Y 2018 Earnings Call

Company Participants

- Yukinori Kuroda, Unknown

Other Participants

- Futoshi Sasaki, Research Analyst
- Kazuki Watanabe, Research Analyst
- Koichi Niwa, Director and Analyst
- Masao Muraki, Director and Senior Analyst
- Tatsuo Majima, Senior Analyst
- Wataru Otsuka, Insurance Industry Analyst

Presentation

Yukinori Kuroda {BIO 19776286 <GO>}

My name is Kuroda from Sompo Holdings. Thank you very much for attending our teleconference despite your busy schedules.

I will be focusing on the numerical side of the fiscal 2017 results and fiscal '18 business forecast. For management strategy, next week, we have scheduled an Analyst Meeting. At that meeting, the management, led by the CEO, will brief you.

Please turn to Page 2. These are the highlights. Fiscal 2017 was a once in 20-year hurricane year in North America and there were other natural disasters in and outside of Japan and there was an increase in large losses at Sompo Japan Nipponkoa. And because of it, there was a significant decrease in ordinary profit. However, net income was JPY 139.8 billion.

As we informed you after first half, because of a decrease in tax expenses in connection with the reorganization of SI, the decline in net income was small. For fiscal 2018, natural disasters, including North American hurricanes and large losses, are expected to normalize.

Consolidated ordinary profit will double year-on-year. And consolidated net income will increase by JPY 70.1 billion, reaching JPY 210 billion, which is the highest ever.

Today, we disclosed a shareholder return information. As you see in the release, we decided upon a share buyback of up to JPY 39.1 billion. For fiscal 2017, our total payback ratio -- the total payback ratio will be 50%.

In the summary of consolidated financial results, we show JPY 130 as the annual dividend forecast. This will be an increase in dividend for 5 consecutive years with an annual increase in dividend of JPY 20.

Please turn to Page 4. These are the consolidated results for 2017.

For the main factors have changed, please turn to Page five and onwards. Page 5. This is the underwriting profit for Sompo Japan Nipponkoa. In addition to the North American hurricane, there was more large losses than average years. And these totaled JPY 21.4 billion. And because of that, year-on-year, there was the decline of JPY 17.6 billion, going down to JPY 94.8 billion.

If you look at the large losses, in fiscal 2016, it was about JPY 10 billion, about average. However, in 2017, the total, led by fire and allied insurance and other lines, expanded to JPY 25 billion.

Now please turn to Page six for investment profits. As is already incorporated in our business forecast, impairment losses of JPY 24.8 billion on group company stocks and losses on sales of securities of Canopius of JPY 10.9 billion were the major factors behind decline. However, as you know, they will be mostly eliminated on a consolidated basis. Excluding these factors, due to more-than-planned reduction in strategic holding stocks and other factors, on a year-on-year basis, the profit is about the same level as the previous year.

Now please turn to Page seven for the consolidated ordinary profit. In addition to the impact on underwriting profit and investment profit, the North American hurricanes had an impact on consolidated ordinary profit. Year-on-year, it declined by JPY 99.8 billion, down to JPY 141.8 billion.

Please turn to 8, Page 8, for net income. As a special factors, at a consolidated net income basis, Sompo Japan Nipponkoa recognizes a decrease in tax expenses in connection with reorganization of SI, which has a positive impact of JPY 72.4 billion. On the other hand, as we explained after the first half, losses on sales of fixed assets was JPY 20.1 billion. And overall year-on-year, the reduction in profit is only JPY 26.5 billion, JPY 139.8 billion.

On Page 9, we -- just for your reference, we have details of the special factors in 2017, including the North American hurricanes.

Please turn to Page 10, business forecast. Consolidated profit will double to JPY 290 billion, an increase of JPY 148.1 billion. Consolidated net income will increase by JPY 70.1 billion to reach JPY 210 billion, which is the highest ever.

