will not be creating a mid-term plan, assuming this year averaging market share. We do want to win in this market. In terms of the number of automobiles in Japan, I thought it was going to decline due to decline in population. However, the number of automobiles has not declined across all companies so far. And as an assumption, our market share in the industry growth to be zero %. And if there is an upside, there can be plus 1% or 2% expansion in terms of market share and that is our target for the next new mid-term plan.

Q - Masao Muraki {BIO 3318668 <GO>}

How do we plan to expand the market share?

A - Unidentified Speaker

There are several things we can do. As a general trend, we are expecting that two years ago we merged two companies and new systems, new administrative work et cetera. We had a lot of burden coming from the merger. But now we are past that period, we got rid of those merger burden. So now we can make future investment and now we have these systems and the structure ready as one integrated entity, using digital technology to provide new services and to create new products et cetera, all of those plans in place. And I believe we are fully fit to compete against our peers in the market.

And regarding the future innovation project, in Korea, for example, they are developing products very quickly. So we went to see that. I guess we talked about that in one of those meetings and we did go and see different companies and also we have spoken to companies who were responsible for creating those systems and we also used the same companies that advise us to receive comments. Right now with their IT systems, the programing volume or lines of programing required is about 200 million steps. So it's very difficult to fix and it's a heavy cumbersome system. But we will now turn that into an open system. And at last we will like to have just about 85 million steps required in programing, which will become a very light and free and a system compatible with the new digital technology.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

I'm Sasaki from Merrill Lynch. I have two questions. First, about the sales of strategically held stocks. You talked about separating our business units and the holding will promote the sales of strategically held stocks, different roles to be played. But I think most of the stocks are related to domestic P&C business. So maybe this responsibility should lie with domestic P&C business unit. Why did you separate it from there, what is the thinking behind this? That's my first question.

And my second question is, I know that digital is an important key word for you. But if we speak to other companies outside of the financial institution, well, will you be tying up with those companies and there will be revision of law at the bank, for example. But is this same kind of approach you're going to apply to your company as well?

A - Unidentified Speaker

Well first of all, regarding strategically held stocks, maybe I didn't explain enough. But negotiation of this reduction has to be done by Sompo Japan Nipponkoa. And risk level has to be reduced for each companies level, the individual company level and we have to release the capital and invest for growth. So the whole strategy actually has to involve other businesses as well. So decision has been made at the holding level. But execution will be down by the domestic P&C entity.

Regarding the strategically held stocks, the capital strategy for the whole Group has to be considered. So in 2010, the two companies merged and JPY740 billion worth of such stocks have been sold over the last six years. And we have JPY1.4 trillion balance at the end of March this year. Sompo Japan Nipponkoa net asset is about JPY2 trillion. So finally, it's about 70% of that we managed to suppress it, shrink it to this level. For the next mid-term plan, the adjusted net asset, 50% of adjusted net asset should be the level of the strategically held stocks and this is the basic policy decided by the Holdings. And when it comes to the specific name picking or how to sell which name, for example, JPY100 billion to be sold in 2016, the specific plan will be formulated by Sompo Japan Nipponkoa.

Now, in terms of M&A, when we conduct large-scale M&A, of course, we need to take a look at our capital status and think about ERM and the solvency ratio. Of course, we do simulation to make the decision. We need to make sure that we can maintain our ratings as well. So after studying these strategically held stocks, we reduced the risk. Then what would our capital look like? Do we need actual capital, in which case maybe we have to think about funding.

So the overall strategy by Holdings and Sompo Japan Nipponkoa play different roles, separate roles, as we proceed with this plan. Thank you.

Now, regarding your question about digital, maybe I misunderstood. But you are asking whether we would be actively collaborating with non-financial companies, is that your question? Was there anything else?

Q - Futoshi Sasaki {BIO 17564798 <GO>}

Well simply speaking, data has accumulated in automotive build vehicles and the government and automotive manufacturers have service. They continue to accumulate data as well. So can you have access to that data, that's going to be very important? So collaboration with the companies outside of financial services, especially automotive manufacturers may be very important, that's the thinking behind my question.

A - Unidentified Speaker

Okay, I will try to answer your question backwards, starting from the end. I don't know whether it's one automotive OEM or the whole industry, it's not very clear. In other words, the government wants to increase the competitiveness of the whole of Japan. So they want to strengthen the whole industry and not just automotive manufacturers. But also related companies, such as insurance companies and the IT industry companies. And I forgot the name. But there is an entity that we'll discuss at the METI level. So automotive vehicles will be used as terminals to collect data, how do we analyze the data that's been collected. Our customers may be the drivers or maybe the taxi companies and how can we contribute to them, based on this analysis. That's a challenge. Technical challenges and also legal challenges.

As far as technical challenges are concerned, I think we have made great progress. And going forward, we'll have to discuss the social acceptance. How far can we go in terms of collecting and disclosing and taking advantage of the data and that is a discussion that's yet to take place globally. Having access to the data of course will put us an advantage. But I don't think it's just a single company. In other words, we have Smiling Road and we signed a contract with our customers and we collect data, we compare the data with the customers vehicles. So that we can provide guidance in terms of safe driving and also maybe connect this data to pricing, as well. That is a possibility. But I don't think we can do this with collaboration with one single company. But we do realize that we cannot lag behind, we have to be one step ahead.

