Q2 2016 Earnings Call

Company Participants

- Unidentified Speaker, Unknown
- Yasuyoshi Karasawa, President

Other Participants

- Azuma Ohno, Analyst
- Futoshi Sasaki, Analyst
- Kazuki Watanabe, Analyst
- Masao Muraki, Analyst
- Natsumu Tsujino, Analyst
- Taichi Noda, Analyst
- Tatsuo Majima, Tokyo Securities Co., Ltd.
- Wataru Otsuka, Analyst
- Yusuke Yabumoto, Analyst

Presentation

Yasuyoshi Karasawa {BIO 7391405 <GO>}

Hello, everyone. My name is Yasuyoshi Karasawa. And I'm the President and CEO of MS&AD Insurance Group Holdings. Thank you for joining us at our information meeting today, despite your occupied schedules.

At present, financial markets appear to be recovering from the sharp adjustments and corrections in September in reaction to the slowing economic growth in China. The Nikkei stock average is also once again inching closer to the 20,000 mark, in part because of the generally strong interim results of Japanese companies.

It is also true, however, that current conditions do not warrant optimism, given events that could have a serious impact on the future course of the world economy, such as the interest rate hike in the United States, which now looks set for December. And the recent terrorist attacks in Paris.

As for natural catastrophe risks, Japan has been hit by the major catastrophes typhoon number 15 and number 18. These and other events keenly remind me that we are constantly confronted by various risks.

Putting all this together, I firmly believe that ERM, which we are now executing, will become increasingly important in the future.

I will begin by describing the main points of today's presentation. Please turn to page one of the handout.

First, our financial results are as notified in last week's financial results announcement.

As for our medium-term management plan, Next Challenge 2017, we steadily executed measures in line with our basic strategy. More specifically, we took initiatives in line with our strategy, which is to improve the profitability of the domestic non-life insurance business; to reduce risk, which is weighted towards domestic strategic equity holdings; to improve capital soundness and efficiency; and, to shift the capital that's released to insurance business, in which we are knowledgeable, we have expertise. And that is easier to control and, in particular, to international business, which has high growth potential.

In today's presentation I will look back on initiatives taken to date. I will also explain how we intend to continuously improve the profitability of the domestic non-life insurance business, which has regained its earnings power.

I will indicate a medium-term target level for strategic equity holdings and explain that we have now raised our medium-term plan target of JPY300 billion to JPY500 billion.

I also intend to take this opportunity to better your understanding of our policy on international business investment.

Please turn to page 2. We started ERM in earnest in FY14 and this was our second year of putting ERM into practice. As you know, during the previous medium-term management plan period, we steadily took measures to improve the profits of automobile insurance, which we saw as an urgent issue. As a result, profits improved greatly and the automobile insurance is now a profit driver of the domestic non-life insurance business.

Our aim now is to continuously improve these profits. To this end, we are leveraging our scale as Japan's largest non-life insurance company by premiums to take measures to increase the number of insured vehicles and policies. And implement product and channel strategies responding to new risks.

We're also pursuing initiatives to improve the expense ratio, which is an issue.

We also took steps to improve capital soundness and efficiency, accelerating the sale of strategic equity holdings and making business investments in the growing international business, based on the recognition that we must mitigate business risks stemming from over-dependence on domestic business and seek geographical diversification of underwriting risk.

Please turn to page 7. I would now like to explain recent conditions in the domestic non-life insurance industry.

As already notified, net premiums written of domestic non-life insurance business jumped 7.8% year on year, reflecting steady growth driven by automobile insurance, as well as a temporary increase in sales ahead of the revision of fire insurance premiums.

The combined ratio, which is an indicator of underwriting profitability, also fell 1percentage point year on year on an earned incurred basis, making steady progress towards the forecast for the fiscal yearend of 94.8%.

I believe that our reorganization by function initiatives are also steadily producing results and contributing to earnings.

To increase growth and profitability further we will need to strengthen net premiums written. More specifically, we are leveraging the respective strengths of MSI and ADI to develop new customer groups and diversify lines of insurance of existing customers by implementing product and channel strategies to increase the number of insured vehicles and number of policies and by marketing products that swiftly grasp needs with regard to growing industries and new risks. And new risk areas.