Page 11, the main points. In the previous year, there was a decrease in tax expenses in connection with the reorganization of SI, loss on sales of fixed assets and North American hurricanes. These special factors will go away. And we expect a more normalized state of business. Factors behind increasing profits for domestic P&C and overseas business, we will be back to normal in terms of North American hurricanes and large losses. And each of the businesses will realize organic growth.

On Page 12, we have breakdown of ordinary profits. So if you can refer to that.

Now I will go to Page 13. Just for your reference, we have the business progress over the past five years. In our case, policy acquisitions tend to be concentrated in April. And most of the typhoons have been in summer. So the general trend is that in the first half, our progress will be sluggish.

One factor holding back progress was strategic holdings in stock but negotiations for sales of strategic holding stocks is going smoothly. And for this year, we're trying to achieve earlier-than-planned sales of strategic holding stocks.

On Page 14, we have the adjusted profit-based numerical management targets.

Please turn to Page 16. Here, we look at the results of Sompo Japan Nipponkoa.

And please turn to Page 17. Net premium written, overall, we saw an increase. For fire and allied lines, because of the impact of reinsurance contracts, on a net premium written basis, there was a reduction. However, with the good business in other lines and an increase in the number of vehicles for voluntary automotive insurance, we have seen good results.

This page shows the loss ratio on a written/paid basis. Loss ratio increased on the back of impact from more large losses than regular years in fire and allied lines and other lines, as I have mentioned.

In this fiscal year in FY 2018, we are planning an improvement of 0.5 points overall due to less impact from natural disasters, even after assuming a rise in API unit cost in the voluntary automobile line.

Please turn to Page 19. This page shows the loss ratio on earned/incurred basis. Just like written/paid basis, loss ratio on earned/incurred basis also increased overall in the year just ended. However, we are assuming an improvement of 1.5 points in FY 2018 due to less impact from natural disasters and a stripping out impact of large losses.

Please turn to Page 20. This is our net expense ratio. Net expense ratio increased slightly because of higher top line in the product lines where agency commission is relatively higher. However, we have been able to continue to control company expense ratio, both for personnel and non-personnel expenses. Therefore, we are assuming an improvement in FY 2018.

We are showing combined ratio on the next page, Page 21.

Please turn to Page 22. This page is on investment profit. Investment profit in FY 2017 is, as I have just explained. With regards to the reduction of strategic holding stocks, we sold JPY 109.6 billion, more than our plan of around JPY 100 billion. In FY 2018, we are projecting investment profit of JPY 142.1 billion, higher by JPY 44.3 billion year-on-year on nonconsolidated basis with expected dividend from SI and not repeating onetime factors, such as losses from sale of securities and impairment losses on securities, which were recognized in the previous year, although eliminated on the consolidated basis.

For FY 2017, interest and the dividend income gains on sale of securities and impairment losses on securities in more details, please refer to the next page.

Please turn to Page 24. This shows business forecast in FY 2018 for Sompo Japan Nipponkoa.

We show assumptions behind these numbers on the next page, Page 25. And the related indicators of automobile insurance business, as we always show, on Page 26. Please refer to them as needed.

Please go to Page 27. Let me make one supplemental comment on the situation of domestic natural disasters. Up until last fiscal year, we budgeted JPY 43 billion for domestic Cat loss at the beginning of the year. However, on the back of current situation of typhoons and the snow damage, we are assuming JPY 48 billion conservatively this year.

Next page is on fund and reserve for your information. Please turn to Page 30. Let me explain the results of Himawari drive. We have made a good progress in accordance with the plan. Premium and other income continued to increase in FY 2017, offsetting an increase in provision for policy reserve due to the revision of standard yield curve as we kept the price unchanged for the main medical line. As a result, ordinary profit and the next income were mostly unchanged year-on-year, yet higher than what we had assumed at the beginning of the year.

For FY 2018, we are expecting ordinary profit to increase by JPY 5.2 billion and net income to increase by JPY 3.8 billion to JPY 12 billion. Main driver is the steady increase in premium and other income.