In terms of digital consideration, collaboration with the non-financial companies, automotive manufacturer is one typical example. But for example, in Silicon Valley, we now have a new location. And as you could read in the news release, in May already we have started using Drag and Place [ph] platform. And Geodesic is a venture capital that we have already invested into. And the objective of these activities are following. When we're just looking at a big major industry, we are expecting to show disruption and evolution, we have to identify technologies that can lead to these evolutions. So that is why we use Fitbit. I mean PayPal also came from this as well. And Uber as well. So we want to identify these newer technologies quickly and the venture capital investing to these new technologies. And in the nursing care and healthcare business, if we can identify very innovative technology, we may consider buying that company or technology, instead of going through venture capital.

So we may be able to do certain things and look for that technology. No. That's not the approach. We actually are looking at the latest technologies and see whether or not they applied to what we want to do. That's how we need to approach the digital industry. Otherwise, our thinking will be too small. So we have to forget that we are insurance companies when we talk about digital. I hope that this answers your question.

Q - Koichi Niwa {BIO 5032649 <GO>}

From SMBC Nikko, my name is Niwa. As for capital allocation and your long-term view, in terms of capital allocation you allocate how many % to each business and also over the final year of the medium-term, what will be the allocation of capital for each business? In September 2011, there was a disclosure over the capital allocation and I wanted to know the update of that and also have some insight into how that will trend. So if you have any numbers in terms of the capital allocation, please let us know.

The second question, with a long-term view. And this is rather abstract. But in 2020, you would like to become one of the global top 10 and when that happens, domestic insurance companies, do you think all of them will be within the top 10 globally? So how would you view the peers in Japan? And also a theme park type of business that you are trying to pursue, what is the reason that you can do it. But others cannot? I know that you would like to do that. But is that something the peers cannot do?

A - Unidentified Speaker

To answer your first question specifically, we do not disclose any numbers today. But just broadly, last year for capital allocation P&C was about -- so if total is 10 [ph], P&C 5 [ph], life 2 [ph], overseas 1 [ph]. Then others for future investment to Holdings was allocated about 2 [ph]. So that was the ratio of the capital allocation across businesses. So this too is going to be allocated for overseas and new businesses.

And to your second question, this is a very difficult question. It's difficult, because there is no scientific evidence to answer that. There is no scientific evidence. But if you do the calculation, the global players, let's say, there is about 23 companies. So how much bottom line are they creating, that can be discovered very easily. But when FX moves, it changes in yen terms. My point is that by 2020, we would like to become one of the top 10 or realistically aim top 10, what I was trying to say was that in terms of scale, we want to be comparable to the global players and not only scale of business. But we want to become a unique insurance group. So not only being big. But providing the theme of security, health and well-being and a company that is realizing this theme park strategy. I might have mentioned this last time, there is Allianz, there is Axa, there's Generale. Compared to Allianz and Axa, Generale may not be as big. However, Generale is doing a roadside business in Brazil, in China, they're doing roadside business. So they are services oriented, perhaps not do any insurance or add insurance after starting services. So Axa, Allianz -- Axa has better profitability. But Allianz is bigger. And from the digital point of view, I believe Axa is more advanced. So in order to be next to the global players, we cannot be within the top 20, we have to be within the top 10 and compared to the names I mentioned, there's Axa, Allianz and then there is SOMPO Holdings. And we want people to be able to compare us and contrast us and be able to talk about the uniqueness of each. So I believe we are right now about 16th or something. Then you just have to go six more notches and you might think it's easy. But it's not, because of FX, et cetera. But that's what I'm trying to achieve. So business model and also scale, in both senses, we want to become one of the top 10.

And what about the other companies? Tokio Marine, they are the 8th and we are the 11th. So who wins, who loses, that's not really the point of discussion. Every company will be pushing their effort to improve themselves. And my emphasis in this presentation, there are three pillars to this business. We have a vision. And how is the vision different from the others. The second is, what is the governance structure and what is the quality of the execution. The third is a differentiating factor, digital. So how much are we committed to the digital strategy and why is this so important. So those are the three major pillars. Whether others can do that or not do that, I don't know. But at least, there are no other companies who are very clearly stating the same three pillars that we have explained today.

Operator

Thank you very much. We already passed the time that we have committed to finish this meeting. So if there is anyone who must ask a question now, I would give a chance, otherwise we would conclude.

Q - Unidentified Participant

Question about page 43, about your active shareholder return policy. In 2018, the plan is JPY220 billion. And 50% of that means that you need cash over JPY110 billion. Adjusted profit from life insurance is the funding. But that is basically a very small amount of cash, because the premiums is discounted by the expected rate. And what about the P&C, you have a net premium return of JPY2 trillion or so. But after taxes, you only have maybe JPY100 billion cash or less. So in 2018, you have adjusted profit of JPY220 billion and cash out of 50% of that may be too difficult for you. I know that you are trying to sell the strategically held stocks. Is that going to be used as a cash-out. Well this is an investment, you have to use it for M&A, it is probably better that way. So JPY110 billion cash has to be somehow provided, based on the JPY220 billion in profit, how are you going to achieve this?

A - Unidentified Speaker

The profit that can be distributed, I think we have enough of that in terms of internal reserve. For example, in 2010 and 2011, we were at deficit. But still we were continuing to pay the dividends as normal. And in addition to that, in 2014, Sompo Japan and Nipponkoa Sompo merged and at that time we changed the capital. And now we have more money that can be allocated for dividends. So we have sufficient internal reserves to execute the shareholder return.

Operator

Thank you. And that concludes the meeting. Thank you very much for joining us, despite your very busy schedule.