For example, in October MSI and ADI started selling a jointly developed automobile insurance product that will encourage the younger generation, which is said to be turning away from driving to purchase cars. This product has been favorably received not only by young people buying cars. But also by the agents involved in selling automobile insurance.

We are also the first in industry to launch a service notifying registered family members in advance of urgent and important information relating to insurance policies, given more and more elderly people are living away from their families.

These are just some examples of initiatives that anticipate social change and grasp our customer needs.

Please move on to page 10. The Group is also focusing on improvement of productivity as the most important and urgent issue alongside top-line strategies for achieving sustainable profit growth.

As announced the other day, following the merger of Aioi Nissay Dowa, ADI proceeded with computer system integration; innovation of employee roles; reorganization by function; and enhancement of roles in business operations.

ADI has now announced various career transition assistance measures for employees, including support for those who take early retirement program, to further accelerate innovation of employee roles and change its personnel structure.

The Group will continue with actions to eliminate overlap with agents through the establishment of regional core agents and establishment of agents by direct investment.

Also, in the area of claims handling services, we are examining the development of a joint claims service system, which is expected to further improve productivity.

Through these initiatives we aim to reduce the combined expense ratio of MSI and ADI to 31.5% in fiscal 2017 and to make further reduction after that.

Next I would like to talk about the reduction of strategic equity holdings, which is a matter of great interest to you. Please turn to page 24.

First, we changed our policy on strategic equity holdings described in our Corporate Governance report in June this year and clarified that we would reduce the total amount of our strategic equity holdings from the ERM perspective of reducing the risk weight of domestic equities.

In terms of actual operations, the economic rationale for holding strategic equities is assessed from the perspectives of the equity risk growth potential and profitability and the medium to long-term business relationship. If the rationale is not confirmed we shall proceed with sales of those strategic equity holdings after obtaining the equity issuers' understanding.

We have also said that we may still sell our holdings taking into account the market environment and our business and financial strategies, even the economic rationale are assessed.

We have also determined and announced the target level of strategic equity holdings.

The risk weight of the Group's strategic equity holdings is around 45%. And their market value rate in the Group's consolidated total assets is around 16%. But we aim to reduce this to a risk weight of around 30% and a market value rate in the Group's consolidated total assets of around 10%. Once reduced to this level, our strategic equity holdings will be at a level comparable to global players in Europe and the United States.

Please turn to page 25. We have also previously explained that we would accelerate sales of strategic equity holdings in line with a target of sales of JPY300 billion over four years. However, in light of this policy we have added an extra JPY200 billion to our sales target for this medium-term management plan period. And set a new target of JPY500 billion.

Please look at page 26. Next I will explain the current status and outlook of the economic solvency ratio. At the end of September 2015, the ESR stood at 197% on a preliminary level. We estimate that the acquisition of UK insurer Amlin will push the economic solvency ratio down by around 20percentage points.

Looking ahead, we expect that the ESR will recover to the target level of 200% by fiscal 2017, owing to the accumulation of profit in line with the plan and the acceleration of sales of strategic equity holdings.

Please look at page 50 and page 51. I would now like to talk about the international business and our business therein. Since our recent announcement of the acquisition of Amlin we have held discussions with the investors and I think the opinions of the investors can be summed up in three points.

The first is understanding for our business strategy. This acquisition is consistent with a strategy of increasing diversification of risk and capital efficiency by investing in the Asian region and Lloyd's business, which are positioned as a strategic areas, while accelerating reduction of risk, which is heavily biased towards domestic equity as discussed previously. We received many comments from investors saying that they could fully understand this.

The second point is a positive assessment of the effects of risk diversification and Amlin itself. Our investors understand that the achievement of geographical diversification of risk across Europe, the Americas. And Asia, through this investment is a positive development. They also understand that Amlin itself is a high quality acquisition in terms of business operation, governance, human capital and so forth.

The third point relates to investors' concerns. We received feedback from many investors saying that they feel anxious since their acquisition is taking place in the downward phase of the market cycle; or, that they found it difficult to make an assessment, because we have not yet provided enough information on the synergies that could justify the acquisition price, due to the regulation under the UK's City Code on Takeovers and Mergers.

Especially with regard to the final point, I intend to provide a proper explanation at the appropriate time after completion of the acquisition. Through this acquisition we will welcome the world-class player Amlin into our Group. I believe that this acquisition, combined with our existing business, will give us our sought-after platform as a world-leading insurance and finance service group.