On the next page, we are showing changing factors of net income between 2017 and 2018 and additional information on calculation of adjusted profit with U.S. GAAP-like adjustments on Page 32.

With regards to MCEV, which is separately disclosed in details, we are showing the summary on Page 33. So please refer to it later on.

Please turn to Page 35. Let me next explain the results for nursing care & healthcare business. As we have mentioned before, we turned the business into profit in FY 2017, mainly driven by improvement in occupancy rate, which is a main KPI as planned.

For FY 2018, we are planning on further improvement of occupancy rate as we continue to implement initiatives we have been doing and reduce costs through the merger of Sompo Care, which is scheduled in July. Thereby, we are projecting profits to increase further. For the occupancy rate trend, please refer to Page 36 for your information.

Please turn to Page 38. Let me explain the results for overseas insurance business. In FY 2017, top line increased a lot as we have started to consolidate SI newly. In FY 2018, we are projecting net premiums written to decline by JPY 53.5 billion to JPY 590 billion level due to stripping out of JPY 129.7 billion contribution last year from Sompo Canopius, which was sold, even though top line of primary insurance business of SI and others are expected to increase. Adjusted profit, as the bottom line, was up by JPY 24 billion in the year just ended with a decrease in tax expenses in relation to reorganization of SI, et cetera, offsetting the impact of hurricanes in North America. We expect these factors not to recur this year. However, we are projecting adjusted profit of JPY 63 billion, up JPY 18.9 billion, driven by steady profit growth centering on specialty insurance line in the United States.

Please take a look at Page 39 for breakdown by region and Page 40 for business results by company data.

Please go to Page 41. We are making supplemental explanation on Sompo International on Page 41 and Page 42. Let me take you through main points. In the year ended, there were impacts from hurricanes in North America, loss ratio deterioration in property line, large losses in some lines such as energy-related and the marine-related.

In addition, there was a positive impact from lower tax expense. In this fiscal year, we are assuming to make steady organic growth centered on U.S. primary business benefiting from some market hardening, although we have not reached our expectation slightly at this stage.

We are assuming combined ratio of 89.3%. Let me add that as you can see at the bottom of the next page, impact of U.S. tax reform on our group is limited.

Please turn to Page 44. Next is ESR. Continuously, there is no issue with regards to soundness.

On Page 45, we are showing the breakdown of adjusted capital and risk amount. So please refer to them later on.

Please turn to Page 46. Lastly, let me take you through asset portfolio on the group basis. There is no extraordinary change.

On Page 47 onwards, we are attaching the portfolio of Sompo Japan Nipponkoa, Himawari Life. And we are starting from this time to attach the portfolio of SI.

I would ask you to take a look at them later on but they are safety-centric portfolios. This completes my explanation.

Thank you. So much. Thank you. Now I would like to move to the Q&A session.

Questions And Answers

A - Yukinori Kuroda {BIO 19776286 <GO>}

Mr. Muraki from Deutsche Securities Inc.

Q - Masao Muraki {BIO 3318668 <GO>}

I have one question on Page 41. You talked about the top line and cost. And I have a question about this page. For the top line, excluding special factors, you expect an increase of about 20%. But taking into consideration the situation between January and March, which part of insurance or reinsurance business do you expect growth? And you have the combined ratio chart at the bottom right of this page. But last year, other than the hurricane factor, you see an increase in loss ratio but my question is why did this happen? And third, about the expense ratio. You expect a decline in expense ratio. I understand that there will be an increase in premium revenue but why are you expecting a decrease in expense ratio?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you very much, Mr. Muraki. Roughly speaking, your question was about the top line, loss ratio and costs. So I will answer each one of them in turn. For SI, as we mentioned, overall, the gross premium written is expected to increase by 34%. And that will be the driver for profit growth. There was a reorganization. And the U.S. company was integrated already. I cannot mention the actual amounts but we have already announced the bolt-on M&A. And these inorganic factors contribute about 13%. So the regular growth is expected to be 21%. That's the plan. I explained this after the first half. But for SI, generally speaking, we expect organic growth of about 10% to 15%, for example, through expanding the number of underwriters. Now the remainder to reach 21% would be 7% to 8%. For this year, we incorporate the hardening of the market or price increase. We only have quick reports so I will not go into the detailed numbers. However, the First Quarter is already over. And overall, we are off to a smooth start. With regards to market hardening. This has been roughly 2 to 3percentage points below our expectations. The overall impact is still small. 40% of reinsurance policies are up for renewal in January. The remainder, 60% of policies, are up for renewal in July before the hurricane season. We will look at the situation. And as necessary, by the end of the first half, we will make the necessary adjustments. But at this moment, the business is smooth. Your second question was about the loss rate. The general picture is that for fiscal 2017, the loss rate, ratio was 82.4%. The previous year, the number was 55.9%, which is on Page 42. So that's an increase of 26.5%. Out of which, 20.8%, if you are to break down this number, is due to North American hurricanes and other factors. And 1.5% comes from nonrenewal of unprofitable policies and reduction of premiums. And 1.9% comes from the regular increase in loss ratio. And as a result for fiscal '17, the number is 82.4%. For hurricanes and nonrenewal of unprofitable policies, this year, we will not have this factor. And we will see a normalization of the general loss ratio and we are reviewing some individual policies and the forecast is 60.4% and we believe this number is reasonable based on the current situation. We only have a quick report number. So I won't go into detailed numbers. However, as of end of First Quarter, compared to the numbers we showed you, we are seeing very good results centering on reinsurance. The last part of your question was about the expense ratio. The ratio is expected to go down. Basically, the premiums written will significantly go up. And of course, with it, the expense ratio will go up. However, compared to the increase in expense ratio, we see the increase in premiums written to go up further. So as a result, the ratio will go down. Thank you very much.

Next questions are from Mr. Watanabe from Daiwa Securities Corporation Ltd.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

My name is Watanabe from Daiwa Securities Corporation. I have 2 questions. My first question is related to adjusted profit for 2017, which turned out to be about JPY 30 billion lower versus your plan. So would you please give me the reasons behind this miss? Was it because of the natural disasters and large losses? My next question is on Page 25 related to catastrophe loss reserve for the domestic P&C business. Normally, at the beginning of the fiscal year, you assume the provisioning to the catastrophe loss reserve. But in this fiscal year, you assumed the reversal of catastrophe loss reserve of about JPY 10 billion. What is the reason for that?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Mr. Watanabe, thank you so much for your questions. To your first question related to adjusted profit for 2017. Let me answer that one first. As you mentioned correctly, we were assuming JPY 195 billion. So we fell short of about JPY 30 billion against our plan. Half of the reason, which is JPY 15 billion, was due to the domestic P&C and the remaining, a little bit less than JPY 20 billion, is due to the overseas business. And reasons are exactly as you mentioned. In the domestic P&C business, mainly it was due to large losses. As I mentioned in the presentation, in normal years, it's about JPY 10 billion but in 2017, it was as large as JPY 25 billion. In overseas, it's mostly due to hurricanes. And up until the first half, we have incorporated some conservatism in the loss projection. But we had not assumed an impact from the wildfire in California, which turned out to be a little bit less than JPY 10 billion. There's not so much change associated with SI. But in Canopius, those claims are -- turned out to be a little bit higher than what we had assumed in the first half. Answer to your second question related to the catastrophe loss reserve is as follows. You are right. Normally, we assume the provisioning to the reserve but in this fiscal year, we are assuming the reversal of the catastrophe loss reserve. That's, relatively speaking, because of the loss ratio or claims payment, mainly in the automobile insurance segment, recently, repair unit cost is increasing and we are incorporating some conservatism in the assumption of our repair unit costs. And based upon the loss assumption, which we think is a sure level at this time, we are assuming the reversal of the catastrophe loss reserve, especially in the automobile line, also in the fire and allied product segment, we are assuming some reversal of the catastrophe loss reserve. Those are the differences for this year versus the regular years. And another difference is that this time, we are incorporating some conservatism in the assumption for the top line. We are assuming the lower top line, which has pushed up the catastrophe loss reserve.