Based on this platform we'll achieve sustainable growth by maintaining a positive growth cycle, improving financial results in existing areas to create a stable management base and making investments for future growth.

The Asian market, which is where we have established the largest insurance network and which has medium and long-term growth potential, remains as important as ever.

We're also always watching market developments in other regions and we'll tap into global economic growth to expand our international business.

Next, I will describe the outlook for numerical management targets. Please go back to page 3. We had initially planned to announce revised numerical management targets at this information meeting. However, due to restrictions on disclosure concerning the Amlin acquisition, we plan to announce revised numerical management targets, including Amlin, at the appropriate time after the completion of the takeover.

On this occasion we are updating our fiscal 2017 outlook, excluding the effect of the acquisition of Amlin. The outlook for consolidated net premiums written in fiscal 2017 is JPY3.230 trillion, versus the initial plan of JPY3.100 trillion. The effect of the acquisition of Amlin will be added on to this.

Likewise, we are raising our outlook for Group core profit in fiscal 2017 to JPY200 billion from the initial plan of JPY160 billion. The effect of the acquisition of Amlin will, in fact, be added to this.

Group core profit, excluding Amlin, can be broken down by business as follows: domestic non-life insurance business JPY140 billion; domestic life insurance business JPY20 billion; and international business JPY35 billion. We aim to achieve a Group ROE of 7% or more.

Finally, please turn to page 28. We are committed to our present shareholder return policy of increasing shareholder returns through expansion in Group core profit. More specifically, we aim to return 50% of Group core profit to shareholders through dividends and share buybacks in medium term. We also seek to maintain stability and increase our dividends.

As already announced at the meeting of our Board of Directors held on November 18, the Company resolved to repurchase the Company's own shares up to a limit of JPY10 billion. We plan to pay an annual dividend of JPY70 as forecast at the beginning of the year.

Finally, we ask for your continued support as we continue to focus on achieving sustainable growth and improvement of enterprise value through a constructive dialog with shareholders and investors.

Thank you very much for your participation despite your occupied schedules.

Questions And Answers

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

So let me move on to the Q&A session. (Conference Instructions).

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Tsujino, JPMorgan. You said only two questions per person. Earlier you said you'd reduce expense ratio to 31.5% for MSI and AD combined in Japan. It seems to imply a reduction of expenses by JPY20 billion from 2015. You have always showed us a graph, which indicated a reduction of JPY20 billion or a little less, maybe JPY17.8 billion or JPY18 billion. What would be different this time? What are additional reductions you are planning to make?

And somewhat related to this, you announced an early retirement program. New systems, I'm sure, must have opened a variety of possibilities. Could you let us know an extraordinary loss stemming from that. And also what sort of expense reduction is expected for next fiscal year? Those are some microscopic aspect. But including them, please give us an answer.

The second question, I somewhat hesitate to ask this. But projected Group core profit is JPY130 billion, dividend JPY70. And if suppose buyback shares worth JPY10 billion and, actually for reference, you repurchased JPY20 billion last May.

So if you repurchased another JPY20 billion next May, the payout is going to be 55.8% of JPY130 billion, in Group core profit.

You have been aiming at a payout of around 50%, over 40% in some years. So could you share with us your thoughts on this, or approach in that regard?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

About your first question related to expenses, you say to reduce the 31.5%, that would require JPY20 billion expense reduction.

And one relates to an answer to your subsequent question. AD's career transition support will result in JPY4 billion reduction. And ADI integrated [ph] holds the IT systems for the transfer of long-term policies, among others.

So together they will result in JPY6 billion savings, starting in fiscal 2017, combined JPY10 billion. In relation to that, joint use of locations; personnel expenses; reduction of personnel expenses, due to innovation of roles, including that, we are expecting over JPY20 billion in savings. Therefore, 31.5%, I believe is well within our reach.

For ADIs career system access plan, an estimated extraordinary loss is JPY12 billion for the current fiscal year, which is already reflected in profit and loss plan. In the years that follow, expense is JPY4 billion lower every year.

Your second question relates to shareholder return. Thank you for doing the calculation on my behalf. We have been saying 50% over a medium term; some years more and some years at the level of 50%. We always aim at, or plan an increase in cash dividend.