Next, Mr. Otsuka from Nomura Securities.

Q - Wataru Otsuka {BIO 16340098 <GO>}

My name Otsuka from Nomura Securities. I have 2 questions. One at a time. I'm looking at Page 12. And it talks about start of dividend income from SI. And with it, income goes up. And if you turn to Page 22, it shows an -- it shows JPY 26.3 billion as dividends from overseas subsidiaries. And I'm assuming that this will be subject to consolidated adjustments. But for that, the numbers on Page 12, consolidated adjustments and others, it seems to be too small. So can you please explain that point?

A - Yukinori Kuroda {BIO 19776286 <GO>}

First, we expect dividends from SI. Basically, the mechanism that you explained is correct, Mr. Otsuka. The amount of dividends from SI that is included in the forecast is JPY 25.4 billion and the remainder is from other subsidiaries. And as we mentioned, this will be subject to consolidated adjustments.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Then for the goodwill, isn't this included in the consolidated adjustments?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes, goodwill is included.

Q - Wataru Otsuka {BIO 16340098 <GO>}

And that -- and consolidated adjustments included? The forecast for 2018 is minus JPY 25.4 billion?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Okay. I understand. The second question is about domestic automobile insurance on Page 26. The forecast for fiscal 2018 is that the loss ratio will worsen. And you talk about a conservative forecast for repair cost per claim but isn't the reduction in cost per claim from January this year incorporated?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes, of course, the price reduction is incorporated.

You see the written-based numbers here. For automobile insurance, premiums written is expected to decline by JPY 9.7 billion. On the other hand, claims paid is expected to increase by JPY 1.8 billion and that pushes up the loss ratio. For the repair cost per claim for (nonflate), 2% and overall, 1.7%. However, there are some lines where we see an increasing cost per claim. And there will be an increase in the total amount. So there will be an offset. However, overall, there will be a decline.

Next questions are from Mr. Niwa from Citigroup Global Markets Japan Inc.

Q - Koichi Niwa {BIO 5032649 <GO>}

My name is Niwa from Citigroup Securities. I have 2 questions. My first question may overlap with the question asked by Mr. Watanabe earlier but let me double-check. Compared to six months ago, it seems like consolidated adjusted profit are -- is down quite a lot versus six months ago. You sounded like it was due purely to natural disasters. But based upon the results of the Third Quarter, when did you see that one coming? When did you catch that information because I want to confirm the accuracy level or confidence level of your forecast. So when did you obtain the information? That's my first question. My second question is on Page 14, relating to the adjusted consolidated profit projection for this fiscal year, which is JPY 220 billion. Let me ask you about how I should interpret this number, JPY 220 billion. About six months ago, when the company reported the first half results, CEO commented that company was making progress ahead of the plan, especially in the overseas business segment. However, it seems like you're projecting the lower end of the range. How should I interpret this JPY 220 billion number? Would you please give me some color.

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you. So much for your questions. To your first question about the adjusted consolidated profit, what has changed since six months ago in the domestic P&C business, impact from large losses is quite large. In some cases, there are some policies where the lead managers, lead underwriters are other companies. Therefore, we got notified or we got to know the situation in -- about the Fourth Quarter. That's the answer to your question, Mr. Niwa. To your second question about the projection of JPY 220 billion. Up until around the first half, we saw a stronger tone, that the tone that we are seeing now but this year is the middle year of the medium-term management plan. Therefore, we have shown the planned figures for this fiscal year. And we asked each business unit to submit the number that is sure to us. Therefore, we are showing minimum, more than JPY 220 billion. That's why we decided to disclose the projection at the minimum that we think we can achieve. So what has dragged down the projection versus six months ago? What has changed? As you mentioned, Mr. Niwa, that's because of the overseas business. Up until the first half, the scale of the hurricanes landed was as large as once in 20-year type size. So we expected more market hardening to progress but it has not really progressed as we expected. And the loss ratio is deteriorating in some areas, especially in overseas, as Mr. Muraki asked at the beginning. So to improve the loss ratio deterioration, we have reviewed and revisited some contracts and policies. So we have changed the starting point. And now, we have more conservative guidance.

Next is from Merrill Lynch Japan Securities, Mr. Sasaki.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

My name is Sasaki from Merrill Lynch. I have just one question. Page 24, Sompo Japan Nipponkoa forecast is given. Underwriting profit is expected to increase by JPY 33.1 billion. If you do a calculation, you see provision for catastrophic loss reserve and then there is the effective natural disasters and large losses. With these going away, these will have a positive impact of JPY 30 billion. On the other hand, there will be a reduction in profit coming from automotive insurance. But overall, what are the factors that you expect will contribute to increase in profit?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Thank you very much. First, the underwriting profit, improvement of JPY 33.1 billion. On a written/paid basis, there will be an impact of expenses. The top line overall will come down and net claims paid overall with normalization of large losses and natural disasters, the net claims paid will come down. And there will be an offset there but we will see a reduction in expenses of tens of billions of yen because of additional cost reduction efforts. For the remaining JPY 20 billion, it's very difficult to do a complete breakdown. However, by forecasting a lower net premiums written in higher loss ratio, there will be a contribution coming from catastrophe loss reserves, as you mentioned.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

So overall, as a trend, except for the impact coming from the reduction in premiums of automotive insurance and reduction in expenses, overall, the trend is the same as previous years?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Yes. That is correct. In addition to that, there will be normalization of natural disasters and larger losses. So overall, there is no change in the trend.

Next questions are from Mr. Majima from Tokay Tokyo Research Center.

Q - Tatsuo Majima {BIO 15338044 <GO>}

Please allow me to ask you a detailed number of related questions. First, on Page 25, you are showing the reserve for price fluctuation. You are assuming the provisioning of JPY 4.2 billion to the reserve. Although every year, you were putting about JPY 10 billion in provisioning to the reserve for price fluctuation but what is the reason for this change? That's my first question. And the second question is related to gains from sale on securities for this fiscal year. Every year, in April, you hedge in the market in Japan to the proportion of planned sales of stocks. For this fiscal year, have you hedged in April as regular years? Or have you not hedged this fiscal year?

A - Yukinori Kuroda {BIO 19776286 <GO>}

Mr. Majima, thank you so much for your questions. To your first question relating to the price fluctuation reserve. As you exactly pointed out correctly, we have changed the reserve ratio, both for Sompo Japan and Himawari Life. In regular years, we were putting the provision of about JPY 10 billion but we have reduced that to about JPY 4 billion. So that pushed up the profit by about JPY 6 billion. That's because after the main crisis, we have been topping up the price fluctuation reserve because we have used the price fluctuation reserve after the main crisis. But the balance of the price fluctuation reserve has increased to a large number, not as large as JPY 100 billion but to a quite large number. And over the past 10 years, we have reduced the strategic holding stocks quite a lot. So we lowered the asset volatility. Because of those reasons, we have decided to change the reserve ratio to the statutory reserve requirement ratio. To your second question relating to gains from the sale of securities. As I mentioned in my presentation, in this fiscal year, we have been negotiating with issuers so that we can sell from the First Quarter. So as we can make certain level of sales this year, there is a possibility that hedge will decrease this year but the reason why we use hedge is as follows. Usually, when we announce our guidance and projection, we use the stock price assumption as of the end of March. If there are opportunities where we can sell at the higher price than our assumed stock price, we'd like to do so to lock in profits. So hedge will not decrease to 0.