So other than JPY70 and scheduled share buyback, are you asking whether we are going to repurchase JPY20 billion again? I am not in a position to answer that aspect. But you might imagine it is feasible. And it is okay for you to be hopeful in that regard.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Thank you for your response.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Thank you.

Q - Taichi Noda {BIO 16478436 <GO>}

Noda of Goldman Sachs Securities, thank you for your explanations. I'd like to ask two questions.

Question number one, re your [ph] policy on strategic equity reduction, over 30% of consolidated total assets and 30% of risk weight. In terms of just ratios, it means 30% reduction to be reduced by one-third in terms of ratio.

May I simply think of this as a proportion based upon consolidated few years, including the acquisition of Amlin? If that is the case, how much is reduced on book value basis, going forward? If you could share with us some figures I would appreciate that.

Secondly, with respect to shareholder return, can capital gains on strategic equity holdings be a factor in considering shareholder return?

And if possible, the last point, your portfolio appears to be a bit biased towards carmakers, as a sacrosanct strategic holdings. What is your thoughts or thinking on automotive equities?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

The first point about the payout yardstick. And this may not have been in your question, I have shown our medium-term target, that is 10% of the market value, based on total assets, at 30% risk exposure. But I did not indicate when.

Assuming the current market value to continue, strategic equity holdings will come down from 16% to 10%.

We hold approximately JPY2.8 trillion in equities. 40% reduction means more than JPY1 trillion. Of that, JPY500 billion will be disposed of during the current plan period.

If another JPY500 billion is sold during the next plan period, assuming the same market value to apply, total will reach JPY1 trillion. But I believe we'll be able to indicate the direction when we announce the next plan.

During the current plan, we'd like to focus on selling JPY500 billion, or even more. So that investors would have confidence in your ability to reduce equity holdings to 30% of risk exposure. And around 10% of consolidated total assets. Once that is realized, I'd like to give more clarity on the timing.

Your second question about handling of a capital gain was mentioned in the last information meeting. And I said we would consider it as one of the factors.

Nevertheless, we also said that we will retain the current shareholder return policy, which does not include capital gains. So I will think about that. But as of now we don't intend to use capital gain for shareholder return.

But around 50% payout, it could fluctuate either above or below 50%. In some years we have capital gains, in others not. And how to approach 50% criteria may be a judgment call.

And the last point -- what was your last point? The -- while automotive sector accounts for large share, are those stocks also subject to disposal, that's what you are asking?

Q - Taichi Noda {BIO 16478436 <GO>}

Yes. Whether subject to reduction.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Nothing is excluded when we ask for issuers' cooperation. As stated in our policy on shareholdings, each shareholding is assessed from perspectives of economic rationale. And medium-term business relationship.

Also, curtailing the aggregate amount of equity holding is a basic premise. I hope you understand that those are premises based on which we seek an issuer's understanding.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Watanabe, Daiwa Securities; two questions please. One relates to page 10, the expense ratio. I think you already reached 31.5% target, at the end of the first half of fiscal 2015. It may partly reflect last minute purchase, before rate hike on long-term fire insurance. Could you tell us, what are positive and negative factors, as you move forward to fiscal 2017? That's the first question.

And secondly, relating to the profit projection for fiscal 2017, another increase in consumption tax rate is scheduled for fiscal 2017, could you talk about your pricing strategy for automobile insurance?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

You are right, during the first half, the last minute take out of fire insurance made expense ratio appear better than otherwise.

This is going to be corrected by fiscal yearend. And we are expecting the end result to be 32.5%. For the expense ratio to come down to 31.5%, reduction of expenses I talked about. And steady growth of top line, hold the key.

The second question, the automobile insurance and consumption tax increase, as for the consumption tax rate hike, for the entire Group, the impact of consumption tax rate increase is JPY18 billion. Net income is affected by JPY18 billion according to our simulation.

I just gave you the impact. Right now, as I mentioned earlier, automobile insurance enjoys a very good profitability.

There are however factors that could lead to an increase. One is consumption tax and the other is statutory interest rate. Although it has not been legislated yet, if statutory rate declines, it would affect claims payment for bodily injury liability. Given those factors, as for now consumption tax increase should be passed on, I believe, essentially.

On the other hand, if overall profitability is trending favorably. And if expense ratio can be duly lowered, we could think of absorbing some of the impact ourselves. Considering such an approach, the impact may be neutral.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

Sasaki, BofA Merrill Lynch. I have two questions.

The first question relates to strategic equity holdings. I believe you have verified economic rationale, which I think your Board has confirmed. What is the outcome distribution? What is the % of issuers or the value of holdings, which you could not find justification for?

And thus far you have generally maintained that reducing strategic equity holdings is difficult, because it would reduce premium revenue. Has that approach changed? And why did you make the sort of decision you did now? How did your feeling change? So those are the questions relating to strategy equity holdings.

Secondly, you didn't cover this. But now that Toyota is going to make a proactive investment in research in automated driving, in the future the insurance industry will be compelled to develop products addressing automated driving or safe driving assistance equipment.

Are you having any discussion with Toyota on this? Could you share with us the outlook of a new automobile insurance including an aspect of that technology development?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

I'll have Fujii [ph] give you the figures later on.

Did I describe our general thinking, as you just said? Did I answer that equity reduction is not possible, because it would reduce premium revenue? Rather than relating it to you a reduced premium revenue, I have always maintained reduction of equity holdings is a part of a needed reduction of overall risk exposure.

So long as we aspire to be a world-leading insurance international services Group, we do think equity holdings is a process we must go through. However, our important clients, we have trusted relationships built up over medium and long term, want us to have their shares for a long time.

Therefore, not due to lower premium revenue. But rather for clients to understand our positions, it is important to have dialog with them as to acceptable timing and time period. With corporate governance code and stewardship code in place, our communication has produced deeper understanding with our clients. And it is accelerating the pace of a sale.

The second point about the automated driving; as for advanced braking system, or ABS, I have learned that the Insurance Rating [ph] Organization is conducting verification with a view towards applying discount system to vehicles with ABS and similar systems.

We are waiting for the verification results to come out, because this is not something we can intervene.

But as for automated driving, not just with Toyota. But also the government is keen to accelerate the technology advancement for automated driving, how our insurance can be a part of this effort; how are we going to sort out liability attributable to manufacturer and liability of a driver?

To clarify those issues, we are involved with studies with various organizations in a variety of forms. We, as an insurance Company, need to keep abreast with the progress of our times. And we are in the process of conducting positive and proactive studies.

And I'll ask Fujii [ph] to give you the figures.

A - Unidentified Speaker

As for the figures, I would just highlight some points reported at the Board meeting.

First about economic rationale; the strategic equity holding overall exceeds the cost of capital. In that sense, we determined that our overall strategic equity holdings has underpinning of economic rationale.

In addition, for each company, as I have mentioned earlier, how much do we incorporate equity yield, profit from insurance underwriting, the future growth, into economic rationale. Here methodology needs to be updated every year. But including those perspectives, approximately 10% or 20% of the companies significantly lacks economic rationale.

So in that sense, honestly speaking, we have already disposed of. And reduced those stocks, in the past rounds of disposal. Of remaining stocks, more than 50% of them genuinely and actually exceed our cost of capital. So in that sense, many of our holdings are backed by economic rationale.

As Mr. Karasawa mentioned earlier, even then our basic stance is to proceed with the selling of stocks by obtaining issuers' consent and keep no stock exempt from this effort.

As for automobile insurance, there is one additional point that I would like to make. In relation to Toyota, already AD launched the connected vehicle insurance in Japan and outside of Japan.

As you already know, we have acquired Insure The Box, the company specializing in telematics. And we are absorbing their expertise. We would like to study our approach and engagement in automatic braking and advanced cars, not just in Japan but overseas as well.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

Thank you for your response.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Otsuka, Nomura Securities; I have two questions. One relates to page one of the handout.

Under 3 in parentheses international business, it says that you have gained a platform as one of the leading insurance and financial services Group by acquiring Amlin. I read this to mean that you now have a platform. Quantitatively speaking, do you have anything that you can share with you (sic) quantitatively?

Does this mean a premium level or profit level? Or are you talking about business portfolio?

From this sentence I get an impression that you've caught up with the world's leading insurance international services group in quantitative terms. So could you give us some figures of quantitative explanation of that? That's my first question.

And second question relates to page 23 where it says challenges. It is stated that profitability and capital efficiency need to be enhanced by making effective use of capital buffer.

Indicators capital efficiency and profitability that is readily visible, to us outsiders, is ROE. And ROE target in the medium-term plan is 7%. With Amlin added, we'll reach close to 10%. The current level is below that. So I suppose you will raise it a little further. What then is your goal here? Is it 7% or higher?

From a little longer perspective than medium term, could you share with us some quantitative yardstick in this regard?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

I may have played with the words, simply taking some of your words out of the context.

The last point, the second point -- question relating to ROE, we aim at becoming a leading level insurance international services Group in the world. Global players' ROE exceeds 10%. So in that sense, over a medium term, we must aim at higher than 10% in ROE. So that's how the medium-term target.

The medium goal world-leading platform. When we talk about leading insurance and financial services group in the world we often have companies, like AXA, Allianz, AIG in mind. Compared with those companies, things we need to accomplish becomes clearer.

One is geographic diversification. Too much concentration in Japan is a risk. Through greater diversification we need to lower domestic business proportion to, if possible, 50% with international and domestic business each accounting for 50%.

Amlin's acquisition has brought us a step closer to that level.

Our earnings are also too concentrated in Japan. Profit bias to Japan undermines the earnings stability. Thus, we need to increase the weight of international business as well as that of life insurance. We need to expand international and life insurance businesses to lower the proportion of domestic non-life business to around 50%, if possible.

Leading players of the world have actually achieved this. We need to achieve so-called profit diversification and diversification of premium income sources. The balance may be easily achieved in a contra-actionary [ph] way. But we must achieve it as we expand our business.

Why do we have to increase profit and premium income? As a leading insurance and financial services group we must provide retail and corporate customers with adequate capacity for risks and risk solutions. For us to be able to do that we must have financial strength as a company and scale, as a company, to be able to offer such a capacity.

We must embrace the challenge to tackle the new risks. We might address an issue of automated driving, how we talked about earlier; and we might encounter cyber risk or pandemic; and natural catastrophe is growing in severity. To be able to offer capacity or solution to those we, ourselves, must accumulate profit diligently to be financially strong to be able to provide coverage.

From such a perspective, by having Amlin in our Group, I think we have gained a foundation for becoming a leading insurance and financial services group in the world, in terms of this scale, geographic diversification and diversification of risk profile.

Q - Wataru Otsuka {BIO 16340098 <GO>}

One additional question on ROE. In relation to ROE there is a structural difference in ROE between global insurers and your Company. That is to say you have lower leverage and capital structure is a little different from an apparent figure, because of a large unrealized gains in securities.

By continuing the sale of equities over the medium term, if you can increase profitability, including that from domestic business, you can catch up with the global peers in ROE as well. Is this what you are thinking?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Yes. Take Allianz for example, their equity rate is around 5%, ROE 10%. We, on the other hand, have 16% in equities and 5% ROE. Naturally, as we've said at the outset, by reducing equity holdings to 10% and increase profit steadily, we can bear comparison with them in terms of ROE as well.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Thank you very much.

Q - Azuma Ohno {BIO 15313120 <GO>}

Ohno, Barclays Securities. On page three you have Group core profit and could you elaborate on the reason why you revised this figure?

Despite JPY40 billion increase in domestic non-life business there seems to be little change in combined ratio, based upon this target. Could you elaborate on the reason for JPY40 billion upward revision?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

As for upward revision of domestic non-life, a reduction in expense ratio and loss ratio itself and the structure of automobile insurance make a significant contribution.

On business-as-usual basis, if top line increases by around 3% in fiscal 2017 as projected here, we can achieve this target.

Q - Azuma Ohno {BIO 15313120 <GO>}

Does it mean that combined ratio target is forecast to be lower than the previous one?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Yes. Assumption for automobile loss ratio when the plan was formulated has turned out to be different from the actual level.

When we formulate the Next Challenge 2017 we had not expected automobile loss ratio to come down as quickly as it actually has. Automobile loss improvement was quite a significant factor.

I wish we could have revised the plan earlier. But we were not 100% sure about the automobile loss improvement, because all the domestic non-life insurance companies suffered from a loss-making automobile insurance for five or six years. The progress in the past two years convinced us that automobile insurance profit and loss can be controlled to a certain extent.

On top of that, we believe a steady improvement of expense ratio has improved the earnings structure of domestic non-life business.

Q - Azuma Ohno {BIO 15313120 <GO>}

Thank you.

Q - Tatsuo Majima {BIO 15338044 <GO>}

Majima, Tokai-Tokyo Securities Center. I have two questions relating to equity holdings.

This year and next year, if you sell JPY5 billion in each year, your equity holdings will have been substantially decreased, which also means you'll have substantial capital gains. I'm under the impression that after selling JPY500 billion repeated twice you may no longer make sizable equity sales.

If that is the case, apparent net income will be much lower. At the same time, the profit contribution from the company you acquired may not be much if you consider goodwill. Under such a scenario your apparent profit, not core profit. But apparent profit, seems to be lower in your next medium-term plan.

Have you not considered this at the moment? That is first part of my question.

And second question relates to the sale of a strategic equity holdings. JPY500 billion over two years. So you will be reducing one-third over two years.

A similar financial institution, on the other hand, announced that they would have the holdings in five years. Both of you may own similar stocks of companies affiliated with banking groups. Did you decide to accelerate the equity sales, because you thought it better to sell before banks sell the same stocks?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

You said after the sale of JPY500 billion-worth shares -- we don't seem to sell equities any more. As a medium-term objective we are going to reduce equity to 30% of risk exposure and around 10% of consolidated total assets.

So long as I stated that, this is the level we want to achieve over a medium term. At the current market price it means we need to sell more than JPY1 trillion. We'd like to keep the sale at this pace. Otherwise, what I have shared with you as our medium-term level is just pie in the sky. So we will keep the pace of equity sale.

Next.

We had already been considering sale long before banks have finally made announcement. It's not a matter of us selling before banks do. Generally speaking, unwinding of gross shareholding leading to overall reform of the Japanese economy and its structure, together with Corporate Governance code, I think is one of the important elements for foreign investors to have confidence in Japanese stock market. We are making progress from such a perspective and so do banks.

Which is better? There may be cases where selling stocks after the banks maybe better or they maybe opposite cases. At any rate, we would like to steadfastly proceed with our sale, as unwinding of core shareholding makes headway, helped by corporate governance code, among others.

Q - Tatsuo Majima {BIO 15338044 <GO>}

The companies affiliated with the same banking groups, they have their shares sold by you and also by banks, it's substantial. Unwinding may be the trend of the day. But damage to those companies must be rather substantial. What is your take on this from your negotiations with them? Do they have good understanding of that? Do they say please sell our stock?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

No company says please sell their shares. Unwinding of core shareholding is a trend of the day. Issuing companies do understand they can't avoid this general movement.

Corporations must find it rather disturbing that banks, non-life insurers, life insurers are all selling. Concerning this, we consult with them about the timeframe, timing, size. And the dispersion of the sale, to gain their understanding.

As you have said, massive sale would cause difficulty to some issuers. Companies in resource sector, in particular, have rather strong resistance, because there is a target for M&A. To those companies, we proceed with utmost care, doing our best to gain their understanding. But it's not an easy task.

Q - Yusuke Yabumoto {BIO 16424475 <GO>}

Yabumoto, Mizuho Securities. Let me ask two questions. First one relates to the share repurchase and the second one relates to the planned core profit for fiscal 2017.

In relation to the first question, the share buyback, in the first half you bought back your shares worth JPY10 billion. As you lower the core profit assumption for the current year, you could have decided not to buy back shares. What sort of discussion led to this decision? What is the message you are trying to send?

Secondly, in the medium-term core profit assumption fiscal 2017, core profit from international business was revised downward. Could you explain the reason why?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

About the first question on share buyback, with interim financial results now out. And with natural disasters passed their peaks, overall final profit picture can be forecast with some clarity. Assuming core profit of JPY130 billion, there is enough room to buy back JPY10 billion in your own shares. So this is a financial aspect.

Furthermore, at current stock price, our price to book is 0.8. So another purpose was to send a message that our stock is still undervalued, given our growth strategy.

Next point, the reason for revision of international business from JPY39 billion to JPY35 billion is, number one, depreciation of Asian currencies due to China's slowdown; profit from Asia when translated into Japanese yen decreases.

Secondly, related to BIG, the company AD acquired, we learned that BIG itself is very valuable, including its brand and expertise. We want to develop this business model of BIG by investing in its IT systems and people. So from that perspective, we've assumed that expenses and upfront investment will be larger than what we had expected initially.

So in this assumption, BIG and depreciation of Asian currencies were the major factors. We are expecting BIG and its business to break-even overall in fiscal 2018, a bit later than originally planned.

Q - Masao Muraki {BIO 3318668 <GO>}

I have two questions; Muraki, Deutsche Securities. The first question relates to reorganization by functions on page 42. Could you bring us up to date on the study and the status on Stage 2?

According to my understanding, the Stage 1 of reorganization by function is quite limited in scale in terms of GPW policies affected by it.

At Stage 2, how deep can you go for reorganization? For example, reorganization and restructuring, everything except for dealer channel and Nippon life channel, could be one possible approach. Is there any technical constraints that you're doing it?

How far is it technically feasible to completely unify claims statement. And consolidate payment and claims adjustment systems?

Second question relates to international business. You have kept saying you are targeting at Lloyd's market. And therefore I was not surprised by the sector you announced your acquisition in. So you now have a large exposure there.

What comes next? North America, where you used to say hurdle is here high, or South America, or non-Asia emerging countries. Where are the next geographies you want to increase your presence in?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

With respect to the first question, the reorganization by function, roughly speaking in terms of domestic premium revenue, we've accomplished quite a bit in Stage 1. The current plan does not specify how to reorganize, including the dealer channel. Thus, I don't have anything to share with you about the progress made to date.

However, we believe the Stage 1 is successfully completed. By successful completion, I mean simultaneous pursuit of growth and efficiency. Especially growth is well on its way, as demonstrated by the fact that MSI and ADI posted number one and number two growth rates in domestic primary insurance sales, although helped by last minute purchase of fire insurance.

Q - Masao Muraki {BIO 3318668 <GO>}

Can they further expand it?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Based on successful cases of consolidation of physical locations, we will consider where else we can have a similar opportunity. If we find such an opportunity, we will take action proactively. If not, new opportunity must be identified in the next plan.

The next major thrust of the reorganization by function I've been thinking would be claims services. As we keep two companies separately and the reorganization by function, to what extent we can capitalize on independence of claims services and payments of two companies was a key consideration in deciding on how far we'd integrate claims services.

As we implement the first stage reorganization, we realized that we can do that. So we want to reorganize the two companies in a manner that generate effects similar to what can be achieved through a merger. A joint development of claims service system is scheduled to be a part of our next plan, because some new efforts will require new systems. With a study for that conducted in Stage 2, we would take on that aspect. In the next plan for systems integration, we will have factors that would lead to significant efficiency improvement.

As for international business, since we now have acquired a Lloyd's player, you are asking what comes next. Our strength is in Asia. And we have been aiming at being among top three. And having leading positions in each of the ASEAN member countries.

Q - Masao Muraki {BIO 3318668 <GO>}

Is there anything we can do to achieve that goal? Other part of Asia, what about India? Increase our equity share as a result of de-regulation. What sort of new initiatives do you take in China?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

As for China and Thailand, where reorganization by function is yet to be conducted, as we implement reorganization by function, we'll indicate a little more in terms of growth strategy for Asia and China. And if there is anything we need, we would like to consider M&A; we would like to have it considered in Asia.

Since we did a deal in Lloyd's, we lower the priority of North America and Latin America. If there are good opportunities in North America and Latin America, from the perspective from ERM, we would like to make disciplined investment in those parts of the world. From that perspective, we opened an office in South Africa this year.

Also, in former Ceylon, in Sri Lanka, we invested in equities of the number one company in Sri Lanka. We now have a certain stake in that company.

In terms of other emerging countries, in Latin America we are the only Japanese non-life insurers with an office in six countries in Latin America.

In Colombia, where Ambassador Hatanaka had been stationed, we have multiple employees stationed there, including augmentation and strengthening this one, working with MAPFRE, we'd like to strengthen our network in Latin America.

Countries with growth potential, including Brazil, are faced with difficulty, affected by China's economic slowdown. But given their population and their growing middle class, they're destined to grow. Unless they grow, the whole world economy will be in trouble.

What sort of business deployment can be considered in that context is being considered. At the moment, we monitor markets in Africa in the context of our AXA alliance. But we would also like to consider if we can do more on our own. Now, that we've established our own office, we'd like to have our own African strategy as well.

Thank you very much for your participation, despite your occupied schedules.